

# Other Hotline

August 09, 2013

## ADDITIONAL FOREIGN DIRECT INVESTMENT REFORMS IN RETAIL

In September last year, the Government of India liberalized the foreign direct investment ("FDI") policy relating to retail trading with a view to promote foreign investment. Despite reforms introduced by the Government, the retail trading sector was unable to attract large international retailers given the ambiguity and stringent conditions attached to such investments. This forced the Government to provide clarifications<sup>1</sup> or reforms<sup>2</sup> in order to ease the entry of foreign investors into the Indian retail markets.

Accordingly, the Government of India has now announced the relaxation of certain conditions that were applicable to FDI in single brand product retail trading ("SBPRT") and multi brand retail trading ("MBRT").

## FDI POLICY RELATING TO RETAIL TRADING

In January 2012<sup>3</sup>, 100% FDI was permitted in SBPRT. Subsequently, owing to tremendous pressure, the Government further liberalized the FDI policy and permitted up to 51% FDI in the MBRT. Such investments however, had to be made with prior government approval and were subject to a number of conditions. You may refer to our earlier hotlines "→ India Notifies 51% FDI in Multi Brand Retail Trading" and "→ India breaks the FDI shackles: Multi Brand Retail Trading and other sectors liberalized" where we have analyzed the provisions of the FDI policy in relation to SBPRT and MBRT.

Since the reforms introduced did not result in adequate investment in SBPRT and there was no investment in MBRT, the Union Cabinet approved certain changes to the FDI policy relating to SBPRT<sup>4</sup> and MBRT<sup>5</sup> on August 1, 2013. These changes will amend the relevant paragraphs of the FDI policy upon notification by way of press notes.

## KEY AMENDMENTS TO FDI POLICY FOR SBPRT

Pursuant to the notification, one of the important changes that will be brought about in the FDI policy will relate to allowing FDI up to 49% under the automatic route (no Government approval required) in SBPRT. Since 2006, the policy on SBPRT has been liberalized in a phased manner. This change would pave the way for many brands that are willing to operate through the joint venture structure with a local resident holding 51% in the Indian single brand retail entity. The prevalent conditions relating to brand ownership, sale of products under a single brand internationally, branding of products at the time of manufacture for FDI in SBPRT sector, as stipulated under the FDI policy, shall continue to apply for FDI up to 49% even though allowed under the automatic route. In addition, for investments up to 49% under automatic route, the product/product categories as well as documents evidencing brand ownership will have to be submitted to the Reserve Bank of India ("RBI").

The Union Cabinet also approved certain key changes in relation to the SBPRT are as follows:

Old provisions	New provisions	Analysis and implications
<b>Brand ownership<sup>6</sup>:</b>		
Only one non-resident entity, whether owner of the brand or otherwise, shall be permitted to undertake 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.	A non-resident entity or entities, whether owner of the brand or otherwise shall be permitted to undertake `Single Brand` product retail trading in the country for the specific brand, directly or through a legally tenable agreement with the brand owner for undertaking single brand product retail trading. The onus for ensuring compliance with this condition will 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 requisite evidence should be filed with the RBI for the	<p>The FDI policy previously provided that only one foreign investor would be permitted to undertake SBPRT in the country for a specific brand. This limitation has now been amended and the amended policy will read to allow a non-resident entity / entities to undertake SBPRT in the country for a specific brand directly or through legally tenable agreement with the brand owner.</p> <p>Originally in October 2011, when the brand ownership requirement was introduced for the first time, the single brand retailer was required to be the owner of the brand. This requirement was then amended in September 2012 where only one single brand retailer was allowed to undertake SBPRT in the country under a legally</p>

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automatic route and SIA/FIPB for cases involving approval.

tenable agreement.

With the recent change, the requirement has been significantly diluted by allowing one or more non-resident entities to undertake SBPRT of a specific brand provided they are owner of the brand or they have some agreement with the brand owner for the specific brand. This would be helpful for structures where for example, more than one foreign entity has been provided with a license for a territory or where the owner and a licensee both invest.

Application seeking permission<sup>7</sup> :

Application seeking permission of the Government for FDI in retail trade of "Single Brand" products would be made to the Secretariat for Industrial Assistance (SIA) in the Department of Industrial Policy & Promotion. The applications would specifically indicate the product/ product categories which are proposed to be sold under a "Single Brand". Any additional to the product/ product categories to be sold under Single Brand" would require a fresh approval of the Government.	Application seeking permission of the Government for FDI exceeding 49% in a company which proposes to undertake single brand retail trading in India would be made to the Secretariat for Industrial Assistance (SIA) in the Department of Industrial Policy and Promotion (" <b>DIPP</b> "). The applications would specifically indicate the product/ product categories which are proposed to be sold under a "Single Brand". Any addition to the product/ product categories to be sold under "Single Brand" would require a fresh approval of the Government. In case of FDI up to 49% the product/ product categories proposed to be sold except food products would be provided to the RBI.	Although FDI in SBPRT was permitted up to 100% previously, such investment had to be made under the Government approval route. The FDI policy has now been amended to provide that FDI in SBPRT is permitted under the automatic route where the investment is up to 49%. Where such investment is up to 49%, details regarding the product/ product categories proposed to be sold except food products need to be provided to the Reserve Bank of India. However, any investment above 49% still requires Government approval.
		Further, the FDI policy does not use the word 'sub brand'. Sub-brands are generally understood to be secondary branding elements that fall below the primary brand in prominence but usually above the product description. The primary brand continues to be the most prominent branding element.
		While the FDI policy did not explicitly allow sale of products of sub brands by single brand retailer, it was the understanding that so long as the product that are sold by the single brand retailer were listed in the application made with DIPP, then sale of products of sub-brands should be allowed.
		There has been some discussion recently regarding sale of products of various sub brands by single brand international retailers and whether it complies with the FDI policy. The amended FDI policy now provides that in case of investment up to 49% the product/ product categories proposed to be sold except food products would have to be provided to the RBI and in case of investment above 49%, the product/ product categories proposed to be sold need to be provided to the DIPP/ SIA.
		However, the amended FDI policy still does not explicitly addresses the issue of sale of products of sub brands and to that extent clarity is required.

KEY AMENDMENTS TO FDI POLICY FOR MBRT

The key amendments to the FDI policy are as follows:

Old provisions	New provision	Analysis and implications
Mandatory Local Sourcing <sup>8</sup>		
At least 30% of the value of	At least 30% of the value of	The FDI policy required entities

procurement of manufactured/processed products purchased shall be sourced from Indian 'small industries' which have a total investment in plant & machinery not exceeding US \$ 1.00 million. This valuation refers to the value at the time of installation, without providing for depreciation. Further, if at any point in time, this valuation is exceeded, the industry shall not qualify as a 'small industry' for this purpose. 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.	procurement of manufactured/processed products purchased shall be sourced from Indian micro, small and medium industries which have a total investment in plant & machinery not exceeding US \$ 2.00 million. This valuation refers to the value at the time of installation, without providing for depreciation. The 'small industry' status would be reckoned only at the time of first engagement with the retailer and such industry shall continue to qualify as a 'small industry' for this purpose even if it outgrows the said investment of US\$ 2.00 million, during the course of its relationship with the said retailer. Sourcing from agricultural co-operatives and farmers co-operatives would also be considered in this category. The 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.	engaged in MBRT to source at least 30% of the value of procurement of manufactured/ processed products purchased locally. Such sourcing was limited to 'small industries' which have a total investment in plant and machinery not exceeding USD 1 million. This requirement has now been amended and investors are permitted to source such products from micro, small and medium industries which have a total investment in plant and machinery not exceeding USD 2 million. The amendment further clarifies that such 'small industry' status is only considered at the time of first engagement and that such industry will continue to qualify as a 'small industry' for this purpose even if it outgrows the said investment of USD 2 million. The above increase in total investment in plant and machinery and clarification is a welcome change given the difficulties faced by the retailers in complying with the requirement.  This amendment to the sourcing requirement in terms of (i) expansion of categories of entities eligible for local sourcing and (ii) increasing threshold of investment in plant and machinery is a great relief as it will broaden the base of suppliers and provide long term supply chain stability as well.
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#### Investment in 'backend infrastructure'<sup>9</sup>:

At least 50% of total FDI brought in shall be invested in 'backend infrastructure' within three years of the first tranche of FDI, where "back-end infrastructure" will include capital expenditure on all activities, excluding that on front-end units; for instance, back-end infrastructure will include investment made towards processing, manufacturing, distribution, design improvement, quality control, packaging, logistics, storage, warehouse, agriculture market produce infrastructure etc. Expenditure on land cost and rentals, if any, will not be counted for purposes of backend infrastructure.	At least 50% of total FDI brought in the first tranche of US\$ 100 million, shall be invested in 'backend infrastructure' within three years, where 'back-end infrastructure' will include capital expenditure on all activities, excluding that on front-end units. For instance, back-end infrastructure will include investment made towards processing, manufacturing, distribution, design improvement, quality control, packaging, logistics, storage, warehouse, agriculture market produce infrastructure etc. Expenditure on land cost and rentals, if any, will not be counted for purposes of backend infrastructure. Subsequent investment in the back-end infrastructure would be made by the MBRT retailer as needed, depending upon his business requirements.	The FDI policy now clarified that at least 50% of USD 100 million i.e. total FDI brought in in the first tranche must be invested in backend infrastructure within three years.  The amendment further clarifies that any subsequent investment in backend infrastructure would be made by the MBRT retailer as needed, depending upon his business requirements.
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#### Setting up of retail outlets<sup>10</sup>

Retail sales outlets may be set up only in cities with a population of more than 10 lakh as per 2011 Census and may also cover an area of 10 kms around the municipal/urban agglomeration limits of such cities; retail locations will be restricted to conforming areas as per the Master/Zonal Plans of the concerned cities and provision will be made for requisite facilities such as transport connectivity and parking; In States/ Union Territories not having cities with population of more than 10 lakh as per 2011 Census, retail sales outlets may be set up in the cities of	Retail sales outlets may be set up only in cities with a population of more than 10 lakh as per the 2011 Census or any other cities as per the decision of the respective State Governments, and may also cover an area of 10 kms around the municipal/urban agglomeration limits of such cities; retail locations will be restricted to conforming areas as per the Master/Zonal Plans of the concerned cities and provision will be made for requisite facilities such as transport connectivity and parking.	The FDI policy also limited the establishment of MBRT retail outlets to cities with a population of more than 10 lakh as per 2011 Census. Where there are no cities that meet such population criteria within a State/ Union Territory, such State/ Union Territory was permitted to exercise discretion and set up retail outlets in cities of their choice. This provision has now been expanded to allow the establishment of retail outlets in cities with a population of more than 10 lakh as per the 2011 Census or any other cities as per the decision of the
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their choice, preferably the largest city and may also cover an area of 10 kms around the Municipal / urban agglomeration limits of such cities. The locations of such outlets will be restricted to conforming areas, as per the Master/Zonal Plans of the concerned cities and provision will be made for requisite facilities such as transport connectivity and parking.

respective State Governments.

The amendment will ensure that every State Government has the discretion to choose the cities in which multi-brand retail outlets are set up and provide a sense of uniformity amongst the States.

## CONCLUSION

Since 2006, the Government of India has taken a calibrated approach towards liberalizing the retail sector in an effort to balance the need for foreign investment and the political turmoil surrounding the issue. With these amendments, the Government has taken a step forward in the reform process.

While it appears that the Government has effected these changes based on industry feedback, a number of issues raised by potential investors still remain to be answered. While investment in SBPRT is showing signs of growth, the real test of these reforms will be FDI in MBRT. India needs to accelerate the reform process and encourage both domestic and foreign investment in the retail sector.

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You can direct your queries or comments to the authors

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<sup>1</sup> In June 2013, the DIPP issued a clarification on the queries of prospective investors in relation to MBRT. Refer to our hotline "[Clarifications on FDI in Multi Brand Retail Trading: As restrictive as it may get](#)"

<sup>2</sup> The Cabinet Committee on Economic Affairs approved a change in the FDI cap for SBRT, permitting upto 49% FDI under the automatic route, on July 16, 2013. Refer to our hotline "[Relaxation of FDI norms on the anvil: A booster provided!](#)"

<sup>3</sup> Press Note No. 1 (2012 Series) dated January 10, 2012

<sup>4</sup> Press release by the Union Cabinet on "[Review of Foreign Direct Investment \(FDI\) caps and routes in various sectors](#)", August 01, 2013, available at <http://pib.nic.in/newsite/pmreleases.aspx?mincode=61>

<sup>5</sup> Press release by the Ministry of Commerce & Industry on "[Review of the policy on Foreign Direct Investment \(FDI\) in Multi-Branded Retail Trading](#)", August 01, 2013, available at <http://pib.nic.in/newsite/erelease.aspx>

<sup>6</sup> Regulation 6.2.16.4 (2) (d) of the FDI policy

<sup>7</sup> Regulation 6.2.16.4 (3) of the FDI policy

<sup>8</sup> Regulation 6.2.16.5(1)(iv) of the FDI policy

<sup>9</sup> Regulation 6.2.16.5(1) (iii) of the FDI policy

<sup>10</sup> Regulation 6.2.16.5(1)(vi) of the FDI policy

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