

Yes, Governance Matters.

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OPPORTUNITIES AND CHALLENGES FOR GLOBAL INVESTORS IN INDIA'S M&A LANDSCAPE

India, with its burgeoning economy and vast market potential, has long been an attractive destination for foreign investors. The country's diverse sectors, ranging from technology and pharmaceuticals to infrastructure and consumer goods, offer lucrative opportunities for mergers and acquisitions. Recent years have seen India implementing transformative reforms aimed at creating a more business-friendly environment, further solidifying its appeal as a global investment hub.

With the global markets entering a recession, investors are increasingly hesitant to part with their capital. In such a scenario, it becomes essential for countries to position themselves as investor-friendly destinations. A key step toward achieving this is easing procedural and regulatory guidelines for doing business.

With this objective in mind, India reduced 39,000 compliances and decriminalized more than 3,400 legal provisions¹. It currently ranks 63rd on Ease of Doing Business Index². India instituted structural economic reforms in recent years that will improve the business environment, including for U.S. exporters and investors. These reforms include liberalizing foreign investment restrictions, modernizing bankruptcy and labor laws, ending retroactive taxation, and replacing a patchwork of state border taxes with a national Goods and Services Tax³.

While these reforms mark significant progress, India's potential to become a global investment leader is boundless. Continued focus on reducing compliance burdens and further simplifying regulatory frameworks will enhance its attractiveness to foreign investors. This article will outline some of the key opportunities and challenges for foreign investors when investing in India, particularly from a merger and acquisition ("M&A") perspective.

1. DEMATERIALIZATION OF SHARES OF A PRIVATE COMPANY

On October 27, 2023, the Ministry of Corporate Affairs ("MCA") released a notification amending Company (Prospectus and Allotment of Securities) Rules, 2014 ("PAS Rules")⁴. It mandated compulsory dematerialization of securities of private companies, except small companies, by September 30, 2024. Additionally, private companies which are wholly owned subsidiaries of foreign companies do not fall within the ambit of small companies and this provision is applicable to them as well. This reform is designed to enhance the safety, transparency, and efficiency of share transfer processes, reflecting India's commitment to modernizing its corporate framework.

For foreign investors, this change brings the benefit of streamlined and secure share transactions, reducing the risks associated with physical shareholding. The dematerialization requirement aligns India with global best practices, fostering greater confidence among long-term investors and positioning the country as a transparent and robust investment destination.

While for short-term, investors may initially find the compliance process, such as obtaining a Permanent Account Number ("PAN"), fulfilling Know Your Customer ("KYC") norms, disclosing shareholding structure and ultimate beneficial owner and paying additional fees for opening the demat accounts, to be more involved, these measures ultimately contribute to a more predictable and secure business environment. Prior to this notification, these investors had an option of purchasing shares physically without registering/ disclosing the transactions.

These reforms may present an adjustment period for investors considering these additional compliances are cost and time intensive and potentially delay the finalization of M&A transactions, but they also signal India's commitment to a more structured and reliable investment ecosystem.

2. DOWNSTREAM INVESTMENTS BY FOCCS

Downstream investment by Foreign-Owned or Controlled Companies (FOCCs) presents a significant opportunity for foreign investors to deepen their participation in the Indian market. This investment route, governed by Rule 23 of the Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 (NDI Rules), establishes a structured regulatory framework. However, as India continues to position itself as a global investment hub, there is an opportunity to further streamline and clarify certain aspects to enhance the ease of doing business.

A key area for refinement is the applicability of pricing and reporting norms for FOCC-driven transactions. Current rules occasionally lead to differing interpretations by Authorised Dealer (AD) banks, particularly regarding fair market value (FMV) thresholds and norms depending on whether the counterparties are residents or non-residents. This variability underscores the need for consistent guidelines that would simplify compliance and boost investor confidence. Additionally, broadening the scope of downstream investment regulations to include instruments such as optionally convertible preference shares (OCPSs) and debentures (OCDs) could ensure greater uniformity and close potential regulatory gaps.

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The regulatory landscape becomes more complex with share swap transactions. Although Rule 6 permits non-cash consideration under the automatic route, conservative interpretations by AD Banks now often push FOCC transactions into the approval route, citing concerns around funding sources specified in Rule 23(4). Additionally, mixed consideration transactions (part cash, part securities), remain an area where clearer guidelines could reduce procedural ambiguities.

Further challenges arise from limitations on deferred payment arrangements and non-cash consideration in downstream investments, which place FOCCs at a disadvantage compared to direct foreign investors. Addressing these issues requires targeted amendments to the NDI Rules. By harmonizing these regulatory elements, India can attract more foreign investment while maintaining robust oversight. We have discussed the issues pertaining to downstream investment in detail [here](#).

3. KYC REQUIREMENT: PRE-REQUISITE FOR MAKING INVESTMENTS IN INDIA

India has robust policies in place to prevent financial institutions from being used for money laundering and financing terrorist activities. The Prevention of Money-Laundering Act, 2002 and the Prevention of Money-Laundering (Maintenance of Records) Rules, 2005, form the legal framework on Anti-Money Laundering (**AML**) and Countering Financing of Terrorism (**CFT**). In pursuance of these statutes, KYC framework has been established. KYC norms require the investor to submit identity, residence proof and any other document as required to the registered entity, as applicable, before investing. This makes the financial framework of the country more trustworthy and less risky. It limits frauds while increasing lending.

While these norms contribute significantly to the integrity of India's financial system, there is room to make the processes more seamless for foreign investors. Streamlining KYC approvals and enhancing coordination among regulatory bodies could reduce redundancies and make compliance more efficient. Foreign national investing in India may not always be comfortable with divulging personal information to a foreign nation, especially when they are already compliant with anti-money laundering policies of their own nations. They may want to avoid this time and cost intensive activity of KYC approval from several different regulatory bodies.

However, in our opinion, this is an important requirement that India cannot do away with for several security reasons. These statutes mentioned above which give rise to the KYC framework, are derived from Global Financial Action Task Force ("**FATF**") norms and rules. It sets standards and promotes effective implementation of legal, regulatory and operational measures for combating money laundering, terrorist financing and other related threats to the integrity of the international financial system. India, being a member of FATF, has to uphold measures to protect the integrity of international financial system.

4. DISCLOSURE OF SIGNIFICANT BENEFICIAL OWNERS ("SBO") OF THE INVESTING COMPANY

India's commitment to a transparent and accountable corporate ecosystem is reflected in the provisions of Section 90 of Companies Act, 2013 ("**CA 2013**") read along with Companies (Significant Beneficial Owners) Rules, 2018 ("**SBO Rules**"). These provisions deal with identification of SBOs in a company along with the register that has to be maintained and returns that has to be filed with the Registrar of Companies ("**RoC**").⁵ This framework not only safeguards the integrity of India's corporate environment but also aligns with global best practices, providing reassurance to international investors about the country's commitment to combating opaque ownership and fostering good governance.

The SBO framework employs a twin-test approach of objective and subjective analysis. The objective test, evaluates the shareholding of the individual in question and whether they indirectly (or together with direct holdings) holds not less than 10% of the shares.⁶ The subjective test examines whether the individual in question has the right to exercise, or actually exercises significant influence or control in any manner, other than through direct holdings.⁷

While the RoC has taken a proactive approach in implementing these provisions, there have been instances, such as the LinkedIn Order⁸, which we have discussed in detail [here](#), where interpretations of the subjective test extended beyond established norms. As foreign investment into Indian entities continues to grow, aligning the implementation of these rules with investor expectations presents an opportunity to refine processes. By initiating open dialogue with stakeholders and ensuring consistent application of SBO norms, India can further enhance its position as a premier destination for global investment.

5. REQUIREMENT OF PHYSICAL SIGNATURES

India's commitment to improving its ease of doing business is evident from its recent reforms and initiatives. However, embracing further digitization and paperless procedures presents an exciting opportunity to make investment processes even more seamless for global investors.

Currently, the need for physical signatures coupled with notarization, apostille, or embassy attestation for incorporation and numerous filings can be time-intensive and add to investment costs for foreign investors⁹. The investment schedule may be further delayed if foreign investors are required to travel to India in person or designate a local agent to finish these requirements.

By implementing digital technologies and paperless procedures, many other nations, such as Singapore, have simplified their investment processes¹⁰. Singapore frequently permits online document submission, remote verification, and electronic signatures, greatly cutting down on the time and expense involved in investment approvals¹¹. These nations may become more appealing to global investors looking for hassle-free and effective business practices due to their ease of doing business.

India, with its strong focus on innovation and technology, is well-positioned to adopt similar measures. By further simplifying these processes, the country can enhance its competitive edge and solidify its reputation as a global investment hub. Such advancements would not only make India more attractive to foreign investors but also reflect its readiness to lead in a rapidly digitizing world.

6. REQUIREMENT OF OBTAINING MULTIPLE VALUATION REPORTS

Given that the regulatory environment in India is changing, it is critical to stay abreast of the valuation requirements when undergoing a M&A transaction in India. In certain transactions it may be required to engage an appropriate valuation professional (i.e., *Registered Valuer, Category I Merchant Banker registered with the SEBI, or Chartered Accountant who is member of the ICAI, as applicable*) to satisfy the specific regulations in India. While this requirement adds a layer of diligence, it also ensures that transactions align with international best practices, protecting both investors and stakeholders. This is primarily due to the overlapping regulatory requirements under the Foreign Exchange Management Act (FEMA), the Income Tax Act, and the Companies Act.

Under FEMA, the RBI mandates that foreign investments must be made at a fair valuation. This often requires a valuation report from a Category I Merchant Banker or a Chartered Accountant as per internationally accepted pricing methodologies. For tax purposes, particularly in cases involving transfer pricing or capital gains, the Income Tax Department may require a valuation to ensure that transactions are conducted at fair market value. The Companies Act, 2013, also has provisions that may require valuation reports, especially in cases of mergers, acquisitions, or issuance of new shares. The valuation must be conducted by a registered valuer to ensure compliance with the statutory requirements.

Each regulatory framework may have its own criteria for determining FMV or fair pricing, leading to situations where valuations obtained for compliance with one regulation may not meet the criteria of another. While the need for multiple valuations may initially appear complex, it underscores India's commitment to creating a transparent and equitable investment landscape. With the right professional guidance and a thorough understanding of the regulatory framework, foreign investors can navigate these requirements effectively.

7. INDIAN COMPANIES TO MAINTAIN DAILY BACK UP OF BOOKS OF ACCOUNTS

The amendments introduced by the MCA in August 2022 to Rule 3 of the Companies (Accounts) Rules, 2014, may pose some complexities for foreign investors. However it reflects India's commitment to enhancing transparency and strengthening the integrity of its financial ecosystem. These changes mandate companies to ensure that books of accounts maintained in electronic mode are always accessible in India, require daily backups on servers physically located within the country, and necessitate detailed disclosures about service providers and data storage practices. For multinational investors relying on global IT infrastructure, these requirements may demand adjustments, including reconfiguring systems and processes, securing additional approvals, and potentially engaging third-party service providers.

While these requirements underscore the importance of data security and regulatory compliance, they also present an opportunity for multinational companies to integrate and localize their operations within India's rapidly growing market. For foreign investors, this can lead to long-term benefits, including improved data protection, better risk management, and increased confidence from Indian stakeholders. Adapting IT infrastructure and aligning with local regulations may involve initial adjustments, but these efforts will position businesses to better leverage India's expanding digital ecosystem and benefit from the country's progressive corporate governance practices.

8. CONSOLIDATION OF MCA FORMS FOR EASE OF DOING BUSINESS

Government of India is focusing on increasing Ease of Doing Business and attracting foreign investors. In pursuance to the same, MCA has taken several commendable steps to simplify the investment process in India, by taking initiatives such as the introduction of the SPICe form¹². However, further consolidation of forms and streamlining of procedures are essential to create a more investor-friendly environment. Currently, the investment process involves multiple forms and approvals from various authorities, leading to significant time and cost burdens. By consolidating these forms and simplifying the approval process, the MCA can significantly reduce the administrative hurdles faced by foreign investors.

A unified platform for all investment-related filings can streamline the process and reduce the compliance burden. By implementing these measures, India can position itself as a more attractive destination for foreign investment, fostering economic growth and creating jobs.

CONCLUSION

India presents vast opportunities for foreign investors, especially in the M&A space, with its dynamic market and growing sectors. By strategically understanding and steering the regulatory, cultural, operational, and economic landscapes, foreign investors can tap into India's immense growth potential. The country has made remarkable strides in streamlining investment processes, creating an environment ripe for business expansion. As India continues to implement reforms and adapt to global economic conditions, it is increasingly positioned as an attractive investment destination, especially in a global market facing recessionary pressures.

While some regulatory measures, such as the one discussed above, present areas for improvement, these steps are part of India's commitment to enhancing the security and integrity of its financial systems. There is a strong opportunity to further streamline processes which would simplify the investment journey for global investors. By building on these advancements, India can further strengthen its business ecosystem, driving economic growth and promoting a more investor-friendly environment.

Authors:

– Maulin Salvi, Janak Pandya and Vaibhav Parikh

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¹<https://www.makeinindia.com/eodb>.

²<https://invest-india-revamp-static-files.s3.ap-south-1.amazonaws.com/s3fs-public/2019-10/9781464814402.pdf>

³<https://www.state.gov/reports/2024-investment-climate-statements/india/>

⁴Notification, Ministry of Corporate Affairs, October 27, 2023, available at <https://egazette.gov.in/WriteReadData/2023/249772.pdf>

⁵Discussed in detail at <https://nishithdesai.com/NewsDetails/15060>.

⁶Rule 2(1)(h)(i) to Rule 2(1)(h)(iii) of the SBO Rules.

⁷Rule 2(1)(h)(iv) of the SBO Rules.

⁸www.mca.gov.in/bin/dms/getdocument?mids=san%252BPg76sl9tkgd5lcHzg%253D%253D&type=open.

⁹<https://www.indiafilings.com/emudhra#:~:text=Overview%20of%20Class%203%20Digital,3%2Dyears>.

¹⁰<https://www.sqlview.com.sg/document-management-system-singapore/electronic-signature/understanding-electronic-signatures-and-its-use-in-singapore-part-2/#:~:text=The%20Singaporean%20government%20has%20special,least%20amount%20of%20red%20tape>.

¹¹<https://sso.agc.gov.sg/act/eta2010>.

¹²https://www.mca.gov.in/Ministry/pdf/SPICe+_help.pdf.

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