

Corpsec Hotline

June 18, 2013

CLARIFICATIONS ON FDI IN MULTI BRAND RETAIL TRADING: AS RESTRICTIVE AS IT MAY GET

The Department of Industrial Policy and Promotion ("DIPP") of the Ministry of Commerce and Industry on June 6, 2013, has issued a Clarification ("Clarification") on the queries of prospective investors with respect to the provisions on Multi Brand Retail Trading ("MBRT") under the Consolidated Foreign Direct Investment Policy ("FDI Policy"), issued by the DIPP vide Circular 1 of 2013 dated April 5, 2013.

BACKGROUND

Foreign Direct Investment ("FDI") upto 51% under the Government route into MBRT was allowed last year vide Press Note 5 (2012 Series) dated, September 20, 2012 ("Press Note"), which was subsequently incorporated in the FDI Policy. We had analysed the Press Note in our hotline [INDIA NOTIFIES 51% FDI IN MULTI BRAND RETAIL TRADING](#) and, *inter alia*, we identified the positives and negatives of the Press Note for the foreign investors and stakeholders interested to enter the multi-billion dollar retail industry in India.

RESPONSE ON THE POLICY

Since its notification, the Press Note with its conditions and ambiguities has deterred foreign investors and international retail giants from investing in MBRT. There has been no formal application filed with the government by any foreign investor in MBRT. They have chosen to wait and seek more clarity on the contents of the Press Note.

Various stakeholders were hopeful that the government would iron out some of the ambiguities and challenges under the FDI Policy for MBRT but much to everyone's dismay, the Clarification has re-iterated the restrictiveness of the policy and left some concerns unanswered.

CLARIFICATIONS

Certain key clarifications and comments issued by the DIPP and their implications are discussed in this hotline, as follows:

- Mandatory local sourcing requirement:** With respect to the local sourcing requirement, the Press Note provided that *"at least 30% of the value of procurement of manufactured / processed products purchased shall be sourced from Indian 'small industries'â€*. Since the Press Note did not mention whether the sourced goods were required to be mandatorily sold in front end units of the MBRT entity, it led to an ambiguity whether goods sourced by an MBRT entity can be sold in a manner other than through their front end units as many retailers were anxious for an option of sourcing and selling the goods to their group entities or other entities in India or abroad. DIPP has now clarified that the requirement of 30% sourcing will be reckoned only with reference to the sale of such goods in the front end stores and shall not be allowed to be distributed by means other than through the front end stores.

Implication: *Over and above the obligation to source the goods, MBRT entities will have to ensure that such sourced goods are also sold in their front end stores, thereby, drastically limiting the options for MBRT entities to deal with the sourcing condition. Further, it is not clear whether 'small industry' entity will or will not include its parent company, subsidiary, affiliate, etc. or will cover its 'group company' as has been recently defined vide Press Note 2 (2013 Series) dated June 3, 2013. The Clarification refers to the query but fails to respond to it.*
- 50% of the FDI to be invested in back-end infrastructure:** The Press Note mandates for an investment of 50% of FDI in back-end infrastructure within three years of the first tranche of FDI. It was not clear under the Press Note whether the said requirement can be satisfied by buying the existing back-end infrastructure in India. The Clarification now elucidates that FDI in MBRT will require fresh investment in back-end infrastructure. Further, FDI into greenfield assets is mandatory for meeting the criteria of 50% investment in back-end infrastructure and the foreign investor cannot use any of the following routes / structures to meet the 50% investment criteria:
 - By buying existing back-end assets or acquiring stake in companies having back-end infrastructure,
 - By investing in equity of a company engaged in developing back-end infrastructure even if it certifies the use of investment towards back-end capacity,
 - By showing the company carrying wholesale trading / cash and carry trading, as company providing back-end infrastructure,
 - By aggregating the investment by the foreign investor in other infrastructure companies which provide logistics, services *etc.*

Further, the government has clarified that the MBRT entity is prohibited from undertaking wholesale activity by

Research Papers

Telemedicine in India

August 31, 2024

Clinical Trials and Biomedical Research in India

August 31, 2024

Compendium of Research Papers

August 27, 2024

Research Articles

Acquirers Beware: Indian Merger Control Regime Revamped!

September 15, 2024

Navigating the Boom: Rise of M&A in Healthcare

August 23, 2024

Navigating The Change in Shareholding and Management Rule for Non-Banking Financial Companies in India: A Practical Perspective

August 22, 2024

Audio

Renewable Roadmap: Budget 2024 and Beyond - Part I

August 26, 2024

Renewable Roadmap: Budget 2024 and Beyond - Part II

August 26, 2024

Renewable Roadmap: Budget 2024 and Beyond - Part III

August 26, 2024

NDA Connect

Connect with us at events, conferences and seminars.

NDA Hotline

[Click here to view Hotline archives.](#)

Video

Union Budget: Key takeaways for Private Equity Investors and Foreign Companies

July 24, 2024

providing supplies to related or third party companies as this would amount to wholesale trading / cash and carry trading. The Clarification provides that any form of retailing has to be through the front end stores only and such front end stores will have to be company owned and company operated.

Implication: *While the intention of DIPP seems to promote 'brick and mortar' investment by MBRT entities in India, the Clarification squarely goes one step ahead in restricting the MBRT entities from deriving any parallel benefit from the back-end infrastructure that gets developed with their money. The condition of requiring the MBRT entity to directly undertake the development of back-end infrastructure might be onerous as they might not be best to directly undertake such developments in India.*

3. **Franchise arrangement:** The Press Note did not mention (or expressly restrict) if an MBRT entity can set up its own franchisee stores across India. It is now clarified that franchisee model is not permissible by MBRT entities and the front end stores set up by MBRT entity will have to be 'company owned and company operated' only.

Implication: *The Clarification sets out the clear distinction between retail trading and franchise as business models. The MBRT entity is required to have its own skin in the game and a franchise model would dilute that.*

4. **Certain welcome clarifications:** DIPP has clarified the following:

- **State discretion:** There was an uncertainty under the Press Note that, with the state government / union territory having the right to impose additional conditions to the policy on FDI in MBRT with respect to their state, can tamper with the foundation of the policy issued by the central government, or in case of change in the state government itself, whether the new government can amend the conditions under the policy making it literally impossible for the foreign investor to continue with its retail store in a given state. It has now been clarified that the states / union territories which have agreed to allow FDI in MBRT in their state / union territory (*i.e.* currently 10 states as noted under the FDI Policy) cannot amend the main policy on MBRT as the same is under the domain of the central government. However, the state government shall have the prerogative of imposing additional conditions under the applicable state laws and regulations. This clarification provides some comfort that the FDI policy itself cannot be tampered with by the states.
- **Non-FDI agreeing states / union territories:** If the foreign investor approaches a state government / union territory that is not included in the list of states / union territories supporting FDI in MBRT as per the prevalent FDI Policy, consent given by such state government / union territory would be acceptable, and a suitable amendment to the FDI Policy will be undertaken by the central government. This clarifies that the investor will not have to wait for such formal notification by the central government. Further, it has been clarified that investment in back-end infrastructure can be made in any state even if such state may not have agreed to the FDI Policy on MBRT. This investment in back-end infrastructure would however have to meet the conditions of the Press Note. This would encourage infrastructure to be set up at the most appropriate locations from a sourcing and procurement perspective.

OPEN ISSUES

Some of the ambiguities in the Press Note are still being studied by the government and the Clarification mentions that the following issues are still under consideration:

- Sourcing restriction amongst 'group companies'.
- Requirement of 50% investment in 'backend infrastructure' within three years of the first tranche of FDI.
- Requirement of 30% sourcing from 'small industry'. Whether sourcing from such 'small industry' cannot be allowed towards fulfillment of this conditionality, if it outgrows, and if so, till what period?

CONCLUSION

The much heralded FDI in MBRT was thrown open to investment almost 10 months ago but as a result of its restrictions and ambiguities, not a single application has been filed with the DIPP. Investors are keen to invest and therefore have sought these amongst other clarifications. The government has undoubtedly a tough challenge in front of it. On one hand it needs to encourage FDI in various sectors including retail and on the other it needs to be mindful of the political realities this sector comes with. With elections due in 2014, one does not expect any easing of the Press Note. Investors will either have to bite the bullet and enter the large Indian retail market or wait on the sidelines for more clarity.

- Mukul Aggarwal, Sambhav Ranka & Vivek Kathpalia
You can direct your queries or comments to the authors

DISCLAIMER

The contents of this hotline should not be construed as legal opinion. View detailed disclaimer.

This Hotline provides general information existing at the time of preparation. The Hotline is intended as a news update and Nishith Desai Associates neither assumes nor accepts any responsibility for any loss arising to any person acting or refraining from acting as a result of any material contained in this Hotline. It is recommended that professional advice be taken based on the specific facts and circumstances. This Hotline does not substitute the need to refer to the original pronouncements.

This is not a Spam mail. You have received this mail because you have either requested for it or someone must have suggested your name. Since India has no anti-spamming law, we refer to the US directive, which states that a mail cannot be considered Spam if it contains the sender's contact information, which this mail does. In case this mail doesn't concern you, please unsubscribe from mailing list.