

Asia Watch:

Acquiring an Indian Company— An Update for U.S. Mid-Market Companies

*By David Laverty, Partner, International Counsel, and Rob Loewer, General Counsel,
National Railway Equipment Company*

Let's say you are told that a Chicago-area mid-market company, or a private equity firm with several growing portfolio companies, is considering an expansion into India. What type of India expansion activities immediately come to mind? For a large segment of corporate America, the mention of "expansion into India" suggests the outsourcing of software coding, call centers and back-office functions. Yet, for a growing number of companies, India is being pursued less for such contract sourcing and more as an equity investment destination.

Large and middle market companies are pursuing acquisitions in India, including for sourcing key inputs. Some that have tried contract sourcing in India are buying-out the operations created by their Indian contractors or are building their own facilities. Others are US manufacturers who are finding that China does not have a monopoly on the world's manufacturing—if contract manufacturing is not for them, such companies may be considering building their own Indian manufacturing operations or acquiring Indian manufacturers with such capabilities.

This update is a follow-up to an India article in the February, 2007 edition of this publication, which offered a snapshot of India's foreign investment restrictions using Wal-Mart's India joint venture and the country's retail sector restrictions as an example. We focus here on Indian market entry through acquisition.

India's General Foreign Investment Approval Requirements

Yes, many have criticized India's regulatory environment, and even casual observers of India will recall hearing something about Indian red tape. Such criticism is echoed by such prominent participants in the world economy as Alan Greenspan, who wrote in *The Age of Turbulence* that "India, the largest democracy in the world, has so much regulation of business activity that it significantly weakens the right to freely use and dispose of individual property. . . [which does not allow a] . . . free market economy to function effectively." However, the Indian government has, in recent years, recognized the constraint that overregulation imposes on investment and has removed some key barriers, including many foreign investment restrictions.

The 2007 ACG International Bulletin India article made the overall point that, outside of the retail sector and a limited range of other sectors, India is reasonably open to foreign investment. A typical U.S. mid-market company will find that most sectors of interest are open to 100% foreign equity investment through an automatic approval process, including virtually all of manufacturing, though a few automatic approval sectors are subject to investment caps, such as insurance (26%), telecommunication services (49%) and trading (which can be up to 51% for certain export trading but may otherwise require approval). Examples of sectors requiring investment approval through India's Foreign Investment Promotion Board include petroleum refining and print media, with outright prohibition limited to sectors such as retail trading (apart from "single brand retailing," as described in the 2007 ACG International Bulletin article), various agricultural sectors and gambling.

Market Entry Through Acquisition

Foreign investment in India through the acquisition of shares from an Indian resident shareholder in an existing Indian company, or the purchase of the assets of such a company, must usually comply with the same set of foreign investment sectoral limits and may be eligible for the same type of "automatic approval" as foreign investment through the establishment of a new company or other equity investment options. There are other restrictions on acquisitions by non-residents which apply, for example, to transfers of shares in the financial services sector or involve takeover regulations for larger acquisitions. Apart from these issues, an acquiring US company needs to be aware of various other factors that impact an Indian acquisition decision, which include:

Indian stamp duties favor stock and not asset purchase deals. Acquiring companies in the US and elsewhere often prefer to purchase the assets of a company as a way of limiting their exposure to undesirable liabilities that they may inherit as a new shareholder in an existing entity. The purchase of stock, though, is gaining ground since the stamp duty imposed in asset purchase transactions is still relatively high. Though there may be ways to structure an asset transfer to further limit the impact of stamp duties, a purchaser of assets in India is subject to a stamp duty which typically ranges from 2% to 10% of the value of property depending on the type of assets involved and the State where the assets are located or where the transfer document is entered into. The purchaser of stock is not subject to the stamp duty, and pays a share transaction tax of .125% of transaction value, provided that the shares qualify as being in a "dematerialized" form, meaning that no share certificates have been issued, which is ordinarily the case.

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