SAMVĀD: PARTNERS

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DECODING FOREIGN DIRECT INVESTMENT IN E-RETAIL

The Government of India, through the Department of Industrial Policy and Promotion ("**DIPP**"), Ministry of Commerce and Industry, has issued Press Note No 3 on March 29, 2016 (the "**Press Note**") permitting foreign direct investment ("**FDI**") in Business-2-Consumers e-commerce ("**e-Retail**") companies, subject to certain conditions.

e-Retail by brick and mortar companies:

Brick and mortar retail companies that intend to carry on e-Retail can explore FDI as a source of capital. This is a significant change proposed by the Press Note. e-Retail is being permitted by such companies so long as the said company is carrying on single brand retail trading, and is operating through brick and mortar stores. However, as on date there are no conditions prescribed (especially on the number of shops being operated, volume of sales / minimum percentage of sales to be carried out through offline channels, to name a few), to qualify whether a company is in substance a "brick and mortar company" or an e-Retail company having offline stores. Given the wide scope of this provision in the Press Note, as currently worded, it is also possible for e-Retail companies to seek FDI so long as such companies are simultaneously operating brick and mortar shop. Accordingly, this will have a significant impact on the FDI influx in the coming years, and many new and simplified transaction structures can be put in place for enabling e-Retail with FDI, on the basis of the above provision.

e-Retail through Marketplace:

FDI has been permitted upto 100% in e-Retail companies operating through the "Marketplace" model. DIPP has defined "**Marketplace**" as a model where information technology platform is provided by an e-commerce entity on a digital and electronic network to act as a "facilitator" between the buyer and seller. To this extent, the Press Note is merely clarificatory, as operating a marketplace, with the e-commerce investee company transacting only with sellers / businesses, but not undertaking the actual retail sale to the end consumer, was not prohibited previously.

The Press Note, however, also clarifies that the e-Retail company seeking to qualify as a Marketplace must necessarily ensure that:

- it does not exercise ownership over the products being sold on its platform;
- it does not directly or indirectly influence the pricing of the products being sold on its platform;
- any warranty/ guarantee of goods and services sold will be the responsibility of the seller selling the products on the platform, and not the e-Retail Marketplace entity;
- post sales, delivery of goods to the customer and customer satisfaction, at all times must be the responsibility of the seller and not the e-Retail Marketplace entity; and
- no vendor / seller operating on the e-Retail Marketplace company's platform (including the e-Retail Marketplace company's group / affiliate companies) can contribute to the sale of more than 25% of the total sales affected through such platform.

While the e-Retail company can provide the B2B sellers transacting through its platform, necessary support services such as warehousing, logistics, order fulfillment, call centre etc., the ultimate responsibility for completing the sale and ensuring customer satisfaction must remain with the seller operating on the Marketplace. The Press Note also clarifies that the Marketplace e-Retail company can facilitate payments for sale, subject to compliance with the guidelines issued by the Reserve Bank of India ("**RBI**"). This also clarifies the Marketplace e-Retail company's ability to open wallets / payment gateways to facilitate payments by purchaser to the seller operating on the Marketplace, without being construed as the "seller" for the purposes of the foreign exchange regulations.

It is pertinent to note that the restrictions on the scope of activities of the Marketplace e-Retail company as set forth in the Press Note, poses many challenges, even to existing e-commerce companies operating under this model. For example, the restriction around influencing sale price (and therefore, the presence or absence of discounts on the platforms), could result in a re-think of the business models and pricing mechanisms by e-Retail companies, generally. Similarly, the restriction on sale by any vendor or group / affiliate companies over 25% of the total sales effected through the platform, is significant. e-Retail Marketplace companies will no longer have the ability to channelize sales through a single affiliate company. In particular, e-Retail Marketplace structure would no longer be feasible for start-ups, as most start-ups have limited vendor / seller partner resources, and volume of sales by any single vendor / seller in most cases would be more than 25% of the total sales effected. Also this restriction will imply constant administration / monitoring (and not just a periodic monitoring), by every company, immaterial of the size or scale of operation, so as to ensure that the volume thresholds are not breached.

e-Retail through inventory based models:

FDI has been restricted in e-Retail companies operating through inventory based model. The Press Note defines inventory based model of e-commerce as a model where inventory of goods and services is owned by the e-commerce entity and is sold to the consumers directly, essentially a pure B2C retail.

Hence any e-Retail company having even a notional ownership of the inventory but involved in the actual sale of the product to the end customer would fall within the ambit of an "inventory based model", and FDI would be restricted in such e-Retail companies.

e-Retail by Manufacturers:

To give further impetus to the Government of India's "Make in India" policy, FDI has been permitted in a manufacturing company engaged in e-Retail. Accordingly, a manufacturing company (whether incorporated in India or otherwise), is permitted to sell its products manufactured in India through e-commerce retail, and FDI in such manufacturing company undertaking e-Retail will be permitted. This is a departure from the previous position, and significantly impacts global e-retail brands who are exploring presence in India, as they will have the ability to undertake such e-retail in India through a subsidiary / joint venture structures, without the need for approval. This change in the policy would also be a welcome relief for many local manufacturers who look towards e-Retail for enhancement of sales.

An Indian manufacturer is also permitted to sell its own single brand products through e-Retail, under the following conditions:

- Indian manufacturer being the investee company, must be the owner of the Indian brand;
- Such a company must manufacture in India; and
- Such a company must manufacture at least 70% of its products in house, and sources not more than 30% from other Indian manufacturers.

Currently the Press Note does not prescribe the sectoral cap applicable to such manufacturing e-Retail companies, and clarity in this behalf will be necessary.

Conclusion

e-commerce, as a sector, has shown great potential for growth and the Press Note is a welcome step for giving further impetus to such growth, through FDI. While FDI has been permitted in certain forms of eRetail, FDI in pure eRetail business continues to be restricted. It is also important to note that this is currently a policy announcement. Necessary notifications / amendments to the foreign exchange laws will need to be made by the RBI in the coming days to operationalize and implement this policy.

****This is an update for general information purposes only and does not constitute legal advice. Should you have any queries please write to us at infodel@samvadpartners.com.***