Deal Talk

June 20, 2025

ZOMATO'S NEW 'DESI' SHAREHOLDING RECIPE: LESS FOREIGN ICE, MORE DOMESTIC SPICE!

INTRODUCTION

On April 18, 2025, the board of directors of the listed company Eternal Limited (popularly referred to as "**Zomato**") approved, subject to shareholder approval, a proposal to limit the total foreign ownership in Zomato to up to **49.50%** shareholding on a fully diluted basis. This limit is intended to include foreign ownership acquired: (i) on primary or secondary markets, (ii) under the foreign direct investment, foreign portfolio investment and indirect investment routes, and (iii) investments by foreign owned and controlled companies, or other persons resident outside India ("**Shareholding Cap**").[1] The proposal for implementing this Shareholding Cap was put for vote before the shareholders of Zomato and was approved with 99.85% of votes in favour of the Shareholding Cap on May 19, 2025.[2]

This entrenchment of a Shareholding Cap in a sector which falls under 'Automatic Route' under Indian exchange control laws is a unique and interesting example of a listed company imposing a restriction on the transferability of its shares. These self-entrenched restrictions are uncommon in listed companies which operate in 'Automatic Route' sectors, as they may have the impact of dampening market liquidity of shares (which is a key feature of publicly traded securities). So, the question remains – what's driving this strategic move? Could there be a deeper legal or regulatory rationale at play?

Dive into our latest Deal Talk to uncover the story behind the introduction of this Shareholding Cap in Zomato, and how it ties back to pivotal events in India's foreign direct investment trajectory and the e-commerce market in India.

WHY WAS THIS DONE? IS THE IMPLEMENTATION OF THE SHAREHOLDING CAP PERMISSIBLE?

The reasons for implementing the Shareholding Cap are two-fold, and we attempt to break it down in the following manner below:

(i) Maintaining the classification of Zomato as an "Indian Owned and Controlled Company" ("**IOCC**");

(ii) Impact of Zomato as an IOCC on the operations of its subsidiaries.

<u>Maintaining the classification of Zomato as an "IOCC":</u>

As on March 31, 2025, Zomato's shareholding comprises of approximately 55% domestic shareholding on a fully diluted basis. Therefore, Zomato qualifies as an IOCC under Indian exchange control laws.

While IOCC is a market-adapted terminology, the usage of this term IOCC is to describe a company which fulfils the requirements of two definitions under the Foreign Exchange Management (Non-debt Instruments) Rules, 2019 ("**NDI Rules**"): (a)"company owned by resident Indian citizens"; and (b) "company controlled by resident Indian citizens". According to Explanation (b) to Rule 23 of the NDI Rules, a "company owned by resident Indian citizens" refers to an Indian company *where the <u>ownership is vested in resident Indian citizens and / or Indian companies, which are ultimately owned and controlled by resident Indian citizens</u>*. On the other hand, Explanation (e) to Rule 23 of the NDI Rules clarifies that a "company controlled by resident Indian citizens" is an Indian company *whose <u>control is vested in resident Indian citizens and / or Indian companies which are ultimately owned and controlled by resident Indian citizens</u>*.

Considering that "ownership of an Indian company" as per Explanation (a) to Rule 23 of the NDI Rules means *<u>beneficial holding of more than fifty percent of the equity instruments of such company by resident Indian citizens</u>*, it can be stated that Zomato is a "company owned by resident Indian citizens". Further, as per publicly available information, Zomato is also controlled by Indian resident citizens. Therefore, as per NDI Rules, Zomato qualifies both as an "company owned by resident Indian citizens" and "company controlled by resident Indian citizens" (i.e. an IOCC).

Now to close the loop, **<u>the Shareholding Cap has been put into place to ensure that Zomato continues to remain an IOCC under Indian laws, going forward</u>**.

In a listed company, changing control as an action can be done either through the board control or shareholding control. If the Shareholding Cap is breached, Zomato would cease to be an IOCC and would become a "foreign owned and controlled company" ("**FOCC**") under the NDI Rules (i.e. an Indian company whose ownership or control is vested with non-residents).

However, this still does not answer the question: why is it so important for Zomato to remain an IOCC?

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Impact of Zomato as an IOCC on the operations of its subsidiaries:

It is publicly known that on August 10, 2022, Zomato acquired 91% shareholding in Blink Commerce Private Limited (formerly known as Grofers India Private Limited) ("**Blinkit**"), by way of a share swap. Prior to this acquisition, Zomato held 9% shareholding in Blinkit. Therefore, as a result of this transaction, Blinkit became a wholly owned subsidiary of Zomato.

Now what is connection between the IOCC classification of Zomato and the business of BlinkIt?

As long as Zomato continues to be an IOCC, the investment by Zomato into BlinkIt will be considered as domestic investment. However, the moment the classification of Zomato changes from an IOCC to an FOCC, the entire investment by Zomato into BlinkIt would be considered as 'downstream investment'[3]. This would essentially mean that BlinkIt would become an entity with 'indirect foreign investment'.

But what is the concern if BlinkIt becomes an entity with "indirect foreign investment"?

Under the NDI Rules, "downstream investments" are also subject to foreign investment sectoral caps and conditionalities prescribed thereunder, when read with the current Consolidated FDI Policy effective from October 15, 2020 ("**FDI Policy**").

Blinkit currently operates as an online marketplace serving as a platform for buying and selling of products sold by third party sellers that own the inventory of goods sold on its platform. It does not have its own inventory from which goods and services are sold on its platform ("**Non-Inventory Model**"). Under the FDI Policy, foreign investment in the "inventory-based model of e-commerce" is altogether prohibited ("**Inventory Based Model**").[4] Therefore, Blinkit cannot change from a Non-Inventory Model to an Inventory Based Model in the event Zomato is classified as an FOCC, and looks like this is exactly what the long term plan of Zomato for Blinkit is – a shift from Non-Inventory Model to an Inventory Based Model! If Blinkit continues with the Non-Inventory Model, then there should not be any risk with respect to the FOCC classification of Zomato.

In its press releases, Zomato has noted that the introduction of the Shareholding Cap is intended to make the business more *"resilient in the long term".*[5] Further, transitioning into the Inventory Model will ensure that Blinkit can introduce new and underserved categories such as home dйcor, gourmet foods, toys, pooja items and seasonal merchandise (which are not being targeted currently by Indian third party sellers and brands on their platform), by offering direct working capital support to such brands and owning the inventory themselves. Additionally, this will also help in the enhancement of margins in fragmented and unbranded categories (including established FMCG).[6]

Further, as per public information, major competitors of Blinkit (such as Amazon[7], Swiggy[8], Flipkart[9]) are currently an FOCC, and thus are hit by the aforementioned FDI prohibition applicable to the Inventory Based Model. For instance, Amazon / Swiggy / Flipkart can only conduct business as per the Marketplace Model in India and cannot sell products based on the Inventory Model. Therefore, in sum, imposition of the Shareholding Cap by Zomato will provide Blinkit a competitive advantage within the industry as it would allow Blinkit to move to an Inventory Based Model.

EVOLUTION OF FDI IN E-COMMERCE

FDI has not always been permitted in the e-commerce space and has been marked by a variety of developments in the Indian legal landscape through legislative and policy efforts. A chronology of pivotal events leading up to the current FDI Policy are as follows –

Date	Nature of Development	Impact on FDI landscape
February 7, 2000	Enactment of Press Note 2 of 2000 ("**PN2**")[10]: The PN2's enactment was important because it allowed for 100% FDI in B2B e-commerce for the first time, subject to the condition that such companies would divest 26% of their equity in favour of the Indian public in five years, if these companies are listed in other parts of the world. However, FDI in B2C e-commerce (i.e. direct retail to consumers online) remained prohibited. This was done to protect the businesses of small shop owners.	PN2 enabled platforms like IndiaMART, which operated on a B2B model, to attract foreign capital. Nevertheless, it continued to restrict B2C models such as those of Amazon and Flipkart from operating in India, and thus foreign investment in this sector remained lower.
August 28, 2012	Enactment of Press Note 5 of 2012 ("**PN5**")[11]: - PN5 revised the FDI framework around multi-brand retail trading, by allowing investments of up to 51% under the government route, subject to prescribed conditionalities being met. The conditions set out were as follows: (i) Fresh agricultural produce was to be unbranded. (ii) The foreign investor must invest a minimum of USD 100 million. (iii) At least 50% of the total FDI is to be invested in "backend infrastructure" (i.e. capital expenditure) within 3 years from the first tranche of	While PN5 helped in creating certainty about the government's intent to permit FDI in multi-brand retail trading, ambiguity in relation to the conditionalities persisted. Accordingly, not much FDI was witnessed in multi-brand retail trading even after enactment of PN5.

Vaibhav Parikh, Partner, Nishith Desai Associate on Tech, M&A, and Ease of Doing Business
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	FDI. (iv) At least 30% of the value of procurement of manufactured / processed products purchased is to be sourced from Indian "small industries" which have a total investment in plant & machinery not exceeding USD 1 million. (v) Retail sales outlets to only be set up in cities with a population of more than 10 lakh people and a 10 kilometre area (as per the census of 2011). (vi) The government of India is to have the first right to procurement of agricultural products. (vii) Retail trading would not be permissible for any companies engaged in multi-brand retail trading.	
May 12, 2015	Enactment of the Consolidated FDI Policy of 2015 ("**2015 FDI Policy**")[12] The 2015 FDI Policy clarified that FDI in single-brand product retailing would be permitted up to 100%, with government approval being required for FDI above 49%. This was subject to multiple conditionalities that were also set out, and the key ones included: (i) products being sold under the same brand internationally, and (ii) sourcing of 30% of the value of goods purchased would require to be undertaken from MSMEs, in case FDI was being invested beyond 51%. Further, with respect to multi-brand product retailing, FDI of up to 51% was permitted under the government approval route. The conditionalities for this investment were similar in nature to the PN5, but modified to the extent below: (i) Fresh agricultural produce to be unbranded. (ii) The foreign investor must invest a minimum of USD 100 million. (iii) At least 50% of the total FDI is to be invested in "backend infrastructure" (i.e. capital expenditure) within 3 years from the first tranche of FDI. (iv) At least 30% of the value of procurement of manufactured / processed products purchased is to be sourced from Indian "small industries" which have a total investment in plant & machinery not exceeding USD 2 million. (v) Retail sales outlets to only be set up in cities with a population of more than 10 lakh people and a 10 kilometre area (as per the census of 2011). (vi) The government of India is to have the first right to procurement of agricultural products. (vii) Retail trading would not be permissible for any companies engaged in multi-brand retail trading.	The 2015 FDI Policy was critical in bringing clarity on the legislative intent surrounding FDI in e-commerce. However, the definition of "e-commerce" was not clarified and the restriction on e-commerce being limited to B2B continued to remain applicable. Thus, practically, parties continued to face similar challenges as before when evaluating foreign investments in this sector in India.
March 29, 2016	Enactment of Press Note 3 of 2016 ("**PN3 2016**")[13]: The PN3 2016 enactment introduced guidelines for FDI in e-commerce and permitted FDI in B2C e-commerce in the following circumstances: (i) A manufacturer is permitted to sell its products manufactured in India. (ii) A single-brand retail trading entity operating through brick and mortar stores. (iii) An Indian manufacturer selling its own single-brand products. The Indian manufacturer would be the investee company, which is the owner of the Indian brand and manufactures in India, in terms of value, at least 70% of its products in house, and sources, at most 30% from Indian manufacturers. Further, along with the definition of certain critical terms, it also specified the conditionalities relating to	PN3 2016 was released in light of pending litigations on issues relating to FDI in e-commerce. For the first time, the PN3 2016 clarified definitions of key terms such as "e-commerce" and "e-commerce entity" and the "marketplace model" and "inventory model". At the same time, it balanced the concerns of brick and mortar retailers who felt threatened by the potential impact of large-scale retailers and e-commerce models on their businesses. PN3 2016 was instrumental in clarifying that "e-commerce" under India's FDI policy included services within its ambit. Under the 2015 FDI Policy, while

	FDI in the e-commerce sector. The key conditions were: (i) E-commerce marketplace may provide support services to sellers in respect of warehousing, logistics, order fulfillment, call centre, payment collection and other services. (ii) An e-commerce entity was barred from permitting more than 25% of the sales affected through its marketplace from one vendor or their group companies. (iii) E-commerce entities providing a marketplace were mandated to ensure that they do not directly or indirectly influence the sale price of goods or services and maintain a level playing field. These points were subsequently codified into the Consolidated FDI Policy of 2017, released thereafter.	PN3 2016 effectively provided much needed comfort, through its definitions, to the structure of Amazon and Flipkart (which were based on the marketplace model overseas), and hence prompted the way towards foreign investments in this sector.
May 9, 2018	Acquisition of Flipkart by Walmart[14]: Walmart, a foreign investor incorporated in USA, acquired a 77% controlling stake in Flipkart for USD 16 billion, valuing Flipkart at around USD 20 billion.	As mentioned above, the enactment of PN3 2016 and the FDI Policy of 2017 facilitated this deal, and the acquisition signalled strong interest from foreign investors into this sector in India.
December 26, 2018	Enactment of Press Note 2 of 2018 ("**PN2 2018**")[15]: While PN2 2018 was largely mirrored around PN3 2016 and the FDI Policy of 2017, certain critical differences were incorporated, as below: (i) PN2 2018 limited an entity having equity participation by an e-commerce marketplace entity or its group companies from selling its products on the platform run by the said marketplace entity. This was done to ensure parity. (ii) Inventory of a vendor would be deemed to be "controlled" by an e-commerce marketplace entity if more than 25% of the purchases of such vendor are from the marketplace entity or its group companies. (iii) An entity having equity participation or control by an e-commerce marketplace entity or its group companies would not be permitted to sell its products on the platform run by such marketplace entity. (iv) E-commerce entities providing a marketplace were mandated to ensure that they do not directly or indirectly influence the sale price of goods or services and maintain a level playing field. (v) Services like logistics, warehousing, advertisement / marketing, payments, financing, etc. could be provided by e-commerce marketplace entity or other entities in which e-commerce marketplace entity has direct / indirect equity participation or common control, to vendors on the platform at arm's length and on a fair, non-discriminatory basis across vendors.	Amazon responded by restructuring Cloudtail and Flipkart separated from its preferred sellers. The issuance of Press Note 2 (2018) intensified the regulatory scrutiny around control over the sellers.

WHAT IF ZOMATO BECOMES AN FOCC? WHAT OTHER THINGS WILL CHANGE FOR ZOMATO?

While the above highlights how Zomato being an FOCC would have impacted the operations of its subsidiaries (and particularly, Blinkit), there are certain other considerations that Zomato will have to bear in mind, in relation to itself, if it is an FOCC.

Since an FOCC is not owned or controlled by Indian residents, the legislative and policy intent is to treat an FOCC at par with a person resident outside India under the NDI Rules and therefore, to treat 'downstream investment' as foreign investment, so that foreign investors do not circumvent Indian foreign exchange laws through their downstream investments.

Accordingly, in case of a transfer of shares of an Indian company by an FOCC to an Indian resident, the FOCC will be treated as a non-resident and the shares will have to be transferred at a maximum of the fair market value ("**FMV**") of the shares at the time of such transfer (i.e. the FMV shall be the "ceiling" price). However, the converse shall apply in case of a transfer of shares of an Indian company to an FOCC by a non-resident, wherein the FOCC will be treated as an Indian resident and the shares will have to be transferred at a minimum of the FMV of the shares at the time of such transfer (i.e. the FMV shall be the "floor" price).

A similar treatment is applicable in the context of primary investments as well, and a consolidated version of the treatment of FOCCs, and corresponding pricing and regulatory reporting requirements under Indian laws is as below –

Scenario	Regulatory Classification of FOCC	Pricing Guidelines, if applicable	Reporting Requirement, if applicable
SECONDARY TRANSFERS			
Transfer of shares of an Indian company by an FOCC to an Indian resident	Non-resident	Yes, as per NDI Rules (FMV is the ceiling price)	Form FC-TRS to be filed
Transfer of shares of an Indian company by an Indian resident to an FOCC	Non-resident	Yes, as per NDI Rules (FMV is the floor price)	Form FC-TRS to be filed
Transfer of shares of an Indian company by an FOCC to another FOCC	-	-	While no reporting requirement is prescribed, the Purchaser FOCC may have to file Form DI (if insisted by the authorised dealer bank)
PRIMARY INVESTMENTS			
Investment by an FOCC into an Indian company	Non-resident	Yes, as per NDI Rules	Form FC-GPR
Investment by an FOCC into a foreign company	Resident	Yes, as per Indian overseas investment regulations	Form ODI and Form APR

On the other hand, as an IOCC, Zomato will be considered as an Indian resident under the NDI Rules and FDI Policy and will not be governed by the above table. Thus, Zomato's decision to remain an IOCC will also have an impact on the manner in which it can conduct its own future primary and secondary investments within the group.

CONCLUSION

Zomato's proposal to implement the proposed Shareholding Cap marks a significant shift in its strategy, potentially for the purposes of aligning itself more closely with India's foreign investment frameworks and its interests of domestic diversification through its group companies.

For foreign institutional investors and foreign portfolio investors, the imposition of the Shareholding Cap may introduce practical limitations on their future investment capacity in Zomato. While the Shareholding Cap does not directly dilute the foreign investors' existing holdings, it could restrict their future ability to increase their stake beyond the prescribed threshold.

SEBI vide Circular Number IMD/FPIC/CIR/P/2018/61 (Monitoring of Foreign Investment Limits in Listed Indian Companies)[16] provided the mechanism for depositories to track the foreign investment in all listed companies and also mechanism to be adopted if any sectoral limits or FDI prohibitions are breached. As per the Circular, upon a breach happening, the depositories shall inform the stock exchanges, and the exchanges can halt all further purchases by all foreign investors. Additionally, upon a breach, the foreign investors also get a period of 5 (five) trading days from the date of settlement of trades to divest their excess shareholding by selling shares to a domestic investor. This circular as it states, only covers FDI prohibitions in the listed company. Therefore, it will be interesting to see if Zomato can engage with the depositories to monitor the contractually agreed Shareholding Cap.

As Zomato navigates the intricate balance between opting for "domestic spice" over "foreign ice", it remains to be seen whether other companies will adopt similar models to expand their group's business operations in India, given that this move may well set a precedent for other Indian startups and newly listed companies seeking to preserve their domestic status under India's foreign investment laws (particularly those operating in sensitive or highly regulated sectors where downstream compliance and business model flexibility are critical).

[1]https://www.bseindia.com/xml-data/corpfiling/AttachLive/017212f2-d17d-4a56-b0a9-1aac41de7db4.pdf.

[2]https://www.livemint.com/market/stock-market-news/zomatos-foreign-ownership-cap-may-lead-to-msci-exit-says-jefferies-stock-falls-3-11747730622989.html.

[3]Downstream investment refers to indirect foreign investment into Indian companies (i.e. investments into Indian companies through India-incorporated entities that are an FOCC under Rule 23 of the NDI Rules).

[4]As per the Table set out in Schedule I of the NDI Rules, "inventory-based model of e-commerce" means an e-commerce activity where inventory of goods and services is owned by e-commerce entity and is sold to the consumers directly.

[5]https://www.bseindia.com/xml-data/corpfiling/AttachHis/00a81abd-41d4-478e-a4d1-c30df4dc6502.pdf.

[6]Meeting Notice (pg. 12).

[7]Amazon India is a wholly owned subsidiary of Amazon Inc. (incorporated in USA).

[8]https://www.bseindia.com/corporates/shpforeignownership.aspx?scripcd=544285&qtrid=125.00&QtrName=March%202025.

[9]Over 75% of Flipkart is held by Walmart (incorporated in USA). See, for example: https://www.businesstoday.in/latest/corporate/story/flipkarts-valuation-drops-by-5-billion-in-2-years-heres-why-421828-2024-03-18.

[10]https://dpiit.gov.in/sites/default/files/pn23_0.pdf.

[11]https://dpiit.gov.in/sites/default/files/pn5_2012_2.pdf.

[12]https://dpiit.gov.in/sites/default/files/FDI_Circular_2015.pdf.

[13]https://dpiit.gov.in/sites/default/files/pn3_2016_0.pdf.

[14]https://www.livemint.com/Companies/qOBduC3OBVpKTv9CpCYayH/Walmart-completes-16billion-buyout-of-Flipkart.html.

[15]https://dpiit.gov.in/sites/default/files/pn2_2018.pdf.

[16]https://nsearchives.nseindia.com/content/equities/SEBI_circular_17052018.pdf.