DOWNSTREAM INVESTMENTS BY FOREIGN OWNED AND CONTROLLED COMPANIES (FOCCS)

Swetha Dutta & Vineet Seervi, Narsee Monjee Institute of Management Studies, Bengaluru

ABSTRACT

"This essay addresses the critical role that downstream investments by Foreign Owned and Controlled Companies (FOCCs) have to play in India's foreign direct investment policy, the challenges, due to stringent rules and regulations, and also about the widening legal framework that surrounds these investments in India. FOCCs act as an indirect means of Foreign Direct Investment. FOCCs, which can be simplified as Indian enterprises owned and controlled by foreign nationals, are used to enhance international engagement in and comprehension of the Indian economy. Entry channels, sectoral limits, and price and reporting conditions for such investments are regulated by the acts, such as, "Foreign Exchange Management Act, 1999", the "Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 (NDI Rules)", and the Master Directions (RBI).

This essay will explore how the regulatory complexity and compliance costs have increasingly constrained FOCCs downstream investments, despite their absolute strategic importance. Common among such constraints are foreign holding bans in particular industries, complicated valuation and pricing obligations, and a lack of a harmonized interpretative approach by AD institutions, leading to uneven practices and increased transaction costs. The deterrents, such as uncertain definitions and disparate procedural regulations, have obstructed the planning and implementation of business-to-business transactions, most notably share swaps, deferred payment schemes, and multi-level investment.

In conclusion, there are still enormous numbers of operational and interpretation issues. Despite, RBI's liberalized policy having raised investor confidence and facilitated M&A activity. There is a need for Standardized intermediary practices, regular interaction among industry participants and regulators, enhanced training, and the establishment of strong compliance infrastructures to deliver long-term results. Finally, regulatory stability, capacity-building, and the timely resolution of disputes will determine the success of the new regime and make India a long-term destination for foreign investment-led growth."

Keywords: FOCCS, Downstream Investment, Challenges, FDI, FEMA, NDI, RBI Reforms.

1. UNDERSTANDING DOWNSTREAM INVESTMENTS BY FOCCS

Downstream investment and Foreign-Owned and Controlled Companies (FOCCs) are the pillars for understanding India's foreign direct investment regulations. These terms reinforce the regulatory framework that enables foreign capital to flow and develop in the Indian economy.

A FOCC is an Indian company or LLP where control or ownership, directly or indirectly, exceeding 50% is held by persons residing outside India. [1]Ownership is the possession of majority equity or capital/profit share, whereas "control" is the ability to appoint majority directors or designated partners, or to control management and make decisions on the rules. The regulatory framework for the regulation of FOCC is mainly set under the Foreign Exchange Management Act, 1999 (FEMA) [2]And further elaborated in the Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 (NDI Rules) and notified by clarifications of the Reserve Bank of India (RBI).

A downstream investment is an instance of a foreign investment of an Indian entity, such as an FOCC, in another Indian entity's capital. These types of investments are classified as indirect foreign investment and are governed by the same sectoral limits, entry routes, pricing rules, and detailing norms as direct foreign investment. More importantly, any investment by a FOCC in another Indian entity is regarded as foreign investment per se without regard to the effective foreign ownership percentage in the investing entity. Such regulations exclude circumvention of FDI limits through the utilization of complex proprietorship structures.

1.1.SIGNIFICANCE OF DOWNSTREAM INVESTMENTS IN INDIA’S FDI FRAMEWORK

The key to improving international investors opinions of and involvement in the Indian market is downstream investment. Regulatory or business considerations aside, the idea allows investors to access new businesses that are otherwise inaccessible. It is an instrument that enables a multi-layered corporate structure, corporate expansion, industry grouping, and also involves a certain kind of portfolio diversification.

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[1] Foreign Exchange Management (Non-Debt Instruments) Rules, 2019, Gazette of India, Ministry of Finance, Notification No. S.O. 3732(E) (Oct. 17, 2019), r. 2(a)(2).
[2] Foreign Exchange Management Act, No. 42 of 1999, India Code (1999).

From the point of view of the government, equivalence of downstream investments with direct foreign investments ensures regulatory parity, prevents evasion of FDI rules, and ensures management of the final use of foreign funds in India. Downstream investments therefore strike a balanced fine line, by the way of endorsing the benefits of foreign investment, besides business facilitation on the one hand and safeguarding sectoral interests and the integrity of India's foreign exchange market on the other side.

2. REGULATION GOVERNING FOCCs.

2.1. FOREIGN EXCHANGE MANAGEMENT (NON-DEBT INSTRUMENTS) RULES, 2019

On 17th October, 2019, the Ministry of Finance, Department of Economic Affairs, notified the Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 (NDI Rules) under FEMA, 1999 [3]to govern overall direct and indirect foreign investment in Indian entities. The NDI Rules make a clear distinction between debt and non-debt instruments and bring non-debt instruments (equity shares, convertible debentures, share warrants, and preference shares) under the regulatory fold of the Central Government. [4]These guidelines mandate the eligible classes of foreign investors, including Non-Resident Indians, Overseas Citizens of India, and Foreign Portfolio Investors, to define approved areas of investment, entry channels (automatic or government approval), and determine sectoral foreign ownership limits. Firm pricing guidelines are also needed to safeguard fair valuation and circumvent misappropriation in the issuance and transfer of equity mechanisms.

One of the most significant components of the NDI Rules is the regulation of downstream investment, which is indirect foreign investment by an Indian entity controlled or owned by Foreign Owners or Controllers (FOCCs) in some other Indian firm or LLP. Significantly, Rule 23(1)[5] enshrines the policy, which guarantees that the same entry channel, sector limits, price norms, and other regulatory norms apply to any Indian entity with foreign investment (including Foreign Portfolio Investors, or FOCCs) as direct foreign investors. Reporting norms and strict time limits for intimation to the Reserve Bank of India are made compulsory to ensure greater transparency and liability. The overall objective is to avoid evasion of FDI rules by

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[3] Foreign Exchange Management (Non-Debt Instruments) Rules, supra note 1, Pt. II, Sec. 3(ii).
[4] Id.., at r. 2(ai).
[5] Id.., at r. 23(1).

foreign investors investing indirectly in Indian undertakings over which they have control or ownership. Therefore, FOCCs are subject to treatment on par with non-residents for all the foreign investment rules except regulation transparency. Transparency in regulations has, however, been absent for a long period, particularly about procedural rules for downstream investment, sectoral limits, and certain types of transactions.

2.2. HISTORICAL CHALLENGES

India's conservative tradition towards foreign capital (1947-1991) was articulated in the form of restrictive acts such as FERA (1973) and the Monopolies and Restrictive Trade Practices Act (1969), which compelled foreign companies to water down local shareholding and, in most instances, led to high-profile departures (e.g., IBM, Coca-Cola). Apart from such a policy, foreign investors also faced painful bureaucratic entry barriers, formal land and finance acquisition, and unapproachable regulatory procedures, issues that continued even when the market was opened in 1991.

Large business projects, such as Nokia's Tamil Nadu factory, also had to deal with land title, labour disputes, and tax scandals. [6]In the same vein, Walmart's growth was kept in check by regulatory obstacles to FDI in multi-brand retailing that forced the use of a joint venture model rather than direct store operations. Cultural and communications issues also frequently made market entry difficult. For instance, Companies like IKEA were forced to change their business model in order to accommodate the Indian consumer needs, and the failure of the Daimler–Hero joint venture proved the failures brought about by non-conforming cross-cultural management styles.

For FOCCs in particular, regulatory doubts regarding allowed investment channels, share swaps, and delayed payment mechanisms for downstream investments remained rampant for decades. Only recently, in the 2024 reforms, regulations allowed only "issuance" but not "transfer" of shares via swaps, which constrained M&A agility and necessitated tedious RBI approvals. Likewise, FOCCs were also barred from employing deferred payment arrangements, a norm in direct FDI transactions, which kept deal-making at bay until regulatory reforms.

[6] Nokia India Sales Pvt. Ltd. v. Assistant Commissioner (CT), Writ Appeal Nos. 1118 & 1119 of 2015, MANU/TN/1141/2016 (Madras HC Apr. 12, 2016).

2.3. REGULATORY AMBIGUITY

Ambiguity arises as the dual classification of FOCCs, alternately, as Indian residents, and alternately, as non-residents (PROIs), under FEMA. [7] And the NDI Rules.[8] These are generating compliance difficulties, mainly for downstream investments, sectoral cap compliance, and pricing. Failure to act on specific guidance has generated divergent procedures by authorized dealer (AD) banks, frequent transaction delays, and frequent requests for clarification from the RBI. FOCCs also possess uncertainties with regard to procedural necessities, including report requirements (e.g., Form DI), handling of certain instruments (e.g., optionally convertible debentures), and circumstances that trigger FDI breaches during indirect share transfers. There is also no one universal generic rule of regulation, and this is a cause of complexities and must be interpreted on a case-by-case basis by banks. Persistent rule-shifting, new category introduction (e.g., FOCEs), and shifting valuation and reporting requirements impose "double compliance" burdens, raise administrative expenses, and deter investment from time to time. Although recent reforms have brought considerable transparency, there remain uncertainties and operational issues for FOCC.

3. RBI'S MASTER DIRECTION HIGHLIGHTS (REFORMS AS OF 2025)

Reserve Bank of India (RBI) has released a detailed Master Direction on Foreign Investment in India on 25 January 2025[9] Fully redesigning foreign investment regulation and, importantly, downstream investment by Foreign Owned or Controlled Companies (FOCCs). The changes also supplement the August 2024 notified Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 (NDI Rules) amendments and remove age-old ambiguities and offer strong and facilitative guidelines.

3.1. ELUCIDATION OF AUTHORIZED MECHANISMS AND PARITY REGULATION

Historically, FOCCs' downstream investment ranked alongside direct FDI in sectoral controls and pricing conventions on the basis of the principle that indirect foreign investment was not to be permitted to find ways around controls over direct foreign investment. But a few

[7] Foreign Exchange Management Act, supra note 2, at § 2(v).
[8] Foreign Exchange Management (Non-Debt Instruments) Rules, supra note 1, at Pt. II, Sec. 3(ii), r. 23.
[9] Reserve Bank of India, Master Direction, Foreign Investment in India, RBI/FED/2025-26/36, Jan. 20, 2025.

operational uncertainties were left for later, most notably, whether FOCCs could access facilities offered to direct FDI, like share swaps (receiving or providing shares and not cash) and delayed payment terms for takeover. A consequence of unclear regulatory sentences and risk-averse practice by Authorized Dealer (AD) banks (most recently following RBI guidance of the year 2023 and at the beginning of 2024), companies were poised to see delays, irregular practices, and uncertainty on compliance.

3.2. THE MASTER DIRECTION OF 2025 HAS CLARIFIED AND LIBERALIZED THIS FRAMEWORK:

a) Share Swaps and Deferred Payment: FOCCs are formally allowed to use share swaps and can also rely on the terms of deferred payment in making downstream investments. This new change places them at the same level as direct FDI investors if otherwise compliant with the NDI Rules in all other aspects. Specifically, deferred consideration up to 25% of the value of the transaction can be paid 18 months after the transaction date, a seamless merging of the FDI policy for non-debt equity investment.[10]

b) Limitation on Domestic Borrowings: FOCCs are not permitted to use on-loan (borrowed) money in India to invest downstream, with the introduction of stringent controls to prevent round-tripping and ensure the sanctity of the FDI regime. Investment would be funded only by foreign capital or domestic accumulations.[11]

c) Subscription to Rights and Bonus Issues: The New Master Direction now clearly allows FOCCs to subscribe to the rights and bonus issues of the investee companies if the transaction is being done in terms and accordance with the Companies Act, 2013, and the NDI Rules. The Non-resident shares should not be priced above Fair Market Value (FMV) where the price is on or above the price to resident or domestic shareholders. Where non-residents subscribe for unsubscribed shares or exercise options reserved for residents, normal pricing guidelines, i.e., not below FMV, are applicable.[12]

d) Registration and Timely Reporting: FOCC institutions are required to reclassify their status and report downstream investments to the RBI on Form DI within 30 days of a

[10] RBI, supra note 9.
[11] id.
[12] id.

change in foreign ownership or control. This will result in best practices in place and guarantee suitable regulatory disclosure, enhancing data reliability and monitoring of the activities of the FOCC.[13]

3.3.ADHERENCE TO THE MOST RECENT 2024 NDI REGULATIONS

The revised Master Direction brings together and enshrines the August 2024 amendments to the NDI Rules, which are meant to make cross-border mergers and acquisitions(M&A) even simpler and compliance even more possible:

a) Secondary Share Swap Arrangements: The new framework now formally recognizes share swaps as valid payment for cross-border transactions, subject to sectoral caps and standards of fair pricing as demanded or prescribed under FDI policy.[14]

b) Sectoral Caps and Entry Channels: All FDI downstream investments by FOCCs will remain subject to the applicability of the sectoral caps and entry channels (automatic or government approval) as specified for direct FDI, under regulatory parity and to avoid circumvention.[15]

c) Financial Sector Institutions: Indian institutions, which are known or also called as sectoral financial regulators, can now accept foreign investment to fulfill their Net Owned Funds (NOF) requirement under the automatic route, they are subject to the condition that such investment is used only for the said purpose. In case of non-issue of a regulatory license or registration, the investment has to be expunged or routed through the correct approval mechanism.[16]

3.4.IMPACT AND RATIONALE

These reforms correspond to the regulatory framework for FOCCs and foreign direct investors (FDI), making regulatory provisions more clear and also closing earlier ambiguities on permitted channels of funding, fees, and disclosure. New rules, by offering certainty on operative features such as deferred payment and share exchange and insisting on proper

[13] id.
[14] Obhan & Associates, The RBI Updated Master Directions on Foreign Investment (Mar. 19, 2025), https://www.obhanandassociates.com/blog/the-rbi-updated-master-directions-on-foreign-investment-for-2025/ (last visited July 18, 2025).
[15] RBI, supra note 9, at § 2.22.
[16] id, at § 3.3(c).

compliance and timely disclosure, RBI's 2025 Master Direction makes downstream investment rules far more transparent and business-friendly. This should make M&A activity simpler, corporate restructuring simpler, and market confidence stronger while keeping regulatory discipline and regulatory arbitrage at bay.

In short, the reforms provision of 2025 establishes one open, liberalized platform for downstream investment of FOCCs, locating them close to the framework related to direct foreign investment practices and easing of doing business for foreign investors in India.[17]

4. REGULATORY CHALLENGES

4.1.COMPLEXITIES OF VALUATION AND PRICING GUIDELINES

Valuation of FOCCs' equity instruments in downstream investments is an important matter with the integration of India's new regulatory values and inclusive commercial practice relating to investment. Now, Indian law demands prices to be consistent with "fair value," typically based on internationally approved methods, such as those certified by Chartered Accountants (CA) or SEBI-registered Merchant Bankers. These methods, however, incline to be significantly different from valuation norms in the investor's home country, and thus, there will leads to divergence and complexity for foreign investors.

This concern will also be intensified in non-cash consideration transactions, such as share exchanges and payments deferred (earn-outs), which are becoming more prevalent in cross-border mergers and acquisitions (M&A). For example,

a) Share exchanges, in the new regime, need the shares exchanged to be of fair market value (FMV) under Indian law, typically in the form of third-party confirmation to satisfy RBI and other stakeholders' requirements.[18]

b) Secondly, the deferred consideration transactions, where payment or transfer of equity is made after the closing date, are limited (up to a maximum of 25% of overall consideration) and will also be subject to strict pricing guidelines. The absence of clear regulation on how to value complex, multistage transactions can delay negotiations,

[17] AZB & Partners, RBI Releases Updated Master Directions on Foreign Investments in India (Apr. 28, 2025), https://www.azbpartners.com/bank/rbi-releases-updated-master-directions-on-foreign-investments-in-india/ (last visited July 18, 2025).
[18] RBI, supra note 9, at § 4.1.

lead to arguments, and delays. (FDI rules under Rule 9(6) of the NDI Rule)[19]

The RBI Master Direction, 2025, is mainly focused on FDI price rule compliance, but there are still some grey areas. Hybrid financial instruments or valuation of embedded options, the timing and form of reporting future payments or price variations, and treatment of post-closing valuation review are technical areas that need technical knowledge and constant interaction with authorized dealer (AD) banks and the regulators to prevent transaction blockages.

4.2.SECTOR CAPS AND ENTRY CHANNELS

India's FDI policy has sector-specific industry caps and demarcates permitted entry modes, including automatic or government approval in different sectors. The complexity of compliance for FOCCs involved in downstream investments is substantial, such as :

a) In order to prevent accumulations of foreign direct and indirect investment from exceeding necessary ceilings, they must outline ownership and control structures at many levels of methodical criteria.

b) At any level, the most restrictive sectoral limit limits downstream, causing upstream constraints to cascade and reduce investment flexibility.

c) It is necessary to continuously monitor changes in foreign shareholding through mergers, acquisitions, or secondary market activity to avoid unintentional violations.[20]

Banking, insurance, defense, telecommunications, and retail are among the most delicate industries; downstream investments typically require pre-regulatory or governmental permission. Non-conformance will still result in fines, a forced sale, or reputational damage even if it is subsequently set. Therefore, prompt remedial measures and well-structured compliance systems are required.

4.3.REPORTING AND COMPLIANCE BURDENS

Despite the opening of downstream investment structures by the 2025 reforms, there has been a significant increase in reporting and compliance requirements.

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[19] Foreign Exchange Management (Non-Debt Instruments) Rules, supra note 1, at r. 9(6).
[20] RBI, supra note 9.

FOCCs have to:

a) Firstly, prescribe that financing downstream investment is made only with foreign capital or domestic accruals alone, and specifically forbid the use of funds raised domestically.

b) Secondly, report all downstream investment transactions on or before the specified goals and follow standard procedures (e.g., Form DI) to the RBI.

c) Lastly, go on and reveal full details of ultimate beneficial ownership, control changes, and sectoral limits compliance continuously. Regulatory control has moved from intermittent disclosure to virtual real-time watch, with AD banks and regulators insisting on elaborate documentation and clear audit trails even for normal transactions. Shortcomings can attract monetary penalties under FEMA, delayed approval of transactions, restrictions on repatriation of funds, and reputational loss for the company.[21]

4.4. DIVERGENT INTERPRETATIONS BY AUTHORIZED DEALER (AD) BANKS

The largest challenge for FOCCs is the inconsistency among Authorized Dealer (AD) banks, which are burdened with making FEMA compliance as it is. Without a clear, centralized interpretation or ambiguity in the interpretation, AD banks are likely to take inconsistent and conservative views, especially on complicated structures and systems like share swaps, deferred payment, or layered downstream investments. This results in:

a) Transactional uncertainty: Even when regulatory certainty exists, some banks will not accept structured investments outright or insist on lengthy legal counsel.

b) More costly legal and consulting costs, lengthier deal cycles, and sometimes failure in deals.

c) Discrepancies between the corporate wishes for immediate settlement and secrecy and

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[21] Shah Nahar & Associates, Updated Master Direction on Foreign Investment in India: Clarifications to the Regulatory Framework (Apr. 4, 2025), https://www.snrlaw.in/updated-master-direction-on-foreign-investment-in-india-clarifications-to-the-regulatory-framework/ (last visited July 18, 2025).

the banks' need for full documentation. Ultimately, this conflicting strategy dilutes India's attractiveness as a destination for shrewd overseas investors who value effective, transparent regulatory processes.[22]

4.5.CONCLUSION

While India's regulatory provision and framework for FOCC downstream investment has itself been significantly more liberalized and international than its original form, it remains complicated. There are issues with matters such as pricing, sectoral caps, compliance, and asymmetric instruction. They can be resolved only by way of strategic vision, strong compliance systems, and active dealings with regulators and financial mediators. There are many such problems that need to be resolved to unlock the full potential of India's liberalized investment policy.

5. WAY FORWARD

India's regulatory environment for Foreign Direct Investment (FDI) in downstream sectors continues to evolve, most recently with the Reserve Bank of India's (RBI) updated Master Direction in January 2025. The comprehensive overhaul is intended to bring an end to age-old uncertainties, ease compliance, and bring FOCC downstream investment into alignment with the direct foreign investment (FDI) administration.

The new framework has now clarified that downstream investments by FOCCs are to be treated as on par with direct FDI for all material purposes. FOCCs can now utilize structures such as equity swaps and deferred consideration, earlier not permitted in downstream transactions, though permitted through direct FDI guidelines. The Master Direction explicitly permits FOCCs to make downstream investments by way of share swaps and allows deferred payment up to 25% of the overall consideration, payable within 18 months, a facility also permitted in direct FDI. These changes enable more flexibility in deal structuring, eliminating earlier ambiguities with respect to phased payments, earn-outs, and post-closing adjustments.

Despite this development, stringent compliance requirements need to be continued. FOCCs continue to ensure that all downstream investments remain and have sectoral ceilings, entry points, and price guidelines compliant under the Foreign Exchange Management (Non-Debt

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[22] AZB & Partners, supra note 17.

Instruments) Rules, 2019 (NDI Rules). The policy justification for the regulation of downstream investments is that "what cannot be done directly, shall not be done indirectly," preventing regulatory arbitrage through multi-level structures. Significantly, the application of funds raised domestically within the nation to make downstream investments remains prohibited; FOCCs can utilize foreign capital or internal accruals only to make these investments.

The reforms have also raised reporting and compliance requirements. FOCCs are required to make time-to-time disclosure of all downstream investments, typically in the form of mandatory forms as provided under the NDI Rules, and coordinate closely with Authorized Dealer (AD) banks to ensure strong documentation. The RBI also has an emphasis on shifting to real-time digital platforms, and auto-generated reminders are designed to improve transparency, simplify compliance, and prevent reporting errors. Yet, staying ahead of changing sectoral bans and policy updates is necessary, as any delay can trigger regulatory action or penalties.

Also, there is a need for greater clarification on valuation techniques for sophisticated transactions and the exact treatment of hybrid financial instruments. Harmonized training and consistent interpretation by AD banks would facilitate uniform compliance and minimize delays in the ongoing transactions. Ongoing dialogue between regulators and the industry, together with an effective dispute-resolution mechanism(ADR), can facilitate the resolution of interpretative divergences and foster investor confidence.

Overall, inasmuch as the regulation of FOCC downstream investments in India is becoming more specific and business-friendly, sustained vigilance, capacity building, and operational openness are the key to deriving maximum benefit from these reforms and to creating a conducive environment for foreign investment-driven growth.

6. CONCLUSION

By completely integrating them with the treatment of direct foreign direct investment (FDI), the Reserve Bank of India's 2025 Master Direction is a groundbreaking shift from the regulation of FOCCs' downstream investment. Cross-border structuring of transactions is made easier and globalized by the regime provision for methods such as equity swaps and deferred consideration, subject to a 25% deal value limit and repayment within 18 months. With safeguards to prevent abuse of indirect channels to go around FDI caps, the regime is still highly compliance-dependent, with strict compliance to sectoral caps, entry channels, and price ceilings. Integrity of foreign capital inflows is maintained by the continuation of the prohibition on domestic borrowing, but financial flexibility is curbed, with the need for proper planning of both domestic and foreign funds.

The reforms have significance of timely and correct reporting, with electronic facilities and automatic reminders to guarantee compliance and openness. However, due to the increased obligations and constant change of sectoral conditions, FOCCs need to keep a tight eye on regulatory developments to prevent penalties or disruption to their business goals. The sector also continues to require more transparent valuation guidelines on complicated transactions and more consistent practices by Authorized Dealer (AD) banks to reduce delay and ensure predictability. Overall, the 2025 Master Direction provides a business-friendly regulatory framework for FOCC downstream investment, but its effectiveness will depend on continuing regulatory certainty, building capacity among intermediaries, and open channels for industry comment. With such assurances, India can reap the maximum benefits of foreign investment while ensuring the protection needed for orderly financial development.