

# Analytical Speaking

## FDI in retail business: Making it sell in India

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After substantial amount of politicking, the Government recently notified the opening up of FDI multi-brand retailing in India. In 1991, when liberalisation process first started, there were substantial doubts as to what it would do to the country. It may be arguable whether the process has paid rich dividends to the masses that make India, but there is little doubt that today, the country looks at the world with far greater power and confidence than it did in 1990s. The consequences of the opening of FDI in multi-brand retail may be a matter of political debate, but it seems clear that the retail scenario in due may be due for a facelift soon.

This article provides a nuts-and-bolts approach to the implementation of multi-brand retail FDI. The article has been presented in form of Q and As.

### 1. What is the change in the Regulations?

Foreign Direct Investment in retail trading except single brand retailing was prohibited in India. In the retail sector, foreign direct investment under the cash and carry trading (whole sale trading) was allowed upto 100% under the automatic route and single brand retailing was allowed upto 51% with Department of Industrial Policy and Promotion (DIPP) and Foreign Investment Promotion Board (FIPB) approval.

FDI norms were recently liberalised in single brand and multi-brand retailing by DIPP on 20<sup>th</sup> September, 2012 allowing FDI in multi brand retail trade up to 51%, with Government approval. The change in the regulations is as tabulated below:

	<b>Earlier position</b>	<b>Current Position (Post amendment)</b>
<b>Cash &amp; Carry Trading</b>	FDI upto 100% allowed	Same as before
<b>Single brand retailing</b>	FDI upto 100% allowed	Same as before, but the conditions to single brand retailing have been relaxed <sup>1</sup>
<b>Multi brand retailing</b>	Not allowed	Upto 51% FDI allowed (subject to certain conditions) <sup>2</sup>

<sup>1</sup> See Press Note 4 (2012 series) [http://dipp.nic.in/English/acts\\_rules/Press\\_Notes/pn4\\_2012.pdf](http://dipp.nic.in/English/acts_rules/Press_Notes/pn4_2012.pdf)

<sup>2</sup> See Press Note 5 (2012 series) [http://dipp.nic.in/English/acts\\_rules/Press\\_Notes/pn5\\_2012.pdf](http://dipp.nic.in/English/acts_rules/Press_Notes/pn5_2012.pdf)

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### 2. What is retailing?

Retail trading or retailing has not been defined under the FDI policy. In layman terms retail trading means selling goods to the general public. So from the local *kirana* stores to mall based shopping formats all would fall under the category of retail trading. The Delhi High Court in case of *Association of Traders of Maharashtra vs. Union of India*<sup>3</sup> defined retail as sale of final consumption or sale to ultimate consumer. Manufacturer selling his own brand is not retailing. Retailing is the bridge between the manufacturer and the final consumer and falls last in the distribution chain having interface with the end customer.

### 3. What is the difference between single brand retailing and multi brand retailing?

The FDI policy does not define single brand retailing and multi brand retailing however the two may be construed to mean:

- Single brand retailing – sale of products of single brands to retail customers for personal consumption. E.g Zara, Mark & Spencer, Espirit, Nokia etc.
- Multi brand retailing – sale of products of multiple brands to retail customers for personal consumption. E.g Walmart, IKKEA, Carrefour etc.

### 4. What are the pre conditions for multi brand retailing?

Multi brand retailing is permitted subject to the certain conditions, some of which are stated below:

- i. Minimum investment by the foreign investor by way of FDI would be US\$ 100 million.
- ii. At least 50% of the total FDI must be invested in back-end infrastructure within 3 years of the first tranche of FDI. Back-end infrastructure includes processing, manufacturing, distribution, etc. but does not include land cost and rentals.

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<sup>3</sup> 2005 (79) DRJ 426

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- iii. At least 30% of the value of procurement of manufactured/ processed products shall be sourced from small industries / village and cottage industries, artisans and craftsmen<sup>4</sup>. This procurement requirement would have to be met, in the first instance, as an average of five years' total value of the manufactured processed products purchased, beginning 1st April of the year during which the first tranche of FDI is received. Thereafter, it would have to be met on an annual basis.
- iv. The company needs to self-certify on the compliance for (i) to (iii) above.
- v. Retail outlets in States which have agreed or will agree to allow FDI in multi-brand retail subject to applicable local State laws;
- vi. Retail outlets only in cities with a population of more than 10 lakh people as per the 2011 census. In States and Union Territories not meeting the population threshold as above may set up retail outlets in cities of their choice (preferably the largest city). In either case, retail outlets can also be set up to cover an area of 10 kms around the municipal / urban agglomeration limits of such cities.
- vii. Prior approval of DIPP and FIPB will be required to determine whether the proposed investment satisfy the guidelines.

### 5. Can I set my shops all over the country?

The DIPP notification permits multi brand retailing as an enabling policy, States and Union Territories are free to use discretion on the implementation of the policy. Hence, stores/ shops can be set up in only cities of such states which allow for multi brand retailing. Currently the following States/ Union Territories have permitted multi brand retailing:

- i. Andhra Pradesh
- ii. Assam
- iii. Delhi
- iv. Haryana
- v. Jammu & Kashmir

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<sup>4</sup> The procurement needs to be sourced from 'small industries having total investment in plant & machinery not exceeding USD 1 million. If the valuation of the industry exceed USD 1 million, it shall not qualify as small industry for procurement purposes.

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- vi. Maharashtra
- vii. Manipur
- viii. Rajasthan
- ix. Uttarakhand
- x. Daman & Diu
- xi. Dadra & Nagar Haveli

Establishment of multi brand retail outlets will be in compliance with state applicable laws such as Shops and Establishments Act.

Further, population thresholds have been put as condition for doing multi brand retail trading . These have been enumerated in Q4 above.

6. Do I have to set up a company in India or can I just start business in the name of a foreign company?

With regard to single brand retailing, the recent press note amends para 6.2.16.4 to states one of the pre-conditions pertinent to address the issue is reproduced as below –

“Only one non-resident entity, whether owner of the brand or otherwise, shall be permitted to **undertake (emphasis ours)** single brand product retail trading in the country, for the specific brand, through a legally tenable agreement, with the brand owner for undertaking single brand product retail trading in respect of the specific brand for which approval is being sought. The onus for ensuring compliance with this condition shall rest with the Indian entity carrying out single-brand product retail trading in India. The investing entity shall provide evidence to this effect at the time of seeking approval, including a copy of the licensing franchise/ sub-licence agreement, specifically indicating compliance with the above condition.

The reading of the above text indicates that the foreign operating company has several options of creating a presence in India by providing licenses, sub-licence, joint ventures<sup>5</sup>, royalty model or may set up an Indian venture for the norms to be applicable.

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<sup>5</sup> See Retail Sector in India, August, 2012 Report to know more on joint ventures with multi brand retailing companies in India [http://www.cci.in/pdf/surveys\\_reports/indias\\_retail\\_sector.pdf](http://www.cci.in/pdf/surveys_reports/indias_retail_sector.pdf)

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In case of multi brand retailing, the notification lays down the pre-conditions for undertaking multi brand retailing which do not include requirement of a foreign company to set up entity. Hence there is flexibility in this regard.

7. What is the procedure for getting into multi brand retailing?

In both single brand and multi brand retailing the investing company needs to make an application to DIPP to verify whether the proposed investment satisfies the conditions stated in the guidelines. Once DIPP is satisfied application needs to be made to FIPB for final approval.

8. What is the extent to which FDI can be held in multi brand retailing?

Currently FDI upto 51% is permitted in multi brand retailing.

9. What is the form (shares, debentures, etc) in which FDI may come?

The extant FDI policy provides for types of instruments through which the investor can make FDI and the same instruments shall be applicable in case of multi brand retailing as well. The instruments include:

- i. Equity
- ii. Compulsorily convertible preference shares
- iii. Compulsorily convertible debentures

10. Can an FDI investor have buy-back agreements with Indian shareholders?

Here again, we need to look at the extant FDI policy to determine whether FDI investors can have a buy back agreement with Indian shareholders.

General permission has been granted to non-residents/ NRIs subject to the sectoral caps, applicable laws and other conditionalities including security conditions to have buy-back agreements with Indian shareholders. Also, if the buy-back is provided at pre-fixed rate of return, then the same would tantamount to External Commercial Borrowing.

11. Are typical Shareholders' Agreements (SHA) clauses enforceable in India?

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Where the SHA forms a part of the Articles of the Company, they become binding on the members of the Company, however the enforceability of the shareholder's agreement, outside the Articles is a grey area<sup>6</sup>.

References may be drawn to Apex Court rulings such as *V.B. Rangaraj v. V.B. Gopalakrishnan*<sup>7</sup> on the enforceability of shareholders agreement.

12. Can payment be made for use of trade name/brand name?

Yes, brand licensing, sub-licensing, royalty models is possible.

13. Is e-commerce retailing permissible?

The Press Note 5 provides that *retail trading, in any form, by means of e-commerce, would not be permissible, for companies with FDI, engaged in the activity of multi-brand retail trading.*

This would mean firms that only list brands on the website can continue functioning and are not impacted by the notification. This would mean the web platforms carrying out enabling function shall not be impacted but foreign firms that buy or sell any goods or services on online portals are prohibited under the FDI policy.

Between the debate of 'anti-people policy' and rosy pictures of 'welcomed change', the status remains India opens doors to multi-brand retailing. Would this 'liberalisation' act be a bane or a boom is for times to testify.

**You may see our other relevant articles on the topic, on our website:**

1. Our notes, articles, views and analysis on FDI, ECB, FEMA related issues at -- <http://india-financing.com/staff-publications-fdi.html>
2. See our analytical review of *Legality of a Shareholder's agreement – Can shareholders agree outside the Articles?* By Nidhi Ladha at <http://india-financing.com/staff-publications-venture-capital.html>

<sup>6</sup> For details refer Nidhi Ladha's article on *Legality of a Shareholder's agreement – Can shareholders agree outside the Articles* on at <http://india-financing.com/staff-publications-venture-capital.html>

<sup>7</sup> AIR 1992 SC 453