

Other Hotline

September 25, 2012

INDIA NOTIFIES 51% FDI IN MULTI BRAND RETAIL TRADING

The Department of Industrial Policy and Promotion ("DIPP") of the Ministry of Commerce and Industry vide Press Note 5 (2012 Series) dated September 20, 2012 ("Press Note")¹ has finally amended the foreign direct investment ("FDI") policy permitting 51% FDI in **multi brand retail trading** under the Government route i.e. with the prior approval of the DIPP and the Foreign Investment Promotion Board ("FIPB") subject to compliance of certain conditions.

Simultaneous with the Press Note, DIPP has also issued other press notes notifying: (i) modified conditions relating to brand ownership, local sourcing requirements and restricting e-commerce by companies with FDI in case of **single brand product retail trading**²; (ii) foreign investment upto 49% in scheduled and non-scheduled **air transport services** under approval route³; (iii) enhanced FDI limits in **teleports, mobile TV, head end-in-the sky broadcasting service** etc.⁴; and (iv) foreign investment upto 49 percent in **power trading exchanges**.⁵

Please refer to our hotline "**India breaks the FDI shackles: Multi Brand Retail Trading and other sectors liberalized**" where we had analysed the decision of the Cabinet at its meeting held on September 14, 2012 agreeing to modification of certain conditions relating to FDI in single brand product retail trading and permitting and/or increasing foreign investment in the areas of multi brand retail trading, aviation, broadcasting and power trading exchanges and their implications.

With issuance of these press notes by the DIPP, the decision of the Cabinet has become effective from September 20, 2012, albeit with certain further variations (discussed further below), and now forms part of the Consolidated FDI policy (Circular 1 of 2012).

SUMMARY OF CONDITIONS FOR FDI IN RETAIL TRADING

Below is the table summarising the conditions applicable in case of FDI in wholesale trading, single brand product retail trading and multi brand retail trading:

Description	Cash & Carry Wholesale Trading/ Wholesale Trading	Single brand product retail trading (SBPRT)	Multi-brand retail trading (MBRT)
Meaning	Wholesale trading is sales for the purpose of trade, business and profession, as opposed to sales for the purpose of personal consumption.	Not defined under the FDI policy. Generally means the sale of products of a single brand to retail customers for personal consumption.	Not defined under the FDI policy. Generally means the sale of products of multiple brands to retail customers for personal consumption.
% of FDI cap	100%	100%	51%
Automatic / government approval route	Automatic route i.e. without any prior approval	Government approval route	Government approval route
Approval from NA		Application to be made to the Secretariat for Industrial Assistance (SIA) in the DIPP.	Application to be processed by DIPP after determination whether the investment satisfies the notified guidelines.
		Application to be processed by DIPP and check whether the investment satisfies the notified guidelines. Once it is satisfied with the compliance, it will forward the application to FIPB for consideration.	Once it is satisfied with the compliance, it will forward the application to FIPB for consideration.
General conditions to be satisfied:	<p>a) For undertaking wholesale trading requisite licenses/ registration/ permits, as applicable should be obtained.</p> <p>b) Sale should be made only to 'valid business customers' with whom wholesale transactions can be entered into (besides the Government).⁶</p> <p>c) Full records indicating all the details of such sales should be maintained on a day to day basis.</p>	<p>a) Products to be sold should be of a 'Single Brand' only.</p> <p>b) Products should be sold under the same brand internationally i.e. products should be sold under the same brand in one or more countries other than India.</p> <p>c) Products should be branded during manufacturing.</p> <p>d) The foreign investor should be the owner of the brand or</p>	<p>a) Retail sales outlets may be set up in those States⁸/ Union territories which have agreed or agree in future to allow FDI in MBRT.</p> <p>b) Retail sales outlets may be set up only in cities with a population of more than 1 million as per the 2011 census. In case of States or Union Territories not having cities with a population of more than 1 million, retail outlets may be set up in the largest cities.</p> <p>c) Minimum amount to be brought in, as FDI, by the foreign investor, would be US\$ 100 million.</p>

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d) Wholesale deals would be permitted among companies of licensee. the same group and such wholesale trade to group companies⁷ taken together cannot exceed 25% of the total turnover of the wholesale venture.

a licensee / franchisee / sub- In case of FDI beyond 51%, sourcing of 30% of the value of goods purchased, will be done from India, preferably from MSMEs, village and cottage industries, artisans and craftsmen, in all sectors.

d) 50% of total FDI brought in to be invested in 'backend infrastructure' within three years. Backend infrastructure will not include cost of land and rentals.

Scope of judicial interference and inquiry in an application for appointment of arbitrator under the (Indian) Arbitration and Conciliation Act, 1996

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Mandatory local sourcing requirement (see detail discussion below)

NA

Obligation to ensure compliance of the conditions

Company which is recipient of FDI and carrying out wholesale trading.

Company which is recipient of FDI and carrying out SBPRT. SBPRT by means of e-commerce would not be permissible.

30% of the procurement of manufactured/ processed products shall be sourced from Indian 'small industries'.⁹

Company carrying out MBRT to ensure compliance of these conditions and investor to maintain accounts duly certified by the statutory auditors.

E-commerce (see detail discussion below)

Wholesale trading in terms of business to business (B2B) e-commerce is permissible.

MBRT by means of e-commerce would not be permissible.

KEY SHIFTS FROM THE CABINET DECISION

The key changes brought about by the DIPP press notes as compared to the Cabinet decision are as follows:

- **FDI in domestic trading via e-commerce not permitted** : It is important to note that the FDI in both SBPRT (100%) and MBRT (51%) under approval route are subject to certain conditions. The DIPP press notes categorically state that retail trading, in any form, by means of e-commerce, would not be permissible, for companies with FDI, engaged in SBPRT or MBRT.

Currently, 100% FDI is allowed under automatic route (no approval required) in companies engaged in Business to Business (B2B) e-commerce¹⁰ and erstwhile restrictions on FDI in domestic trading were also applicable to e-commerce as well. With opening of FDI in SBPRT and MBRT, the restriction of FDI in domestic trading in e-commerce was also expected to be relaxed. However, such an express restriction will certainly impact global and local e-commerce retailers intending to offer Indian consumers wide range of products via e-commerce. One of the reasons for such an express restriction being imposed could be the difficulty in monitoring the trading via e-commerce in the States who have not allowed MBRT. Also, a similar restriction in SBPRT is now categorically put to bring it in parity with policy on MBRT. Interestingly, e-commerce has not been defined and one will need to ascertain whether it will be construed broadly or narrowly. For instance: would any form of interaction (such as information sharing or advance booking) with a brick and mortar store, via its website, be considered e-commerce? Further, whether any trading (i.e. buying or selling of products) through any mobile phone application or through tele-booking mode will be considered as e-commerce?

- **Local sourcing requirements stretched over a five year period** : In relation to the mandatory 30% local sourcing requirement for SBPRT and MBRT, the respective press notes clarify that the local procurement requirement as applicable would have to be met as an average of five years' total value of the goods purchased, beginning April 1 of the year during which the first tranche of FDI is received. Thereafter, this requirement is to be complied on an annual basis. The modification of the local sourcing requirement stretched over a five year period is in line with the proposal made by many prospective investors who had emphasized the aforesaid condition shall be computed for a cumulative period from the date of approval instead of being required to comply on day 1 or soon thereafter.

Additionally, in case of SBPRT, the language in the Press Note 4 (2012 Series), in case of mandatory 30% local sourcing requirement is strengthened as it is provided that in case of FDI beyond 51%, sourcing of 30% of the value of goods purchased, will be done from India, preferably from MSMEs, village and cottage industries, artisans and craftsmen, in all sectors, and the words – 'where it is feasible', as were in the Cabinet announcement, are now removed. Additionally, since the word MSMEs is not defined for this purpose, one can borrow the definition of MSMEs from Micro, Small and Medium Enterprises Development Act 2006.

In case of MBRT, the 30% sourcing requirement is to be calculated on the purchase of manufactured and processed products. Therefore, non-processed agricultural products would not be included.

- **DIPP to review the application before forwarding to FIPB** : DIPP is now required to check whether proposed investment in SBPRT and MBRT satisfies the notified guidelines. Once it is satisfied with the compliance, it will forward the application to FIPB for consideration.

CHALLENGES MOVING FORWARD

While the policy framework in relation to FDI in MBRT is now put in place, the implementation of the same is bound to have certain challenges. Some of which include:

- **Implementation at State level** : It is for the first time that FDI policy is introduced as an enabling policy and implementation of the same is left to the discretion of the State Governments / Union Territories and draws support from the fact that 'trade and commerce within the State' is a State subject under the Constitution of India. Such a policy may give unrestricted powers to the State Government / Union Territories to impose conditions in addition to those prescribed by the DIPP. State level regulations could also lead to an inconsistent policy framework at the state level which will need to be carefully understood and followed by potential investors. There is also the risk of a State Government changing its policy on MBRT and reversing earlier decisions, especially in the event of a change in political power as this scenario has not been construed by the DIPP in the Press Note.

In effect, a foreign investor will have to be mindful of the local rules and regulations of each State before finalizing the transaction structure / business model, especially when the investor intends to set up outlets in all the States.

Further, for the existing entities operating across India, it would get difficult to get FDI in entity without restructuring of its operations.

- **India's commitments under international investment agreements / treaties** : India is signatory to various international trade agreements / treaties like the General Agreement of Trade in Services, Trade Related Investment Measures, bilateral investment protection agreements¹¹, comprehensive economic cooperation agreements in the field of trade and economic affairs signed to promote investment inflow. While the Government in its press release¹² has categorically concluded that the policy framework does not violate any commitments/ obligations arising out of India's international agreements, the introduction of FDI in MBRT and SBPRT with conditions such as domestic sourcing and state wise implementation has raised a few questions with respect to India's commitments under these treaties and agreements.

Regulatory overlap and dealing with multiple authorities: The retail sector cuts across various industries and business models. As a consequence, there is higher scope for regulatory overlap. While general corporate, tax, commercial laws and laws related to intellectual property, trade and employment laws are uniform across industries, state level laws and regulations like the Agricultural Produce Market Committee Act, local zoning regulations differ from each other and foreign investors will have to deal with multiple regulations and authorities.

CONCLUSION

The Cabinets' decision allowing FDI in MBRT was welcomed by the foreign investors and retailers with some skepticism, given the past experience of flip flop with this particular policy. While anomalies in terms of implementation of this policy at state level remains, immediate formal notification after Cabinet clearance sends a clear signal to India and to the world, that India is once again ready for business.

– Retail Team

You can direct your queries or comments to the authors

¹ http://dipp.nic.in/English/acts_rules/Press_Notes/pn5_2012.pdf

² http://dipp.nic.in/English/acts_rules/Press_Notes/pn4_2012.pdf

³ http://dipp.nic.in/English/acts_rules/Press_Notes/pn6_2012.pdf

⁴ http://dipp.nic.in/English/acts_rules/Press_Notes/pn7_2012.pdf

⁵ http://dipp.nic.in/English/acts_rules/Press_Notes/pn8_2012.pdf

⁶ These entities should be either: a) holders of sales tax/ VAT registration/service tax/excise duty registration; b) holders trade licenses under Shops and Establishment Act, issued by the relevant governmental authority, evincing that the purchaser is engaged in a business involving commercial activity; c) holders of permits/license for undertaking retail trade (like tehbazari and similar license for hawkers) from the relevant authority; and d) institutions having certificate of incorporation or registration as a society or registration as public trust for their self-consumption.

⁷ Please note that the term 'group companies' as used in the FDI policy with respect to wholesale trading is not a defined term.

⁸ Andhra Pradesh, Assam, Delhi, Haryana, Jammu & Kashmir, Maharashtra, Manipur, Rajasthan, Uttarakhand and the Union Territory of Daman & Diu and Dadra and Nagar Haveli.

⁹ Small industries mean industries which have a total investment in plant & machinery not exceeding USD 1 million. This valuation here refers to the value at the time of installation, without providing for depreciation. Further, if at any point in time, this valuation is exceeded, the industry shall not qualify as a 'small industry' for this purpose.

¹⁰ E-commerce activities refer to the activity of buying and selling by a company through the e-commerce platform.

¹¹ India has signed bilateral investment protection agreements with 82 countries, out of which 72 are already in force and the rest are yet to be entered into force.

¹² Press release of Ministry of Commerce and Industry on "FDI Policy on Multi Brand Retail Trading and India's Commitments under International Investment Agreements" dated September 18, 2012.

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