ENLARGING THE SCOPE OF FDI IN AVIATION SECTOR

September 2012

The Cabinet Committee of Economic Affairs ("Committee") on September 14, 2012 approved the proposal of Department of Policy and Promotion ("DIPP") for permitting foreign airlines to make Foreign Direct Investment ("FDI") in the aviation sector. Once the proposal is implemented, the prevailing restriction on foreign airlines from investing in the airline business will be removed. Prior to the change in policy, foreign airlines were permitted to invest and participate in equity only in companies operating cargo airlines, helicopter and seaplane services.

The change in FDI shall permit foreign airlines to invest in "scheduled and non-scheduled air transport services." The investment will be allowed under the approval route up to a maximum of 49%. In addition to this, any investment in the aviation sector must also comply with the relevant regulations of Securities Exchange Board of India such as the Issue of Capital and Disclosure Requirements Regulations/Substantial Acquisition of Shares and Takeovers Regulations, as well as other applicable rules and regulations.

The announcement by the Committee also lists certain specific conditions which form the basis for permitting FDI up to 49% by a foreign airline. Firstly, for a Company (in which 49% FDI has been allowed) to obtain a scheduled operator's license, its principal place of business and registered office must be in India, the Chairman and at least two- third of the directors of the company must be Indian citizens and substantial ownership and effective control should be in the hands of Indian nationals. Secondly, any foreign national who will be associated with Indian scheduled or non-scheduled operations, i.e. who will be appointed to the board of the Indian airline which has received FDI, must also go through and obtain security clearance, presumably from the Ministry of Home Affairs before beginning any work in India. Lastly, the Committee has also mentioned that all import of technical equipment as a result of the investment under the 49% limit must be approved by the Ministry of Civil Aviation. Though these specific conditions have been mentioned, the directives for implementation are yet to be announced and it is likely that these directives will be made public by mid October.

From a general reading of the conditions mentioned by the Committee, it is apparent that the grant of FDI to foreign airlines is simply to bolster the ailing Indian Aviation sector by access to another avenue for funds and equity infusion. It is evident that the intention is to ensure that control and management of Indian Scheduled airlines stays in Indian hands. While the permission for FDI by foreign airlines has been long anticipated for rescuing the aviation industry in India, whether this strategy will succeed remains to be seen. In our opinion, introduction of direct investment and involvement by foreign airlines will do much for raising the standards of service in the aviation sector, there is also a possibility, though remote, of cartelization by foreign airlines which may not only render the strategy of the government for reviving the aviation sector ineffective, but also adversely affect the struggling Indian airlines.

By:

Ashutosh Chandola
Krishna Jhala