Reforms in FDI Policy ahead of LIC IPO

For Prelims: Foreing Direct Investment, Initial Public Offering.

For Mains: Significance of increasing FDI upto 20 % in LIC, Disinvestment.

Why in News?

Recently, the Union Cabinet cleared an amendment to the FDI Policy **to allow** Foreign Direct Investment (FDI) **up to 20%** under the "**automatic route**" in Life Insurance Corporation (LIC) ahead of its **proposed** Initial Public Offer (IPO).

- The government **expects to mobilize Rs 63,000-66,000 crore from the proposed share sale to meet its** disinvestment **target** of Rs 78,000 crore for FY 2021-22.
- **LIC is fully owned by the government**. It was set up in 1956. It has the biggest share in India's insurance business.
- In most contexts, **disinvestment typically refers to sale from the government, partly or fully, of a government-owned enterprise.** A company or a government organisation will typically disinvest an asset either **as a strategic move for the company, or for raising resources to meet general/specific needs.**

What are the Key Points?

- At present, the FDI policy **does not prescribe any specific provision for foreign investment in LIC** which is a statutory corporation established under **LIC Act, 1956.**
- The policy permits **FDI in insurance companies and intermediaries or insurance intermediaries** in the insurance sector.
- The **FDI ceiling for public sector banks is 20% on the government approval** route.
  - While the government had last year raised the FDI limit in the insurance sector to 74% from 49%, **it did not cover LIC that is governed by a specific legislation.**
- Since LIC does not fall in any of these categories and no limit is prescribed for foreign investment in LIC under the LIC Act, the government has decided to allow foreign investment up to 20% for LIC and other corporate bodies.
- In order **to expedite the capital raising process**, such FDI has been kept on the automatic route, as is in the case of the rest of the insurance sector.

What is the Significance of this Move?

- The reform in the FDI policy will **facilitate foreign investment in LIC and other corporate bodies,** for which the government may have a requirement for disinvestment purposes.
- The change in the FDI policy for LIC will ensure that **foreign investors do not face any hurdles** while subscribing for the public offer.
- The reform will also **facilitate ease of doing business and lead to greater** FDI inflows, and at the same time, ensure alignment with the overall intent or objective of FDI policy.
- Increased FDI inflows **will supplement domestic capital, technology transfer, skill**

development for accelerated economic growth and development across sectors, to support the implementation of **Atmanirbhar Bharat.**
- Allowing FDI will **ensure that foreign portfolio investors are able to purchase shares in the secondary market.** It also sends a positive signal to investors.

What is the Status of FDI Inflows in India?

- FDI inflows in India stood at USD 45.15 billion in 2014-2015 and have increased to USD 81.97 billion during the financial year 2020-21, despite **Covid 19 pandemic,** which is 10% higher than USD 74.39 billion compared to the previous financial year 2019-20.

PYQ

With reference to Foreign Direct Investment in India, which one of the following is considered its major characteristic? (2020)

(a) It is the investment through capital instruments essentially in a listed company.
(b) It is a largely non-debt creating capital flow.
(c) It is the investment which involves debt-servicing.
(d) It is the investment made by foreign institutional investors in the Government securities.

Ans: (b)

What is FDI and its Routes?

- **About FDI:**
    - FDI is the process **whereby residents of one country (the home country) acquire ownership of assets for the purpose of controlling the production, distribution and other activities of a firm in another country** (the host country).
        - It is **different from** Foreign Portfolio Investment where the foreign entity merely buys stocks and bonds of a company. FPI does not provide the investor with control over the business.
    - Flows of FDI comprise **capital provided (either directly or through other related enterprises) by a foreign direct investor** to an enterprise.
    - FDI has three components, viz., **equity capital, reinvested earnings and intra-company loans.**
        - Equity capital is the foreign direct investor's purchase of shares of an enterprise in a country other than its own.
        - Reinvested earnings comprise the direct investors' share (in proportion to direct equity participation) of earnings not distributed as dividends by affiliates, or earnings not remitted to the direct investor. Such retained profits by affiliates are reinvested.
        - Intra-company loans or intra-company debt transactions refer to short- or long-term borrowing and lending of funds between direct investors (or enterprises) and affiliate enterprises.
- **Routes through which India gets FDI:**
    - **Automatic Route:** In this, the foreign entity does not require the prior approval of the government or the RBI.
    - **Government route:** In this, the foreign entity has to take the approval of the government.
        - The Foreign Investment Facilitation Portal (FIFP) facilitates the single window clearance of applications which are through approval route.

PYQ

Which of the following would include Foreign Direct Investment in India? (2012)

1. Subsidiaries of foreign companies in India.
2. Majority foreign equity holding in Indian companies.
3. Companies exclusively financed by foreign companies.
4. Portfolio investment.

Select the correct answer using the codes given below:

(a) 1, 2, 3 and 4
(b) 2 and 4 only
(c) 1 and 3 only
(d) 1, 2 and 3 only

Ans: (d)

Source: TH