On with the show

The financial crisis has not brought the curtain down on India's entertainment sector. Recent reforms have stimulated foreign investment. Opportunities beckon ...

Gowree Gokhale, Khushboo Baxi and Ranjana Adhikari report from Mumbai

India's media and entertainment industry has experienced robust growth over the last five years and is one of the fastest growing sectors of the economy today. Analysts believe that although its growth may be affected by the economic slowdown, the sector will continue to enjoy substantial investment from cash-rich enterprises overseas. The entertainment industry, a blend of creativity and commerce, provides diverse investment opportunities in such areas as theatre and multiplex infrastructure, television, film, animation, print media, sport, mobile entertainment and advertising.

By liberalizing foreign direct investment (FDI) in the sector, the government has enhanced these opportunities, stimulating a flow of cash that is needed to keep India entertained through the downturn. Between 2005 and 2008, it opened the doors to foreign investment in several new sectors of the industry, and relaxed foreign ownership restrictions in others.

In June 2005, for example, the government scrapped its 50-year-old policy prohibiting the publication of foreign newspapers in India. In addition, it made changes that now permit up to 20% FDI in FM radio broadcasting.

In addition to stimulating foreign investment, the liberalization of the media sector was undertaken with the aim of increasing the diversity of content available locally, and even more importantly, ensuring that domestic consumption remains high. In a similar vein, the Central Board of Excise and Customs (CBEC) recently clarified that the exhibition of films in cinemas and multiplexes will not be subject to service tax until and unless it amounts to a "business support service" under the service tax regime.

Although FDI receipts in the entertainment sector amounted to only 1.5% of the overall receipts of foreign investment in 2007, the rise over the previous year indicates the growth potential of the industry. According to recent reports by the Federation of Indian Chambers of Commerce and Industry and PricewaterhouseCoopers, the Indian media and entertainment industry is set to witness a cumulative growth of 18% over the period to 2011, at which date it is likely to be valued at Rs1,000 billion (US$19.3 billion). The industry is currently estimated to be worth around US$8.5 billion.

While mainstream sectors such as print, television and filmed entertainment continue to grow robustly, emerging fields such as animation, gaming and visual effects, radio, out-of-home advertising and online advertising are growing even faster.

Enter the regulator

The regulatory authority for the media industry is the Ministry of Information and Broadcasting (MIB). It is responsible for the formulation and administration of rules, regulations and laws that govern the sector, as well as facilitating information sharing within and around the industry. The MIB is also charged with fostering international cooperation with regards to mass media, films and broadcasting, interacting with its foreign counterparts on behalf of the Indian government. Its operations are divided into three main areas: information, broadcasting and films, each being further subdivided into different units.

Based on current trends in the television, film, radio, print, advertising and animation markets, analysts predict that the Indian entertainment industry will generate sharply increasing profits over the next couple of years. As one of the world's largest television viewing markets along with China and the US, Indian audiences continue to generate a steady stream of revenue. Profits in the television sector rose significantly in 2007, recording a growth of 18% from the previous year. A substantial part of this growth was attributed to increased audiences for reality shows and specialized content such as the T-20 cricket matches. From 2004 to 2007, the sector grew by 21% overall, just behind online advertising and radio. The MIB has issued a series of guidelines for uplinking and downlinking of television channels and the government has recently allowed the launch of internet protocol television (IPTV) in India.

From Bollywood to Hollywood

As one of the largest film producers in the world, it is unsurprising that the Indian film industry has benefited both creatively and financially from advances in technology, content development, financing, exhibitions and marketing. Filmed entertainment recorded steady growth of 14% in 2007, and from 2004 to 2007 grew by 17% overall. The industry is becoming increasingly corporatized, prompting producers to look overseas for co-production partners. Anil Ambani's Reliance ADAG recently signed a deal to invest US$550 million in Steven Spielberg's Hollywood venture, DreamWorks, enabling the American director to launch a new studio and break away from Viacom's Paramount Pictures. Between 2007 and 2008, India saw the entry of media and entertainment conglomerates Viacom, NBC Universal and Walt Disney through partnerships with Network 18 Group, NDTV and UTV Software Communications, respectively. Private equity players and venture capital investors continue to prove their willingness to take on the risk-reward balance associated with these deals.

INX Media was the biggest beneficiary of FDI in 2007, receiving US$220 million from Temasek Holdings via Dunearn Investment, New Silk Routes, Kotak and SREI Group, for the expansion of its television broadcasting network. Meanwhile, American investor George Soros acquired a 3% stake in Reliance Entertainment by contributing Rs4 billion for internet development, new media, films and television broadcasting.

Other media deals saw Sun Direct Television receive US$140 million from South Asian Entertainment Holdings, a group company of Astro All Asia Networks, to expand its direct-to-home broadcast reach. The company acquired a 20% stake in Sun Direct.

Innovative Media, the out-of-home media subsidiary of Entertainment Network India (ENIL), meanwhile, received US$40 million to further its out-of-home media expansion, invested by Goldman Sachs and Lehman Brothers (Mauritius entity), each of which acquired an 8.28% stake in ENIL.

These agreements, and many others like them, may be the first wave in a stream of deals that could draw Bollywood and Hollywood closer together. In addition to churning out approximately 1,000 films a year, the industry in India has gained strong impetus from the development of an attractive multiplex cinema culture, most visible in metropolitan cities such as Mumbai, Bangalore, Kolkata and

Movie-mania: India produces around 1,000 films each year.

Delhi. This phenomenon in contemporary urban leisure has gained tremendous popularity, especially among younger audiences.

Opening the airwaves

Radio broadcasting has also been opened to private investment after decades of domination by the state broadcaster, All India Radio. The government, keen to encourage and facilitate overseas participation, has implemented regulatory changes to permit FDI of up to 20% in the sector. As the most cost-effective source of entertainment in India, radio has become an extremely attractive sector for investment, particularly following the offering of up to 338 FM radio licences for bidding by private players. These cover approximately 91 cities, most of which until recently were serviced only by the state broadcaster. The radio broadcasting industry performed well in 2007, with profits increasing by 24% from the previous year.

The print media industry has also received attention from the government. Foreign investment of up to 26% is now permitted in Indian publications dealing with news and current affairs, subject to certain preconditions. The foreign investment cap under the non-news category has been raised from 74% to 100% for scientific, technical and specialty magazines. In line with its earlier decision to ease requirements for the inclusion of local content and advertisements, in September 2008 the government introduced its new "Guidelines for Publication of Indian Editions of Foreign Magazines dealing with News and Current Affairs".

These efforts were intended to foster growth in the magazine industry and provide local readers with access to foreign news magazines at reduced prices. From 2004 to 2007, the profitability of India's print media industry rose by 15% – a bigger jump than that experienced by any other country in the world.

Another prominent sector is advertising and animation, which together are valued at roughly US$12 billion.

Regulations take centre stage

Investment in the entertainment sector is subject to the following limits prescribed by the Ministry of Information and Broadcasting

Sector	Area	Foreign investment permitted
Broadcasting	FM radio	FDI + foreign institutional investment (FII) of up to 20%, subject to Foreign Investment Promotion Board (FIPB) approval
	Cable networks	FDI + FII of up to 49%, subject to FIPB approval
	Direct-to-home	FDI + FII of up to 49%, subject to FIPB approval, but FDI level cannot exceed 20%
	Setting up hardware facilities such as uplinking, HUB, etc.	FDI + FII of up to 49%, subject to FIPB approval
	Uplinking a news and current affairs TV channel	FDI + FII of up to 26%, subject to FIPB approval
	Uplinking a non-news and current affairs TV channel	100% subject to FIPB approval
	Downlinking a news and current affairs TV channel	100% subject to FIPB approval
	Downlinking a non-news and current affairs TV channel	100% subject to FIPB approval
Print media	Publishing of newspapers and periodicals dealing with news and current affairs	26% subject to FIPB approval
	Publishing of facsimile editions of foreign newspapers	100% subject to FIPB approval
	Publishing of scientific magazines /specialty journals/periodicals	100% subject to FIPB approval

Advertising revenues escalated by a phenomenal 31% in 2007 from the level of the previous year. Internet advertising, accessible worldwide, is expected to post the highest annual growth in the sector, rising above 40%.

It's showbiz time

For investment in most sectors of the media and entertainment industry, the MIB requires an applicant entity to be an Indian company registered under the Companies Act, 1956. The best entry option for a foreign investor who desires management control is therefore through the establishment of a wholly owned subsidiary. A subsidiary of a foreign company is treated the same, in almost all respects, as a company which has resident Indian shareholders.

A foreign company can set up a wholly owned subsidiary, a liaison office or a branch office in India. A liaison office is suitable for foreign companies wishing to facilitate interaction between the parent company and its operations and clients in India; a branch office is similar, but the activities it may undertake are restricted. Establishing a subsidiary in India is generally preferable to opening a liaison or branch office, due to the greater number of activities it is permitted to engage in. The activities of a wholly owned subsidiary are governed by the terms of the investment approval under the exchange control regulations of India, the provisions of the Companies Act and other applicable acts.

A subsidiary can be incorporated under the Companies Act either as a private limited company or a public limited company. The minimum capitalization requirement for private companies is Rs100,000 and for public companies Rs500,000. Apart from the minimum capitalization norms, the costs of setting up an Indian company are relatively low. The foreign company could invest in its Indian subsidiary through an intermediate holding company set up in a tax-favourable jurisdiction. Taking advantage of India's wide treaty network and judiciously choosing an appropriate offshore location could result in many benefits for the parent company, such as a reduced or zero rate of tax on capital gains income and reduction in withholding tax rates. The choice of an offshore entity would be guided by the benefits available under the treaties between India and different offshore jurisdictions, and by the domestic tax laws of those offshore jurisdictions.

A liaison office is not permitted to earn revenue in India. Any expenses generated are required to be borne by the foreign company. Therefore, liaison offices are not profits tax-liable. The business profits of a foreign company are taxable only if they are attributable to a permanent establishment of the company in India. Branch office profits are taxable at the rate of 42.23% against 33.99%, which is the rate applied to Indian companies. However, foreign entities (such as the parent company of a branch office) are not taxed. For transfer pricing purposes, the branch and the head office would be considered associated enterprises and any transactions between the two entities would be at arm's length.

Three important points to bear in mind when structuring an investment in this sector are the entity, the jurisdiction and the investment instrument. With respect to investment instruments, apart from the issue of equity shares by the Indian company, the issue of compulsorily convertible debentures (CCDs) is another option that may be utilized. CCDs are considered to be FDI for exchange control purposes; however, for the purposes of the Income Tax Act, 1961, they are considered to be debt. This creates a benefit in that the interest payable to the foreign CCD holder is a tax deductible expense in the books of the Indian company.

Cross-media ownership

A number of companies in India have recently entered into strategic tie-ups and alliances in order to offer a complete spectrum of media services. The Times Group, considered to be the most vertically integrated media company in India, with several cross-media owned enterprises such as Radio Mirchi, Zoom TV, and out-of-home advertising, has established a 50-50 joint venture with BBC Worldwide Media for the publication of magazines. Meanwhile, Raghav Bahl's CNBC has established a partnership with TV18.

The rise of cross-media ownership as a means of corporate diversification has prompted a debate on the issue, more so after the Telecom Regulatory Authority of India issued a consultation paper inviting suggestions from stakeholders on whether cross holdings (vertical or horizontal) among media companies should be permitted.

While the importance of encouraging competition and diversity has been widely acknowledged, there is also significant opposition to cross-media ownership, based on the desire to prevent the creation of monopolies. Opponents are worried that media owners could amass excessive power to further their personal and business interests and publicize their political views, while simultaneously narrowing the platform available for competitors with different agendas.

Business enterprises in favour of cross-media ownership are attracted to benefits such as the promotion of quality content across a variety of platforms, and greater brand awareness. Proponents of this business model believe restrictions on ownership could impede the free flow of capital, technologies and business synergies between players.

Currently, cross-media ownership restrictions are in place in relation to direct-to-home satellite services and private FM radio. Broadcasting companies and cable networks are allowed to own a maximum 20% equity in a direct-to-home satellite services company. For example, Star Group, a division of News Corp, owns a 20% stake in Tata-Sky. The market share for private FM radio is also limited. Companies are not allowed more than one radio station per city or more than 15% of all stations in the country.

The all-important 'happy ending'

Despite the recent slowdown in global economic growth, the long-term picture for the media and entertainment sector remains bright. Digital technology and the expansion of broadband internet access will transform virtually all entertainment and media segments by opening up new distribution outlets. The internet has proved itself an effective companion to traditional media, rather than a competitor to be feared.

However, lawyers play a pivotal role in any investment in entertainment and media. Since the stakes and risk factors in this sector are very high, it is crucial for investors to carry out proper due diligence before any deal is finalized. In addition, investors require good corporate and tax structuring advice to extract the maximum benefits that are available, while ensuring full compliance with the regulations. ■

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