



Intra Legem

March 31, 2016

FDI IN TRADING Revolution from Trading to E-Commerce

Evolution in Trading – A journey of Ancient India to Digital India

Since the times of the Indus Valley Civilisation, ancient India has been a trader's paradise. Due to its extensive maritime network, India was considered one of the largest exporters of goods including textile, spices, handicrafts, art, hardwood, furniture, in lay work being exported to different parts of the world. Thereafter, due to various extraneous factors and forces, India fell into a vicious trap of poverty, unemployment, rising inflation, export-import deficit and indebtedness. However, economic liberalization reforms introduced by the New Industrial Policy 1991 ("**Industrial Policy**") rescued India from a number of challenges faced by it

then. With the advent of the Industrial Policy, the closed Indian economy opened its arms to welcome Foreign Direct Investment ("**FDI**") which acted like a catalyst in the growth and development in various sectors in India including the trading sector.

FDI in Trading - A boon for Indian MSMEs

Micro, small and medium enterprises ("**MSMEs**") are widely regarded as the cornerstones of the Indian economy contributing significantly to the industrial, economic, technological and regional development. MSMEs have grown at a



consistent pace of 4.5% in the last five years¹.



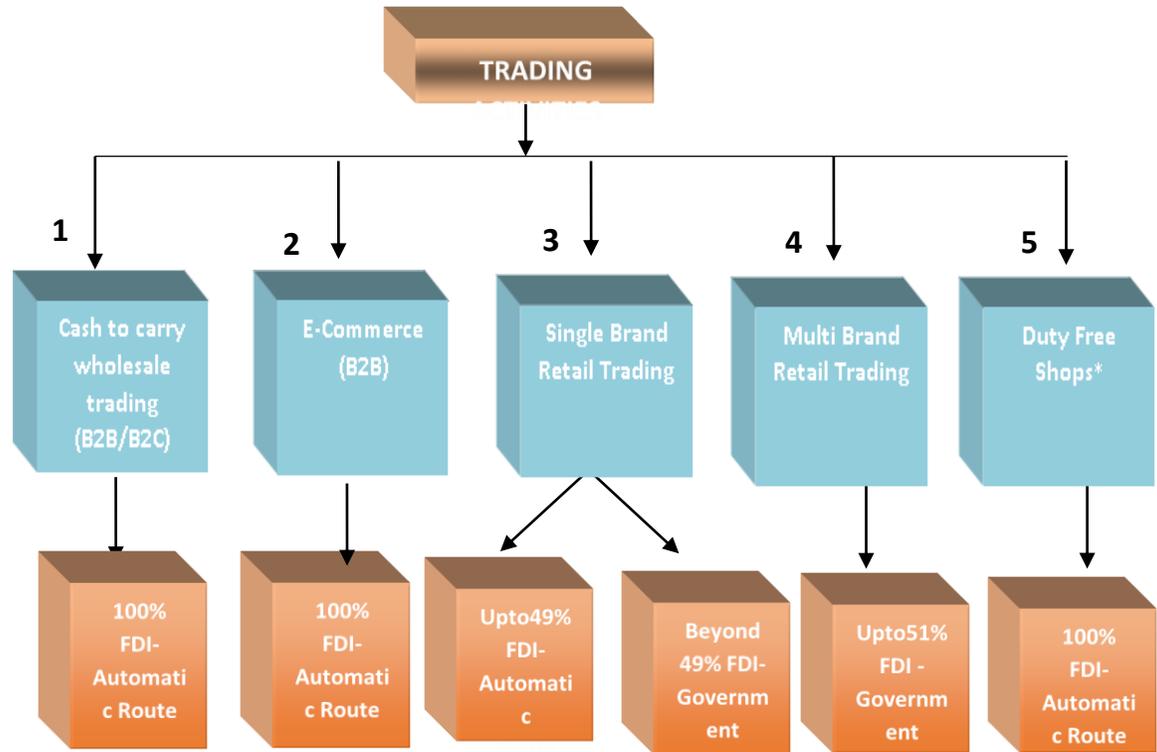
investment in plant and machinery not exceeding US \$ 2.00 million, ("**Sourcing Requirement**"). Thus, while certain single/multi brand retail traders may find it onerous to comply with the Sourcing Requirement, this condition not only enables MSMEs to scale-up production and operations, generate employment, but also provide increasing opportunities at an international level, access to state-of-the-art technologies, leading to the manifestation of global managerial practices and opportunities for integration into global markets for the MSMEs.

Permissible Trading activities for FDI – An Overview

The sectoral caps of the permissible trading activities as set out under the Existing FDI Policy read with the ²Press Note 12 of 2015 ("**Press Note 12**") are graphically represented below:

1. Annual Report for the year 2014-15 issued by the Ministry of Micro, Small and Medium Enterprises, Government of India.
2. Press Note 12 of 2015 dated November 24, 2015 issued by DIPP

The latest Foreign Direct Investment Policy ("**Existing FDI Policy**") effective from May 12, 2015 requires single/multi brand retail traders to source at least 30% of the value of the goods (i) in case single brand retail trading, from India, preferably through MSMEs, village and cottage industries, artisans and craftsman, and (ii) in case of multi brand retail trading, from Indian MSMEs, which have a total



Addressing the concerns of the stakeholders and in order to encourage foreign investments in India to further complement the "Make in India", "Start-up India" and "Skill India" campaigns envisioned by Prime Minister Narendra Modi, the Department of Industrial Policy and Promotion has, by way of Press Note 12 of 2015 dated November 24, 2015, introduced various reforms and relaxations to further liberalise different sectors covered under the Existing FDI Policy including the trading sector. The salient amendments introduced by Press Note 12 in the trading sector are set out below:

Activity	Details
Wholesale Trading	Wholesale traders have now been permitted to open retail shops for sale to the consumers directly. Such retail trading is subject to the conditionalities prescribed for Single Brand Retail.



Activity	Details
Single Brand Retail	<ul style="list-style-type: none"> ➤ In case of proposals involving more than 51% FDI in Single Brand Retail, single brand retailers are now required to comply with the Sourcing Requirements only for the first store in lieu of an average of the first five years as was earlier reckoned under the Existing FDI Policy; ➤ Single band retailers who have been granted permission to undertake Single Brand Retail will now be permitted to undertake e-commerce activities.
Duty Free Shops	100% FDI is now permitted under the automatic route in Duty Free Shops located and operated in the Customs bonded areas subject to the conditionalities prescribed by Press Note 12.

The Government of India has recently, as a part of the Budget 2016, announced its proposal to permit 100% FDI under the approval route in marketing of food products produced and manufactured in India, subject to certain conditionalities. However, considering that this reform is still at a proposal stage, it is yet to be notified by DIPP by way of a formal press note.

The Marketplace concept

Online marketplace is a technology platform concept where multiple sellers and buyers are hosted for the purpose of buying and selling goods and services. Considering that India has an internet user-base of about 375 million (*read 30% of population*) as of Q2 of 2015³ and is the second largest user-base in world (*after China*), the online marketplace industry has been growing at an unprecedented rate with around 6 million new entrants being every month⁴.

3. Reported by Economic Times on September 03, 2015

4. Reported by Times of India on November 20, 2014



While the Existing FDI Policy permits 100% FDI under automatic route in companies engaged in the business to business (B2B) e-commerce, it does not permit FDI in e-commerce companies engaged in retail trading. On account of this restriction in the Existing FDI Policy, companies including Flipkart, Snapdeal, Amazon, Shopclues and Paytm are currently operating on a market place model wherein such e-commerce companies do not by itself engage in retail trading but only provide an online platform for the actual buyers and sellers thus facilitating retail trading activity. However, the Retailers Association of India and the All India Footwear Manufacturers and Retailers Association have filed

separate petitions in the Delhi High Court alleging violations of the Existing FDI Policy by e-commerce companies, contending that while FDI is not permitted in e-commerce companies engaged in business to consumers (B2C), e-commerce companies have been undertaking retail trading activities⁵. The Delhi High Court has ordered the Enforcement Directorate to investigate on whether or not such e-commerce companies, including Snapdeal, Jabong, Myntra and Amazon-owned Junglee have violated the Existing FDI Policy.

The DIPP has, on March 29, 2016 by way of Press Note 3 of 2016⁶, released its Guidelines on FDI in the e-commerce sector ("**Press Note 3**")⁷. 100% FDI is permitted under the automatic route in a market place model of e-commerce, however FDI is not permitted in an investor based model of e-commerce. The Press Note 3 has also defined the terms "e-commerce", "inventory based model of e-commerce" and "marketplace model of e-commerce" wherein a reference has been made to an "e-commerce entity" which conducts either of

5. Reported by Economic Times on January 6, 2015
6. Press Note 3 of 2016 dated March 29, 2016 issued by DIPP
7. The salient features of these Guidelines have been discussed in the March 30, 2016 edition of our "De Jure"



these activities. The term "e-commerce entity" has been defined under the Press Note 3 to mean either a company incorporated in India or a foreign company covered under Section 2(42) of the Companies Act, 2013 or an office or branch or agency in India owned or controlled by a person resident outside India and conduction e-commerce business. As such by virtue of this definition, a foreign company or a foreign office or agency or branch have also been recognized as entities which can undertake e-commerce activities.

The Press Note 3 has laid down conditionalities for the 100% FDI in a "marketplace model of e-commerce". These include conditions relating to cap on sales on the marketplace by a single vendor/its group companies, prohibition on the e-commerce entity to own the goods sold on the marketplace, prohibition on the e-commerce entities to directly or indirectly influence prices of products being sold etc.

Our Views

The growth and development of e-commerce companies, better accessibility of the 3G and 4G internet network, the need to have better standard of living, availability of wider range of products on the online platforms, busy lifestyle of

the middle class, increased disposable income coupled with a rise in consumerism, are some of the major driving forces which have given impetus to the consumer technology in India and have revolutionized the concept marketplace from traditional "bazaars" to "online platforms".

The Press Note 3 has provided the much-needed and awaited clarifications on the e-commerce model and entities permitted to undertake e-commerce activity. This should hopefully assist in providing a boost to the "Start-up India" and "Digital India" campaigns. At the same time introduction of conditions for FDI in the market place model should not only go a long way in rationalizing the manner in which marketplaces (operations of which have been largely unregulated) function especially where pricing of products is concerned and also allay to some extent, concerns which retailers have had on this model.

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