China-India FDI: Insights And Approval Strategies

In 2020, the Indian government, amid rising tensions with China, introduced 'Press Note Number 3 of 2020', or PN3, requiring prior government approval for investments from entities based in countries sharing a land border with India, including China. This measure was aimed at preventing opportunistic takeovers of Indian companies during the Covid-19 pandemic. As a result, all Chinese investments, direct or indirect, now require government approval, with additional regulatory hurdles and restrictions on participation in management roles and public procurement.

This article examines recent trends in PN3 application and outlines strategies to increase the likelihood of securing approval. Key strategies include aligning investments with India's economic priorities and demonstrating a long-term commitment to India's economic growth.

Recent Trends

The term ‘beneficial ownership’ was deliberately left undefined under PN3, allowing broad interpretation by Indian regulators. In today's globalised world, many companies investing in India have some level of Chinese shareholding. Consequently, numerous global deals have fallen through either due to investor apprehension about breaching PN3 or the failure to obtain the rigorous PN3 approval. For instance, the Indian government has rejected several proposals by Chinese investors to set up manufacturing facilities and generate local employment. Due to the broad applicability and stringent nature of PN3 approval, there have been consistent requests for the government to interpret PN3 in a way that balances monitoring Chinese-influenced investments without hindering those with nominal Chinese holdings.

Recent trends indicate that the Indian government may be looking to soften its approach to FDI from China. FDI inflows dropped by 62.17% in the financial year 2023–24, according to RBI data. Meanwhile, India-China trade reached nearly $118 billion, with India facing a trade deficit of over $100 billion. The Economic Survey 2023–2024 recommended encouraging Chinese investment in India to boost exports rather than relying solely on trade. As stated in the survey:

> .. it is more effective to have Chinese companies invest in India and then export the products to these markets rather than importing from China, adding minimal value, and then re-exporting them

The Economic Survey 2023-2024
Accordingly, the Finance Minister of India recently hinted at potential relaxations for investments from China and neighbouring countries, suggesting in her post-budget speech that opening up investment from these regions is possible. We hope the government will ease PN3 restrictions in non-sensitive sectors, provided investments meet criteria for national security and data integrity. Such amendments should address concerns from PN3, ensuring capital flow and maintaining India's attractiveness as an investment destination without compromising PN3's original intent.

Recommendations For Those Applying For PN3 Approval

While the Economic Survey 2023-2024 and the recent statement by the Finance Minister of India raise hopes for potential relaxations to the PN3 regime, our experience indicates that the government of India typically favours PN3 applications in the following cases:

Data security: There must be no concerns regarding data storage, leakage, or sharing. The Indian government is particularly cautious about investments in sectors where data security is crucial, ensuring compliance with local regulations and safeguarding national security and individual privacy.

Avoidance of sensitive sectors: Investments should avoid sensitive sectors such as defence, telecommunications, and data processing.

Significant employment generation potential: Investments should demonstrate a clear potential for creating substantial employment opportunities within India.

Promotion of local industry: Investments should promote the growth of local industries or seek to plug the gaps in existing capabilities and include the potential for technology transfer. Projects that can enhance the capabilities of domestic industries, bring in new technologies, and improve the overall industrial landscape are preferred.

Shareholding and management structure: Preference is given to applications where the majority of the investment and key managerial positions are held by Indian shareholders, such that control remains within the country.

Legitimate Indian investor/joint venture partner: The Indian investor should not be perceived as a mere pass-through entity for foreign shareholders and must have relevant sectoral experience. The government aims to avoid scenarios where foreign entities use local companies as fronts to bypass regulatory requirements.

Since PN3 approvals are granted on a case-by-case basis, it is crucial for the application to clearly outline the benefits of the proposed foreign investment, even if it does not meet all the specified requirements. The guidelines are indicative, so the application should demonstrate how the investment supports the country's development goals and mitigates potential risks associated with foreign control and influence.

Atul Pandey is Partner and Hirak Mukhopadhyay is Counsel at Khaitan & Co.

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