FOREIGN INVESTMENT IN RETAIL IN INDIA – RESTRICTIONS AND WAY AROUND

Foreign Direct Investment (FDI) Policy of India permits foreign investment in India either under 'automatic route' or 'approval route'. Under the 'approval route' prior approval of the Government of India is required for any foreign investment in an Indian company carrying on retailing business.

FDI Policy on retail trading classified retail trade as either Single Brand Retail Trading ('SBRT') e.g. companies like Marks & Spencer's, Ikea, Uniqlo, Nike or Apple or Multi Brand Retail Trading ('MBRT') for retailers like Walmart, Carrefour or Tesco. Traditionally, there were restrictions in foreign investment in both SBRT and MBRT activities under FDI Policy.

Prior to January 2018 FDI Policy of India allowed 49% FDI in SBRT activities under automatic route and government approval was required for FDI beyond 49% which could go upto 100%. With a view of liberalizing FDI Policy, the Government decided to allow 100% FDI in SBRT activities under automatic route without requiring any government approval effective from January 2018.

The FDI policy for SBRT has laid down the following requirements:

- Products to be sold should be of a 'Single Brand', which are branded during manufacturing.
- 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.
- 'Single Brand' product-retail trading would cover only products, a non-resident entity, whether owner of the brand or otherwise, for the specific brand, either directly by the brand owner or through a legally tenable agreement executed between the Indian entity undertaking SBRT and the brand owner.

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- In respect of proposals involving foreign investment beyond 51%, sourcing of 30 percent of the value of goods purchased, will be done from India.
- Such an Indian entity is also allowed to sell through e-commerce platform.

Although government allowed foreign investment in single brand retail a few years ago, but most of the foreign brands still operate in India through local franchises and distributors. For example, Genesis Luxury Fashion Pvt. Ltd., a marketing and distribution company of Reliance Group, has brought several global iconic brands such as Bottega Veneta, Giorgio Armani, Hugo Boss, Emporio Armani, Jimmy Choo, Paul Smith, Tumi, Burberry, etc. in India.

Due to restrictions and various conditions for retail trading under FDI policy, foreign companies were finding it more convenient to enter India through franchise route. Under a franchise or distribution agreement, a global retailer partners with an Indian company. Indian company pays a fee to the brand owner and invests in marketing and launching the brand in India. It was not uncommon that the brand owner would invest in the Indian retailer to expand it's brand footprint into Indian retail sector rather than expecting to receive brand fees or royalty. In the recent past Gap Inc., Aeropostale Inc. and Ipanema, are some of the companies who have entered India through franchise agreements.

Post January 2018, Indian entities of global retailers having FDI of more than 51% have been exempted from the requirement of local sourcing, for up to three years from commencement of the business if it is undertaking SBRT of products having 'state-of-art' and 'cutting-edge' technology, and where local sourcing is not possible, such as Apple. This requirement of local sourcing was challenging for entities trading in hi-tech products. There are brands which engage in manufacturing and trading of products which are produced from goods not sourced in India due to various factors and constraints. Whether a product will qualify as having 'state-of-art' and 'cutting-edge' technology, will be examined by a Committee formed by the government in this regard.

Further, there is no explanation of what constitutes 'state-of-art' and 'cutting edge', which creates ambiguity. The relaxation given is only for a period of 3 years, after which the SBRT entity would be required to meet the 30% sourcing norm. All these factors pose challenges for the foreign investor engaged in trading of such products.

Apart from franchise model, a way around the requirement of mandatory sourcing norm is to keep FDI upto 51% and find a local partner to hold the balance 49%. Under this structure the requirement of local sourcing is not applicable to the Indian entity in which FDI is being made by the foreign brand owner.

As far as multi brand retail trading is concerned, FDI is limited to 51%, with prior government approval. No automatic route of FDI is available in case of MBRT. Moreover,

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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. In the past Indian Government has frowned upon creative joint venture models to circumvent majority foreign ownership in MBRT.

There is another significant issue relating to retail trading which needs clarification - whether 'sub-brands' constitute a single brand. For example, Marks & Spencer ('M&S') sell goods under sub-brands such as M&S Women, Autograph etc. under the M&S Parent brand. So, it becomes important form the perspective of restrictions under FDI Policy whether these sub-brands can be treated as a single brand or will fall under MBRT.

To conclude, there are certain key areas such as sourcing norms in case of hi-tech products retailers, as well as the question of sub-brands, which need to be addressed. Till then foreign brands would prefer the franchise or distribution route to sell their products in India.