Singhania & Partners LLP
Solicitors & Advocates

FDI IN RETAIL TRADING IN INDIA

Ravi Singhania
Managing Partner
E: ravi@singhania.in

Arjun Anand
Partner
E: arjun@singhania.in

The Indian retail sector has tremendously grown over the last decade with a significant shift towards organised retailing format. India's retail market contributes to over 10 percent of the country's Gross Domestic Product (GDP). The share of the Indian retail market is expected to increase by 60 percent to reach USD 1.1 trillion by the year 2020. Typically, retail is understood to be the sale of goods to end users, not for resale, but for use and consumption by the purchaser. The retail transaction is at the end of the supply chain. Interestingly, courts in India have defined the term 'retail' as a sale for final consumption in contrast to a sale for further sale or processing (i.e. wholesale). Traditionally, the retail sector in India was considered to be a sensitive sector especially due to factors, such as (i) the employment it generates and (ii) of its early and undeveloped stage (particularly the domestic organized retail segment) it is not in a position to compete with large players. As a result, the Government policy has largely been to protect agriculturist and small retailers and therefore has discouraged entry of bigger retailers. However, that has now changed, and the government of India has revised its foreign direct policy (**FDI Policy**) to allow foreign direct investment (**FDI**) in the retail sector subject to certain conditions. Some of the key changes are discussed below:

<u>Food retail:</u> The FDI Policy allows 100 % FDI in entities engaged in food retail however, the FDI Policy treats food retail different from other retailing provisions (whether single brand retail trading or multi brand retail trading). Retailing of food products produced / manufactured in India (whether single brand retail trading or multi brand retail trading) including via e-commerce requires prior Government approval. Although not expressly mentioned, it may be inferred that retailing of imported food products is not permitted by entities in India having foreign investment.

<u>Wholesale cash and Carry:</u> The FDI Policy allows 100 % FDI in entities engaged in the business of wholesale cash and carry however, per the FDI Policy, to determine whether the transaction is wholesale or retail would depend on the type of customers to whom the sale is made and not the size and volume of sales. Wholesale trading would mean the sale of goods to retailers, industrial, commercial, other professional business users or to other wholesalers, but not for personal consumption. The FDI Policy also lists a number of 'valid business customers' with whom wholesale transactions can be entered into (besides the Government). These entities should have relevant tax and business registrations. It is expressly clarified that a wholesale trader cannot open retail outlets, whereby sales will be made to the customer directly. Under the existing FDI Policy, wholesale deals would be permitted among companies of the same group. However, such wholesale trade to group companies taken

together should not exceed 25 percent of the total turnover of the wholesale venture.

Single-Brand Product Retail Trading (**SBRT**): FDI Policy allows FDI up to 100 percent in entities involved in SBRT business without any government approval subject to certain conditions. Some of the key conditions are (a) the FDI Investee entities should ensure that products to be sold should be of a 'Single Brand' only and 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); (b) 'Single Brand' product-retailing would cover only products which are branded during manufacturing; (c) local sourcing of products that require the investee entities, receiving FDI beyond 51 percent, to mandatorily source at least 30 percent of the value of goods purchased from India, preferably from MSMEs village and cottage industries, artisans and craftsmen, in all sectors. These local procurement requirements 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. However, the FDI Policy provides certain relaxation, for the initial 5 years commencing from the date of opening the 1st store, by providing an option to the investee entities to set off their incremental sourcing of goods from India for its global operations, against the mandatory 30 percent domestic sourcing of goods requirement. Goods sourced globally from India by the group companies of these investee entities would also be considered for the purpose of availing this set off. Incremental sourcing means the increase in terms of value of goods sourced from India for that single brand (in rupee terms) in a particular financial year over the preceding one. Moreover, the government also may relax sourcing norms for these investee entities undertaking SBRT of products having 'state-of-art' and 'cutting-edge' technology and where local sourcing is not possible.

Multi Brand Product Retail Trading (**MBRT**): FDI up to 51 percent in entities undertaking MBRT is allowed with the prior approval of the government subject to compliance of certain conditions. The FDI Policy does not define the term 'multi brand'. However, MBRT generally implies the sale of multiple brands to end customers for personal consumption. Some of the important conditions, per the FDI Policy, requiring compliance are (a) MBRT can be undertaken only in states in India that have agreed to allow the same subject to certain conditions relating to population size etc.; (b) minimum amount to be brought in, as FDI, by the foreign investor, needs to be USD 100 million; (c) 50 percent of total FDI brought in to be invested in backend infrastructure (defined in the FDI Policy); (d) Similar requirement of mandatory local sourcing as applicable in SBRT is applicable to MBRT however, certain relaxation with respect to local sourcing, as provided to SBRT entities having FDI, are not applicable for MBRT. Retail trading, in any form, by means of e-commerce, would not be permissible, for companies with FDI, engaged in the activity of MBRT.

Ecommerce: The FDI Policy permits FDI without any governmental approvals in entities engaged in the marketplace model of e-commerce where the e-commerce entity simply acts as an information technology platform that connects buyers and sellers. However, FDI is not permitted in inventory-based model where the inventory of goods sold on the portal is owned or controlled by the e-commerce entity. Additionally, the policy places certain restrictions, among others, on market place model such as an entity having equity participation by an e-commerce marketplace entity or its group companies will not be permitted to sell its products on the information technology platform run by such marketplace entity and e-commerce marketplace entity will not mandate any seller to sell any product exclusively on its platform only.

Conclusion

While opening of the retail sector to FDI is a welcome step, some regulatory aspects need to be examined by the government to ensure robust growth of this sector. Some of these aspects relate to (a) local sourcing requirements which adversely impacts quality control for big retail giants. Further, the relaxations, from local sourcing requirement, provided to the SBRT entities, having state of the art technology, needs clarity as there is no specific definition set out in the FDI Policy setting out what constitutes state of the art technology; (b) government approval in connection with MBRT and food retail can be time consuming resulting in high costs for such entities; (c) Restrictions on ecommerce entities having relations with any of its vendors needs to be balanced keeping in mind the interest of the consumer as such relations do benefit the end consumer in the nature of discounts etc.