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INTERNATIONAL INSIGHTS

INDUSTRIAL GROWTH TRENDS IN INDIA

by Neil Bagchi

A previous issue of *International Insights* (the first part of a three part series on doing business in India) provided an overview of best practices for contracting with Indian parties. Part two is a general description of high growth sectors in the Indian market economy, as well as a summary of investment guidelines for foreign investors.

Industrial Growth Trends

Arguably, India's emergence as a global economic leader may be attributed to three interrelated factors. First, economic and financial institutional level reforms are beginning to take effect. They were implemented by the Indian government in 1991 and focus on the privatization and development of a strong industrial base and the liberalization of rules governing foreign direct investment. Second, the Indian services sector has become a global leader, largely on the strength of its IT (information technology) services industry, which accounts for more than 60% of the country's GDP (http://www.indiaonestop.com/economy-macro-view.htm). India's nascent life sciences industry is poised to produce even greater returns for India. Third, India's domestic consumer market (comprised of 300 million middle class persons) represents an enormous market opportunity for domestic and foreign companies and investors alike.

The following industries are experiencing tremendous growth in India:

IT Services

This industry's strong reputation is based primarily on software development and IT enabled services/business process out-

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IN THIS ISSUE:

Article:

- *Industrial Growth Trends in India*

Situations, Strategies & Solutions:

- *Inbound Distribution*

Attorneys in our international practice group have extensive experience with international business operations and can be of great value to both (i) United States companies operating in foreign jurisdictions as well as (ii) foreign companies doing business in the United States. Unique legal issues arise in both contexts, and our experience can be critical in addressing those issues.

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sourcing. Employing over 700,000 people, the IT services industry lists as clients more than 50% of Fortune 500 companies (http://www.atimes.com/atimes/South_Asia/GK04Df02.html). This industry's services are exported to over 133 countries. Analysts project that India will continue to maintain its market leading position in this sector, which is projected to continue growing over the next ten years (http://www.atimes.com/ atimes/South_Asia/GK04Df02.html).

Life Sciences

As a member of the World Trade Organization and a signatory to the General Agreement on Tariffs and Trade, India is a party to the Agreement on Trade Related Aspects of Intellectual Property and the Patent Co-operation Treaty. As a condition to its participation in the foregoing, India reformed its patent protection regime to meet, and in some cases exceed, international patent protection standards (although the legal remedies for patent infringement remain a work in process). With India's global patent protection standards in place, over 67 FDA approved pharmaceutical manufacturing facilities and an experienced life sciences industry built upon a strong (pre-2005) generics sector, Western companies are increasingly collaborating with Indian partners for pre-clinical, drug discovery, clinical and manufacturing services. Apart from pharmaceuticals, India's developing life sciences reputation is bolstered by its biotechnology, health care and information management companies.

Consumer Products

The Indian retail industry is an estimated $350 billion dollar per year industry (expected to grow at the rate of 30% a year) (http://www.indiareports.com/retail/nov06.aspx), with approximately 20 million retailers and 40 million employees (*Ernst & Young, Tax and Business Guide: "Doing Business in India,"* p. 41). Most of this anticipated growth potential centers around the absence of, and trend toward, organized, multi-unit retail establishments, which create potential investment opportunities for foreign investors, especially in light of the liberalization of foreign direct investment caps on the retail industry. Global retailers, private equity funds with a retail focus, restaurants, single brand retailers, hospitality companies, credit card companies, mortgage companies, automobile manufacturers and other consumer goods companies are part of a growing wave flooding the Indian retail marketplace. One interesting and high growth retail sector is India's wine market, which is growing at the rate of nearly 30% per year.

Infrastructure Related Industries

Indian Prime Minister, Manmohan Singh, projects that India will require investment in excess of $320 billion by 2012 in order to continue to modernize its roads, ports, airports, power generation, water treatment facilities and other infrastructure. Almost every Indian state is developing several large infrastructure projects, one of the largest being the Golden Quadrilateral Project, which will connect Delhi, Mumbai, Chennai and Calcutta by way of over 5,846 kilometers of highway. In order to stimulate the required capital investment for such projects, the Indian government has liberalized foreign direct investment restrictions in many infrastructure-related sectors.

General Information for Foreign Investors

The Indian government's economic reforms focus on the liberalization of foreign direct investment. Foreign investors are permitted to purchase, through certain channels, publicly traded Indian securities, as well as non-publicly traded securities of Indian companies. Foreign investments in publicly traded Indian securities are regulated by the Securities Exchange Board of India ("SEBI"). Investments may be made by registering with SEBI as a foreign institutional investor ("FII") or as a subaccount holder of a FII (although this scheme is under review by SEBI), through a pooling of interests vehicle or through investments in a derivative instrument referred to as a participatory note.

Government consents required for investments in non-publicly traded securities depend on the type of investment. Certain investments in non-publicly traded securities are subject to the "automatic approval" procedure, under which a foreign investor does not need to obtain approval prior to making such an investment. In such cases, however, the company issuing securities to a foreign investor must send to the appropriate branch of the Reserve Bank of India (the "RBI") a notice of such investment within thirty days after such issuance. Foreign investments that do not fall under the "automatic approval" procedure must be registered with the Foreign Investment Promotion Board. Examples of such investments include those (i) in sectors that require industrial licensing, (ii) in the financial services sector, (iii) in certain agricultural sectors, (iv) in sectors in which a foreign investor has an existing Indian venture, and (v) in excess of sector specific foreign investment caps. Foreign investments in sectors such as atomic energy are not permitted.

Foreign investments made in India can only be repatriated through a foreign account held in compliance with the Foreign Exchange Management Act 1999. The Indian Rupee is freely convertible into foreign currency for trade and current account purposes, subject to a negative list of transactions that are prohibited or require prior approval. Foreign capital invested in India is generally allowed to be repatriated, along with capital appreciation, after the payment of applicable taxes, if the invested capital was approved on a repatriation basis. If not, repatriation of equity capital is permitted only on liquidation or transfer of shares, and compliance with certain requirements of RBI. India does not tax the recipients of dividends paid by Indian corporations.

In order to circumvent the ordeal of directly complying with the foregoing requirements, many American portfolio investors looking to participate in India do so through U.S. based funds of which there are over twenty. Such funds range from $10 million to $1 billion, with minimum investments ranging from $250,000 to $1 million. A number of funds are closed to new investors; however, new funds with credible investment teams seem to appear frequently. Since investments contemplated under this arrangement are made through a U.S. entity, the main risk involved with such an investment is associated with determining which fund is most credible and best positioned to achieve the investor's investment goals.

Certain statistics and information provided above, if not directly attributed, come from:

Ernst & Young, Tax and Business Guide: "Doing Business in India," General Editor Mohan R. Pillay, Thomson and Sweet & Maxwell Asia (1st edition 2004).

Neil Bagchi is a corporate associate in the international and business and technology practice groups. Neil's practice involves representing U.S. companies and Indian companies in joint venture and strategic partnership transactions with one another.

SITUATIONS, STRATEGIES & SOLUTIONS

Inbound Distribution

by John Murchison

Situation

I am the Sales Director of a company based in London that is formulating plans to introduce its products in the United States. In Europe, we use a limited distribution system that seeks to protect our distributors from free-riding and other disincentives to their sales efforts. We have encountered some problems in implementing this system in a manner that complies with EU competition laws. Will we have the same issues under U.S. antitrust laws?

Strategies/Solutions

You will not have as many problems in implementing a limited distribution system under U.S. antitrust laws as you may have faced under EU competition laws.

As you know, in a limited distribution system, a supplier seeks to protect its resellers from competition from other distributors and resellers of its products so that they can focus their efforts on the suppliers' competitors. This is generally done by the use of various "vertical restraints," which are termed "vertical" because they involve parties operating at different levels of the production or distribution chain (rather than being horizontal competitors). Typically, a limited distribution system could entail the use of sales only through authorized distributors or resellers who have exclusive territories, restraints on reselling to non-authorized distributors, the use of exclusive supply provisions and non-compete provisions that preclude distributors from carrying competing goods. Since a principal objective of the EC Treaty establishing the European Union was the free movement of goods and services among the Member States, prohibitions against provisions such as those involving exclusive territories have been especially severe under EU competition laws.

Under U.S. antitrust laws, vertical non-price restraints are analyzed under the so-called "rule of reason" in which restraints are examined on the basis of the effect that they have on competition. In the absence of substantial market power, therefore, it is highly unlikely that a vertical restraint could result in a net adverse effect on competition leading to higher consumer prices. So long as your company doesn't have a substantial share of the market and there are other brands that you compete

against, you should not encounter any substantial problems in developing an appropriate and reasonable limited distribution system in the United States.

One area in which EU competition laws and U.S. antitrust laws take a similar view is with respect to vertical pricing restraints. An agreement between a supplier and its distributors or resellers as to the minimum resale price of the product is "per se" unlawful under U.S. antitrust laws and a hardcore restraint that would violate EU competition laws. There is presently pending before the United States Supreme Court a case that challenges the per se treatment of vertical minimum price fixing, but as of this date, no ruling has been issued.

John Murchison is of counsel in our Business Law Department and regularly counsels clients on antitrust matters and represents clients in antitrust investigations conducted by the Antitrust Division of the Department of Justice and other government agencies.

About Us

Founded in 1957, Kennedy Covington is one of the largest law firms in the Carolinas with offices in Charlotte, Raleigh, Research Triangle Park, Columbia and Rock Hill. Our more than 200 attorneys use their diverse experience and knowledge to counsel clients in varied industries such as banking and finance, real estate, technology and manufacturing. At Kennedy Covington, we give more than a legal opinion; we provide a business perspective.

This newsletter is published as a service to clients and others interested in international issues. The information provided herein is general in nature and should not be relied upon as legal advice as to specific factual situations. Our international practice group welcomes your comments or inquiries about this newsletter or about any specific matters you may wish to discuss with us.

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