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VOLUME I

LIMITATIONS AND STIPULATED CHANGES TO THE FDI POLICY IN INDIA WITHRESPECT TO RETAIL SECTOR

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ABSTRACT

FDI can be a powerful catalyst to spur competition in the retail industry, due to the current scenario of low competition and poor productivity in India." The policy of single-brand retail was adopted to allow Indian consumers access to foreign brands. Since Indians spend a lot of money shopping abroad, this policy enables them to spend the same money on the same goods in India. This allows the government to capitalise on such transactions by way of taxation and utilise the money so received for the development of the economy. This also results in increased competition and a gradual slow transfer of technology to India."

It has been observed that an FDI inflow of US$196.46 million under the category of single brand retailing was received between April 2006 and September 2010, comprising 0.16 per cent of the total FDI inflows during the period. Retail stocks rose by as much as 5%. Shares of Pantaloons Retail (India) Ltd ended 4.84% up at Rs 441 on the Bombay Stock Exchange. Shares of Shopper's Stop Ltd rose 2.02% and Trent Ltd, 3.19%. The exchange's key index rose 173.04 points, or 0.99%, to 17,614.48.[1] This goes on to demonstrate the importance of FDI and its impact on growth on the economy.

The policy of allowing FDI in retail can benefit both the foreign retailer and the Indian partner – foreign players get local market knowledge, while Indian companies can access global best management practices, designs and technological know-how.

Key Words: Foreign Direct Investment, Policy, Retail, Business, Licensing and Franchise.

[1] Nabeel A. Mancheri, NIAS, *India's FDI Policy: A Paradigm Shift*, (Oct. 10, 2018), http://www.eastasiaforum.org/2010/12/24/indias-fdi-policies-paradigm-shift/.

TABLE OF CONTENTS

Table of Contents 2
Introduction 3
  Definition 3
  History and Development 3
  Division of Retail Industry – Organised and Unorganised Retailing 4
  Approval mechanism- Routes for investments 4
Overview of Research 4
  Hypothesis 4
  Research Questions 4
  Aims and Objectives 4
  Mode of Citation 4
FDI Policy in India 5
  Franchise Agreements 5
  Cash And Carry Wholesale Trading 5
  Strategic Licensing Agreements 5
FDI in Single and Multiple Brand Retail 6
  FDI in Single Brand Retail 6
  FDI in Multiple Brand Retail 6
Concerns of Foreign Investors 7
  Infrastructure 7
  Intermediaries dominate the value chain 7
  Erratic Government Control 7
  Lawlessness 7
Highlights of the Change in FDI Policy 8
  Investment and entry vehicles 8
  Conditions for Single Brand Retail Trading In India under FDI Policy, 2016 8
  Conditions for Multi -Brand Retail Trading In India under FDI Policy, 2016 9
Conclusion 10

INTRODUCTION

Until most recent times retail trading (except under single-brand product retailing — FDI up to 51 per cent, under the Government route[2]) is prohibited in India. Simply put, for a company to be able to get foreign funding, products sold by it to the general public should only be of a 'single-brand'; this condition being in addition to a few other conditions to be adhered to.

DEFINITION

In 2004, The High Court of Delhi[3] defined the term 'retail' as a sale for final consumption in contrast to a sale for further sale or processing (i.e. wholesale). *A sale to the ultimate consumer.*

Thus, retailing can be said to be the interface between the producer and the individual consumer buying for personal consumption. This excludes direct interface between the manufacturer and institutional buyers such as the government and other bulk customers. Retailing is the last link that connects the individual consumer with the manufacturing and distribution chain. A retailer is involved in the act of selling goods to the individual consumer at a margin of profit.

HISTORY AND DEVELOPMENT

India being a signatory to World Trade Organisation's General Agreement on Trade in Services, which include wholesale and retailing services, had to open up the retail trade sector to foreign investment. There were initial reservations towards opening up of retail sector arising from fear of job losses, procurement from international market, competition and loss of entrepreneurial opportunities. However, the government in a series of moves has opened up the retail sector slowly to Foreign Direct Investment ("FDI"). In 1997, FDI in cash and carry (wholesale) with 100 percent ownership was allowed under the Govt. approval route. It was brought under the automatic route in 2006[4]. 51 percent investment in a single brand retail outlet was also permitted in 2006[5]. FDI in Multi-Brand retailing was prohibited in India. In 2012, 100% FDI in single brand retail outlet (Govt. approval route) was permitted[6]. 51% FDI in multi brand retail was also allowed (subject to certain conditions) [7]. In 2015 Technology giants like Sony and Apple were allowed to open fully owned stored in India[8]. In 2016 100% FDI was allowed in e-commerce industry.[9]

[2] NDTV, *Government retains 51% FDI in Multi Brand Retail*, (Oct. 10, 2018), https://www.ndtv.com/india-news/government-retains-51-fdi-in-multi-brand-retail-which-bjp-had-opposed-762655.

[3] Association of Traders of Maharashtra v. Union of India, 2005 (79) DRJ 426.

[4] DIPP – Ministry of Commerce (Government of India), *Press Note 1(2006)*, (Oct. 10, 2018), http://dipp.nic.in/sites/default/files/pn1_2006_0.pdf.

[5] Id.

[6] DIPP – Ministry of Commerce (Government of India), *Consolidated FDI Circular 2012*, (Oct. 10, 2018), http://dipp.nic.in/sites/default/files/FDI_Circular_01_2012%20%203_0.pdf.

[7] Id.

[8] DIPP – Ministry of Commerce (Government of India), *Consolidated FDI Circular 2015*, (Oct. 10, 2018), http://dipp.nic.in/sites/default/files/FDI_Circular_2015%20%201_0_0.pdf.

[9] DIPP – Ministry of Commerce (Government of India), *Consolidated FDI Circular 2016*, (Oct. 10, 2018), http://dipp.nic.in/sites/default/files/FDI_Circular_2016%282%29.pdf.

DIVISION OF RETAIL INDUSTRY – ORGANISED AND UNORGANISED RETAILING

The retail industry is mainly divided into:- 1) Organised and 2) Unorganised Retailing

Organised retailing refers to trading activities undertaken by licensed retailers, that is, those who are registered for sales tax, income tax, etc. These include the corporate-backed hypermarkets and retail chains, and also the privately owned large retail businesses.

Unorganised retailing, on the other hand, refers to the traditional formats of low-cost retailing, for example, the local *kirana* shops, owner manned general stores, *paan/beedi* shops, convenience stores, hand cart and pavement vendors, etc.

OVERVIEW OF RESEARCH

Hypothesis

The FDI Policy in India is governed by a complex web of laws

Research Questions

1. What is the Foreign Direct Investment Policy in India?
2. What are the limitations of the present setup
3. What are the recent changes in the FDI policy?

It has been observed that "the Indian retail sector is highly fragmented with 97 per cent of its business being run by the unorganized retailers"[10]. Further, The organized retail however is at a very nascent stage. The sector is the largest source of employment after agriculture, and has deep penetration into rural India generating more than 10 per cent of India's GD. [11]

APPROVAL MECHANISM- ROUTES FOR INVESTMENTS

Under FDI Policy investments are "allowed under Automatic Route" (without any prior approval from the Reserve Bank of India) and/or "under Government Route" (with a prior approval from the Reserve Bank of India) according to sectors.[12]

Aims and Objectives

This research is aimed to draw up an introductory analysis of the FDI policy in relation to the retail sector. Through this project the researcher aims to analyse the present laws governing the issue at hand and also tried to understand and point out the flaws with the system.

Mode of Citation

This submission follows BLUEBOOK (19[TH] EDITION).

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[10] Sumitra Nandan Srivastava, *The Indian Retail Sector*, (Oct. 17, 2018) https://www.scribd.com/document/50648395/The-Indian-retail-sector-is-highly-fragmented-with-97-per-cent-of-its-business-being-run.

[11] ASA Associates, Retail Sector in India (Oct. 17, 2016) http://www.cci.in/pdf/surveys_reports/indias_retail_sector.pdf.

[12] DIPP – Ministry of Commerce (Government of India), *Frequently asked questions*, (Oct. 10, 2018), http://dipp.nic.in/investors/Investor%20Guidance/frequently-asked-questions.

FDI POLICY IN INDIA

FDI as defined in Dictionary of Economics (Graham Bannock *et.al*) as "investment in a foreign country through the acquisition of a local company or the establishment there of an operation on a new site. To put in simple words, FDI refers to capital inflows from abroad that is invested in or to enhance the production capacity of the economy."[13]

Foreign Investment in India is governed by the FDI policy announced by the Government of India and the provision of the Foreign Exchange Management Act (FEMA) 1999. The Reserve Bank of India ('RBI') in this regard had issued a notification,[14] which contains the Foreign Exchange Management (Transfer or issue of security by a person resident outside India) Regulations, 2000. This notification has been amended from time to time."

The Ministry of Commerce and Industry, Government of India is governs and monitors the FDI policy continuously. The concerned departments here are the Secretariat for Industrial Assistance (SIA), Department of Industrial Policy and Promotion (DIPP). The RBI or Foreign Investment Promotion Board ('FIPB') grants permission where it is required (outside the automatic route).

FDI Policy with Regard to Retailing in India

It will be prudent to look into Press Note 4 of 2017 issued by DIPP and consolidated FDI Policy issued in 2017 which provide the sector specific guidelines for FDI with regard to the conduct of trading activities:[15]

a) FDI up to 100% for cash and carry wholesale trading and export trading allowed under the automatic route.

b) FDI up to 100 % with prior Government approval (i.e. FIPB) for retail trade of 'Single Brand' products.

c) FDI up to 51% with prior Government approval (i.e. FIPB) for retail trade of 'Multiple Brand' products.

d) FDI up to 100% for retail trade over 'e-commerce sites' products under the automatic route.

Entry Options for Foreign Players prior to FDI Policy

"Although prior to Jan 24, 2006, FDI was not authorised in retailing, most general players had been operating in the country. Some of entrance routes used by them have been discussed in sum as below:

Franchise Agreements

This is fairly simple to understand. With permission from RBI, FDI (unless otherwise prohibited) is allowed. Foreign Brands enter into binding contracts with entities in India to sell product. Products are imported into India and sold under same Brand name. This trick was used by players like Pizza Hut, Lacoste, Mango, Nike etc.[16].

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[13] HEMANT BATRA, RETAILING SECTOR IN INDIA PROS CONS, http://www.legallyindia.com/1468-fdi-in-retailing-sector-in-india-pros-cons-by-hemant-batra.

[14] Notification No. FEMA 20/2000-RB dated May 3, 2000.

[15] DIPP – Ministry of Commerce (Government of India), *Consolidated FDI Circular 2017*, (Oct. 10, 2018), http://dipp.nic.in/sites/default/files/CFPC_2017_FINAL_RELEASED_28.8.17_0.pdf.

[16] DR. M. S. RANGARAJU AND DR. S. HANUMAR KENNEDY, INNOVATION IN MANAGEMENT: CHALLENGES IN THE NEXT DECADE, (Allied Publishers, New Delhi, 2010).

FDI IN SINGLE AND MULTIPLE BRAND RETAIL

FDI in Single Brand Retail

The Government has not categorically defined the meaning of "Single Brand" anywhere neither in any of its circulars nor any notifications."

In single-brand retail, FDI up to 51 per cent is allowed, subject to Foreign Investment Promotion Board (FIPB) approval and subject to the conditions mentioned in Press Note 3 that

(a) only single brand products would be sold (i.e., retail of goods of multi-brand even if produced by the same manufacturer would not be allowed),

(b) products should be sold under the same brand internationally,

(c) single-brand product retail would only cover products which are branded during manufacturing and

(d) any addition to product categories to be sold under "single-brand" would require fresh approval from the government[17].

While the phrase 'single brand' has not been defined, it implies that foreign companies would be allowed to sell goods sold internationally under a 'single brand', viz., Reebok, Nokia, and Adidas. Retailing of goods of multiple brands, even if such products were produced by the same manufacturer, would not be allowed. [18]

FDI in 'Single brand' retail implies that a retail store with foreign investment can only sell one brand. For example, if Adidas were to obtain permission to retail its flagship brand in India, those retail outlets could only sell products under the Adidas brand and not the Reebok brand, for which separate permission is required. If granted permission, Adidas could sell products under the Reebok brand in separate outlets." [19]

"There is ambiguity in the interpretation of the term 'single brand'. The existing policy does not clearly codify whether retailing of goods with sub-brands bunched under a major parent brand can be considered as single-brand retailing and, accordingly, eligible for 51 per cent FDI. Additionally, the question on whether co-branded goods (specifically branded as such at the time of manufacturing) would qualify as single brand retail trading remains unanswered.

FDI in Multiple Brand Retail

The government has also not defined the term Multi Brand. FDI in Multi Brand retail implies that a retail store with a foreign investment can sell multiple brands under one roof.

In July 2010, Department of Industrial Policy and Promotion (DIPP), Ministry of Commerce circulated a discussion paper[20] on allowing FDI in multi-brand retail. The paper didn't suggest any upper limit on FDI in multi-brand retail. 51% FDI in multi brand retail was allowed (subject to certain conditions) in 2012 [21].

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[17] DIPP – Ministry of Commerce (Government of India), *Clarification on FDI Policy in Single Brand Retail*, (Oct. 10, 2018), http://dipp.nic.in/sites/default/files/Clarification_On_FDI_Policy_On_Single_Brand_Retail_Trading_0.pdf.

[18] MOHAN GURUSWAMY, IMPLICATIONS OF FDI IN RETAIL, (Oct. 16, 2018) http://www.scribd.com/doc/36888679.

[19] Dr. Dinesh Bhakkad, *Changing Scenario of Business and Commerce* (Prashant Publications, Jalgaon, 2012).

[20] Discussion Paper on FDI in Multi Brand Retail Trading, http://dipp.nic.in/DiscussionPapers/DP_FDI_Multi-BrandRetailTrading_06July2010.pdf.

[21] DIPP – Ministry of Commerce (Government of India), *Consolidated FDI Circular 2012*, (Oct. 10, 2018),

CONCERNS OF FOREIGN INVESTORS

Infrastructure

There has been a lack of investment in the logistics of the retail chain, leading to an inefficient market mechanism. It has been observed that though India is the second largest producer of fruits and vegetables (about 180 million MT)[22], it has a very limited integrated cold-chain infrastructure, with only 5386 stand-alone cold storages, having a total capacity of 23.6 million MT. , 80% of this is used only for potatoes[23]. The chain is highly fragmented and hence, perishable horticultural commodities find it difficult to link to distant markets, including overseas markets, round the year. So, even when there is inflow of FDI in India, the foreign players find it very difficult to function due to these poor infrastructural facilities. Lack of adequate storage facilities cause heavy losses to farmers in terms of wastage in quality and quantity of produce in general". "Though FDI is permitted in cold-chain to the extent of 100%, through the automatic route, in the absence of FDI in retailing; FDI flow to the sector has not been significant.

Intermediaries dominate the value chain

Intermediaries often flout *mandi* norms and their pricing lacks transparency. "Wholesale regulated markets, governed by State APMC Acts, have developed a monopolistic and non-transparent character. According to some reports, Indian farmers realize only 1/3rd of the total price paid by the final consumer, as against 2/3rd by farmers in nations with a higher share of organized retail [24]. There intermediaries contribute little to the economic growth and eat up most of the profits thereby corrupting the system

Erratic Government Control

The rules of the Indian government are ever changing as is evident with the change in policy multiple times (almost every year) over the past 2 decades. This has led to uncertainty among and loss of confidence in the Indian markets globally.

Lawlessness

Foreign players are often faced with protests and hooliganism by angry crowds in India. Wal-Mart stores have been vandalised in the past and properties worth crores of Rupees torched and reduced to nothingness. All of this while the governments and policy have done nothing to take the situation under control. This has added to the depleting confidence of Global Investors.

http://dipp.nic.in/sites/default/files/FDI_Circular_01_2012%20%203_0.pdf.

[22] DR. DINESH BHAKKAD, CHANGING SCENARIO OF BUSINESS AND COMMERCE (PRASHANT PUBLICATIONS, JALGAAON, 2012).

[23] Id.

[24] Id.

HIGHLIGHTS OF THE CHANGE IN FDI POLICY

The government in June, 2016 notified changes in the policy in sectors including pharmaceuticals defence and single-brand retail. The changes in the policy include allowing 100 per cent FDI under government approval route for trading, including through e-commerce, in respect of food products manufactured and/or produced in India[25]. To attract investment in the defence sector, the government has removed the condition of 'state-of-art' technology, besides permitting foreign investment in manufacturing of small arms and ammunitions. The government has also permitted 100 per cent FDI through automatic route in broadcasting carriage services like teleports, direct-to-home and mobile TV. It allowed 100 per cent FDI in airlines and relaxed norms for overseas investments in brownfield airports. In private security agencies, FDI limit was raised to 74 per cent from 49 per cent earlier [26].

In single-brand retail trading, government said the mandatory local sourcing norm for foreign firms "will not be applicable up to three years from commencement of the business *i.e.* opening of the first store for entities undertaking single brand retail trading of products have 'state of art' and 'cutting edge' technology and where local souring is not possible[27].

This shows the easing of norms by the Government of India to attract more FDI.

Investment and entry vehicles

A foreign company planning to set up business operations in India may "Incorporate a company under the Companies Act, 2013, as a Joint Venture or a Wholly Owned Subsidiary; or set up a Liaison Office / Representative Office or a Project Office or a Branch Office of the foreign company which can undertake activities permitted under the Foreign Exchange Management (Establishment in India of Branch Office or Other Place of Business) Regulations, 2000."[28] Thus, investments can be made either into unincorporated entities such as liaison office, branch office, project office, etc.[29]

Conditions for Single Brand Retail Trading In India under FDI Policy, 2016[30]

a. Products to be sold should be of a 'Single Brand' only.

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.

c. Single Brand product-retailing would cover only products which are branded during manufacturing. Any non-resident entity / entities can undertake such trading for a specific brand directly or through legally tenable agreement with the brand owner. The onus for ensuring compliance with this

[25] DIPP – Ministry of Commerce (Government of India), *Consolidated FDI Circular 2016*, (Oct. 10, 2018), http://dipp.nic.in/sites/default/files/FDI_Circular_2016%282%29.pdf.
[26] Id.
[27] Id.
[28] DIPP – Ministry of Commerce (Government of India), *Frequently asked questions*, (Oct. 10, 2018), http://dipp.nic.in/investors/Investor%20Guidance/frequently-asked-questions.
[29] Master Circular on Establishment of Liaison / Branch / Project Offices in India by Foreign Entities, RBI/2015-16/54, Master Circular No.7/2015-16, July 01, 2015, (Oct. 15, 2018) https://www.rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=9861.
[30] DIPP – Ministry of Commerce (Government of India), *Consolidated FDI Circular 2016*, (Oct. 10, 2018), http://dipp.nic.in/sites/default/files/FDI_Circular_2016%282%29.pdf.

condition rested with the Indian entity carrying out trading in India.

d. In respect of proposals involving FDI beyond 51 percent, mandatory sourcing of at least 30 percent of the value of goods purchased will have to be done from India, preferably from MSMEs, village and cottage industries, artisans and craftsmen, in all sectors. The local procurement requirement 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, under the new policy, an exemption from local sourcing up to three years is allowed if the product produced is 'state-of-art' and uses 'cutting-edge technology' where local sourcing is not possible. Retail trading, in any form, by means of e-commerce, is allowed to an entity operating through brick and mortar stores.

Conditions for Multi -Brand Retail Trading In India under FDI Policy, 2016[31]

a. **State government discretion –** A key MBRT condition is that multi-brand retail outlets can only be set up in those states, which agree to allow FDI in MBRT. So far, the States of Andhra Pradesh, Assam, Delhi, Haryana, Himachal Pradesh, Jammu & Kashmir, Maharashtra, Manipur, Rajasthan and Uttarakhand and the Union Territories of Daman & Diu and Dadra and Nagar Haveli have approved FDI in MBRT. A foreign investor proposing to invest in MBRT in other states can seek specific consent from the relevant State Government.

b. **Minimum investment -** The foreign investor must infuse "a minimum of $100 million in the entity, which will engage in MBRT in India (MBRT entity)".

c. **Backend infrastructure -** Minimum extent of investment: At least 50% of the total FDI into the MBRT entity must be invested in backend infrastructure within three years from the first tranche of FDI.

d. **Front-end stores –** The front-end stores of the MBRT entity must be "company owned and company operated only – the MBRT entity cannot adopt a franchisee model. The front-end stores must be set up as new stores and not through acquisition of existing retail stores".

e. **Sourcing from small industries –** At least 30% of the value of the manufactured or processed products purchased by the MBRT entity must be sourced from Indian "small industry" units which have a total investment in plant and machinery not exceeding $1 million as certified by the District Industries Centre. Procurement of fresh produce is not covered by this MBRT Condition since it wouldn't qualify as a "manufactured or processed product".

f. **Location –** Multi-brand retail stores can be set up only in cities with a population of more than 1 million (determined by the 2011 census). The MBRT entity does have the flexibility to invest in backend infrastructure anywhere in India, including in states that have not approved of FDI in MBRT.

[31] Id.

CONCLUSION

Walmart in association with Bharti Enterprises has opened stores in India already. It has been reported that “it plans to have 15 stores by March and enter new states like Andhra Pradesh, Rajasthan, Madhya Pradesh and Karnataka”. [32]

Many of the foreign brands would come to India if FDI in multi brand retail is permitted which can be a blessing in disguise for the economy. The government is balancing the twin objectives of economic growth and social welfare.

The dis-advantages of opening an unstructured economy like ours to foreign direct investment are many. The frequent disruptions and protests are witness to these. The foreign players with huge capital resources are known to have wiped small indigenous businesses in totality. They often use unfair trade practices like dumping and capture the market only to make windfall gains later. Thereby, cheating the economy and the people alike.

However also on the other hand, the advantages of allowing unrestrained FDI in the retail sector are also many. These include better choices and cheaper goods for the people, upgrade of infrastructure and creation of service based jobs, economic boom, etc.

Thus, in the fierce battle between the advocators and antagonist of unrestrained FDI flows in the Indian retail sector, the interests of the consumers and of producers have to be balanced and taken care of with utmost care. Therefore the involvement of the Government is of paramount importance.

India has been on the road to openness and change. The economic change which began in 1991 have continued to shape the Indian economy in the form of these changes in FDI policies, the coming up of Goods and Service tax, etc. All in all, the trend has been to move towards embracing the world economy as part of our own and integrating the Indian economy into one that has been coming at a global level. Whether or not these changes work for the Indian people at large is something that only time will tell.

[32] *FDI in retail to contain inflation*, ECONOMIC TIMES RETAIL NEWS (Oct. 10, 2018); Walmart http://retail-guru.com/allow-100-fdi-in-retail-to-contain-inflation-walmart.