# The Tips and Traps to Avoid When Investing in India

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The India-story has continued to chug on in the present fiscal year, despite an otherwise tepid global investor outlook. The Government of India's unrelenting approach to the liberalisation of India's regulatory ecosystem has borne fruit. India has been ranked at 77 for 2019, up from 100 for 2018, in the 'Ease of Doing Business Index' under the aegis of the World Bank [1].

India is yet to see a marked improvement in its global standings, particularly, in key parameters relating to its tax system, setting up a business, dealings in real property, and enforcing commercial contracts. However, the general positive investor sentiment has gradually cemented India's place, as one of the largest markets for deal-making in the Asia-Pacific region.

India poses a unique set of challenges to foreign investors, contributing substantially to transaction cost overruns and deal complexity. Material challenges and bottlenecks that foreign enterprises are likely to encounter in India are:

**Multiplicity of regulators and approval requirements** - While private participation and liberalisation has been the hallmark of the state economic policy, the degree of oversight and monitoring by state machinery, remains significant. Businesses often remain enmeshed, within a web of regulations administered by multiple regulators. Investments in construction development activities or social infrastructure projects, for instance, require foreign businesses to liaise with governmental authorities and agencies at both, the federal and state governments.

As a long term measure, foreign enterprises must acclimatise to local conditions, in order to appreciate the regulatory, cultural, and socio-political context, within which they need to function. The outreach program would typically require regular interactions with sector-specific regulators, affiliations with industry associations, and liaising with consumer associations.

**Exchange control regulations** - The current Foreign Direct Investment (FDI) policy prescribes limits on eligible foreign participation in certain sectors, performance-linked conditionalities that foreign enterprises would need to adhere to in relation to the investment, and other approval requirements, if any. FDI in crucial sectors like insurance, multi-brand retail trading or broadcasting, requires that the Indian enterprise remain Indian-owned-and-controlled, and the administering authorities conduct a detailed check on the investing enterprises, before granting approval. Moreover, governmental authorities would continue to monitor investee Indian companies, to prevent contraventions of the FDI policy.

Foreign investors must appreciate the context – historical, political, and economic – that forms the basis of restrictions under the FDI policy. Instead of a check-the-box compliance, Indian investee companies should be required to develop a sufficiently robust dynamic compliance program to comply in spirit.

**Complex tax framework** - India is often criticised for its complicated tax framework and often, international businesses have been slapped with tax notices running into billions of dollars. While it is imperative that the prospective buyer secures expert tax advice, the revenue department has been known to adopt extremely orthodox interpretations of the tax legislations.

It is advisable for foreign enterprises to develop an India-specific tax program, instead of aligning it with the group level program. Indian tax authorities are receptive to tax structures, having sound commercial and business rationale, and not mere arrangements which result in tax base erosion.

**Issues relating to land acquisition** - The availability of land in geographically feasible locations has been a major difficulty for investors. Large parcels of land are not easily available, and landholdings are severely fragmented. Further, projects have also come under scrutiny for human rights violations in the recent past [2]. Typically, the central and/ or the state governments facilitate the acquisition of the land parcels for the manufacturing facility.

The introduction of the Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2013, ensures that land acquired by the relevant government for the foreign investor to set up the plant, is done with the consent of the natives who will be affected by the acquisition of land and ensuing operations at the plant. However, the acquisition process remains lengthy and is often faced with severe hold-out problems.

**Corporate governance concerns** - Corporate ownership in India remains concentrated within families. Private businesses are often operated in blatant disregard for established norms of corporate governance. Often, investors struggle to evaluate and adequately diligence the commercial substance, nature, and value of the affiliate transactions that family-held businesses enter into. Strategic buyers and acquirers are often required to build up internal administrative systems and controls from scratch.

Foreign enterprises must evaluate qualitative aspects of a potential joint venture or legacy issues in the business. Background checks and a thorough fidelity diligence on investee businesses can avoid untoward issues at a later stage.

**Environmental concerns** - Environmental norms applicable to businesses are codified in the Environment (Protection) Act, 1986. Historically, India's track record of enforcing environmental legislations has been weak; however, civil society activism has shed light on several instances of infractions by companies. In particular, manufacturing companies are required to undergo periodic environmental audits, to ensure process compliance with applicable environmental norms.

It is imperative that the prospective buyer undertakes a thorough diligence of environmental compliances, at plants operated by the target company in India. Where the investor is evaluating a green-field investment, the proposal has to undergo a thorough 'environment impact assessment' that is undertaken by the local pollution control board. The process also involves undertaking a thorough social audit, involving families and communities, who may be potentially affected by the development.

It may be advisable for foreign enterprises to focus on an outreach program addressing concerns of stakeholders, including civil society, local residents, and governmental authorities. It is also essential that the bona fides of the foreign enterprise is amply demonstrated.

**Human resources managing trade unions** - Indian human resource and labour jurisprudence evolved during the socialist era, characterised by a strong workmen's rights movement. The extant legislations

[1] Doing Business 2019: Reforming to Create Jobs, The World Bank Group; available at: http://www.doingbusiness.org/content/dam/doingBusiness/media/Annual-Reports/English/DB2019-report_web-version.pdf
[2] "POSCO Project has taken away rights of communities"; available at: http://www.thehindu.com/news/national/posco-project-has-taken-away-rights-of-communities/article4863253.ece

create a highly regulated labour market and restrict the ability of businesses to adjust wages and its hiring-and-firing policies, according to market needs. Certain sectors are heavily unionised and trade unions are typically affiliated to one of the major political parties, and often seen as aggressive in their approach towards the management. Management of trade unions remains a sensitive matter for large industries. Additionally, the collective bargaining process may also result in undue interference from state authorities, which have the power to mediate between the parties.

**Law and order issues** - Concerns regarding law and order problems continue to plague certain areas of India. While dealing with sensitive political issues, the foreign enterprises may choose to engage with the state and federal authorities to ensure security of investment and assets, under bilateral investment agreements. In large projects, the foreign collaborator should seek government's commitment in terms of stability in policy making and actual delivery of promised incentives.

## EVOLVING POSITIVE TRENDS

Beset with these numerous difficulties, India remains a developing economy that is gradually undergoing subtle structural changes, in its evolution towards a vibrant market economy with the following encouraging signs:

**Mature local entrepreneurs** - Indian businesses have been making headlines, with leading global businesses vying for an opportunity to pick up valuable enterprises. Having dealt with seasoned private equity players (who are incumbent shareholders), Indian entrepreneurs are becoming increasingly business-savvy, bound to be a valuable asset to global corporations.

**Focus on infrastructure** - The Government of India has laid strong emphasis on the development of both, social and physical infrastructure. By setting up the National Investment and Infrastructure Fund, it has highlighted the importance of using innovative financial vehicles to pool investments in India's infrastructure sector.

**GST** - The Goods and Services Tax regime introduced in 2017, has created a single market for goods and services. Earlier, each state had fiscal powers to impose taxes on the supply of goods and services. These are now subsumed in the GST regime and businesses across India can compete on an equal footing.

**Digitalisation and formalisation** - India is rapidly moving towards greater formalisation, with major structural changes being pushed through by the Government of India[3].

A larger segment of the working population could be brought under formal social security covers. Furthermore, policy measures to wean businesses away from the cash economy to digital payments, are likely to drive innovation in payment systems and allied technologies, stronger compliance systems, and ultimately, a cleaner business environment devoid of unaccounted cash.

## Conclusion

India and Indian businesses offer tremendous potential for expansion to foreign businesses. India's market size and polity tenacity make it an ideal investment destination. Indeed, global businesses already set up in India have learnt to adapt to Indian circumstances and often achieve pole positions in market share. Having said that, India is a potential minefield for the unfamiliar. While there is no fool-proof minesweeper, domestic counsels and accounting firms are well-versed with local circumstances to hand-hold the buyer in its India entry and companies that do not adequately invest in compliance functions like finance, internal audit, and legal, may prove to be penny wise and pound foolish!

[3] Annual Report of the RBI for the Year 2017-2018; available at: https://rbi.org.in/Scripts/AnnualReportMainDisplay.aspx