FDI IN RETAIL SECTOR LIBERALISED

The Cabinet Committee on Economic Affairs ("**CCEA**"), the apex body for formulation of economic policies of the Government of India ("**GoI**"), approved some significant reform measures at its meeting on 14 September, 2012, despite a string of protests from various political parties, including the ruling coalition partners of the ruling government. One of the main reform measures was to allow foreign direct investment ("**FDI**") participation of up to 51% in multi brand product retail trading. In addition, the CCEA approved certain amendments to the existing FDI policy on single brand retail trading and relaxed some of the conditions which were widely perceived as regressive. Subsequently, the Department of Industrial Policy and Promotion, Ministry of Commerce and Industry, GoI ("**DIPP**") gave final shape to the policy measures and revised the existing FDI policy.

FDI in both multi brand and single brand retail sectors is under the approval route and is subject to prior approval from the Foreign Investment Promotion Board ("**FIPB**"), i.e. the authority constituted to approve/reject FDI proposals.

I. FDI POLICY AMENDMENT ON FDI IN SINGLE BRAND RETAIL

The reform measures in the single brand retail trading sector have been reflected in press note 4 of 2012 series ("**Press Note 4/2012**") issued by the DIPP, which amends the conditions on which FDI up to 100% is allowed in the sector. Some of key changes to the investment conditions are set out below.

1.1 Eligible investor: Not just the Brand Owner

Under the earlier regime, only a non-resident brand owner could invest in an Indian company undertaking single brand retail trading activities ("**SBRT Indian Co**"). However, under Press Note 4/2012, the GoI has recognised that a non-resident investment company may be different from the entity which actually owns the brand and has allowed not just a brand owning non-resident entity but any other entity which has rights over a brand to invest in an SBRT Indian Co. However, Press Note 4/2012 also clarifies that only one non-resident entity would be permitted to invest in an SBRT Indian Co for a specific brand.

The non-resident entity which proposes to invest in an SBRT Indian Co is required to comply with the above requirement and while seeking the approval of the FIPB, the investor has to furnish a copy of the trademark/branding agreement.

1.2 30% local sourcing: not mandatorily from small scale industries

One of the most significant changes made relates to local procurement obligations. Under the earlier policy, if an SBRT Indian Co had more than 51% FDI then such company was required to procure <u>30% of value of the products sold</u> mandatorily from small scale industries, village and cottage industries, artisans and craftsmen. The DIPP has relaxed this condition and under the new regime, 30% of the value of '<u>goods purchased</u>' (and not the value of the products actually sold) by such SBRT Indian Co would have to be procured locally preferably (and not mandatorily) from 'micro, small and <u>medium enterprises</u>' ("**MSME**"), village and cottage industries, artisans and craftsmen. There is therefore an added option of procurement from 'medium enterprises', i.e., which have an investment of approximately USD 1 mn to USD 2 mn.

The SBRT Indian Co has to self-certify the domestic procurement which then has to be checked by the auditors.

1.3 First 5 years - local sourcing requirement based on average procurement

In the first five years of operations commencing on 1 April of the year in which the first tranche of FDI was received, the local procurement requirement would have to be met as an average of total goods purchased during such 5 year period. After expiry of such 5 year period the requirement would have to be met on an annual basis.

Thus, it seems that an SBRT Indian Co with FDI must ensure that it procures at least 30% from domestic sources, preferably from MSME, village and cottage industries.

1.4 No e-commerce

SBRT Indian Cos with FDI have been prohibited from engaging in e-commerce activities. Such companies would thus not be able to undertake online sales and would have to appoint franchisees or local third parties to sell online.

II. FDI POLICY AMENDMENT ON FDI IN MULTI BRAND RETAIL

The GoI has, under press note 5 of 2012 series ("**Press Note 5/2012**") issued by the DIPP, lifted the prohibition on non-resident entities engaging in multi brand retail and has now permitted FDI of up to 51% in a company engaged in multi brand retail, subject to prior approval of the FIPB.

The GoI had also approved the liberalisation of the sector in November, 2011 ("**2011 Approval**") but the decision was put on hold due to wide spread political opposition. Press Note 5/2012 is a revival of the 2011 Approval with some changes, including its applicability to only those states that agree to implement FDI in multi brand retail trading.

The new policy seems to be intended to strike a balance between the interests of market forces and those of the small scale enterprises. Some of the key highlights of new policy are as follows.

2.1 USD 100 million minimum FDI with 50% to be used for backend infrastructure

A non-resident investor is required to invest a minimum of USD 100 million as FDI. Of such FDI, 50% is required to be utilised, within a fixed period of 3 years from the date of the investment, for developing 'backend infrastructure', i.e., capital expenditure on all activities excluding front end infrastructure. Press Note 5/2012 clarifies 'backend infrastructure' to include sorting, design improvements, quality control, processing, packaging, transportation and storage. Expenditure on cost of land/rentals is not to be included in such backend infrastructure.

2.2 30% local sourcing: mandatorily from small industries

30% of the value of goods purchased by such FDI receiving entity, will need to be purchased by the FDI receiving company from Indian 'small industries' having a total investment in plant and machinery of less than USD 1 million based on valuation at the time of installation without providing for depreciation. The flexibility to also procure from MSME has not been extended to the multi-brand retail trading sector.

Press Note 5/2012 also provides that, if at any time, the valuation of the relevant small industry exceeds the above referred cap, the goods purchased by the FDI receiving entity will effectively not be considered as compliant with the requirement of the FDI policy. This provision would mean that the Indian companies would need to have strong information and audit rights over their local small scale industries suppliers.

2.3 **Reconciliation of the indigenous sourcing**

As in the case of single brand retail trading, during the first 5 years of operations the local sourcing requirement would have to be met as an average of the total goods purchased for such 5 year period. After expiry of such 5 years' period the requirement would have to be met on an annual basis.

2.4 **Location of stores: Cities with population exceeding 1 million**

Multi-brand retail stores can be opened only in Indian cities with a population of more than one million as per the 2011 Indian population census. In case an Indian state does not have any cities with the above population, the state government may permit stores to be opened in its cities even with a lower population, but preferably the largest city and may also cover an area of 10 kilometres around the municipal/urban agglomeration of such cities.

2.5 **Agricultural produce - unbranded & right of first procurement**

Press Note 5/2012 clarifies that fresh agricultural produce, including fruits, vegetables, flowers, grains, pulses, fresh poultry, fishery and meat products, may be unbranded. It also provides that the government has the first right to procure agricultural products. The policy does not, however, clarify the manner and price at which such first right may be exercised.

2.6 **FDI subject to state policy**

The liberalised policy of the government under the Press Note 5/2012 has been made subject to the policy of the states in which the retail stores are proposed to be set up. The FDI policy has identified the states of Delhi, Haryana, Maharashtra, Andhra Pradesh, Rajasthan, Assam, Uttarakhand, Manipur and Jammu and Kashmir as states which have agreed to the implementation of the FDI policy on multi brand retail. The establishment of the retail stores will at all times be subject to state laws such as the Shops and Establishments Act.

2.7 **No e-commerce**

Similar to the conditionality imposed on companies engaged in single brand retail trading, a company engaged in multi brand retail having FDI is not permitted to engage in e-commerce activities.

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