Rajani Associates

De Jure

October 17, 2012

Update on FDI in Multi Brand Retail in India

Press Note No. 5 (2012 Series) issued by the Department of Industrial Policy and Promotion reviewing the policy in Multi Brand Retail

Government of India allows 51% FDI in 'Multi Brand Retail'

"51% FDI allowed in multi brand retail"

The Indian Government has recently permitted Foreign Direct Investment ("**FDI**") up to 51% in multi-brand retail under the Government route vide Press Note No. 5 (2012 Series) ("**Press Note 5 of 2012**") issued by the Reserve Bank of India ("**RBI**") dated September 20, 2012 subject to fulfilment of specified conditions.

Until now, FDI in retail trading was prohibited, except for FDI in single-brand product retail trading which could be undertaken through the Government route up to 100%.

This initiative of the Indian Government has been welcomed by foreign multinational players such as Walmart and Carrefour who have been eagerly awaiting the liberalisation of the FDI Policy to set up operations in India.

While many believe that this recent decision of allowing FDI in multi-brand retail will prove beneficial to the Indian economy and the consumers at large, this move has also attracted severe opposition from Indian local traders and State Governments who are of the strong view that the entry of foreign players in the Indian retail sector will jeopardize the Indian economy and the business of local traders in India who will not be able to compete with the multinational players.

An Overview – View of the Supporters and Opposition for FDI in multi-brand retail

Issue	View of supporters	View of opposition
Requirement of mandatory sourcing of a minimum of 30% from Indian micro and small industry.	Supporters believe that this mandatory procurement condition will help create local employment opportunities within the manufacturing and agricultural sector and also generate income to local manufacturers and farmers. Further, the Indian manufacturing and agricultural sector will also benefit from the training and know-how acquired from the foreign multinationals.	However, the opposition foresees that the implementation of this condition could prove to be a major challenge in the long run owing to a number of factors such as, amongst other things, an ambiguous policy, time and costs involved in imparting training to locals to enable them to supply their requirements, unavailability of certain products in India, low production capacities of small industries and standard of the products due to the outdated technologies.

If you would like to know more about the subject covered in this publication or our services, please do contact us. To email, please contact poorvi@rajaniassociates.net.

Issue	View of supporters	View of opposition
	Furthermore, the condition that these large multinational retailers source goods directly from the farmers/ small scale entrepreneurs will also eliminate the requirement of middlemen thereby ensuring that the farmers/ small scale entrepreneurs get better prices.	The opposition, however, argue that the procurement of goods directly from the farmers/ small scale entrepreneurs by multinational retailers may not necessarily ensure that the farmers/ small scale entrepreneurs getting better prices due to unequal bargaining power of the multinationals. Furthermore, elimination of middlemen in the supply process will lead to loss of current employment opportunities in this sector.
Requirement of minimum investment of $100 million with at least half the amount to be invested in back-end infrastructure, including cold chains, refrigeration, transportation, packing, sorting and processing.	Supporters contend that improved back-end infrastructure, storage and handling will considerably increase shelf life of perishable food items post harvesting thereby minimising wastages and reducing losses.	The opposition, however, contends that the development of back-end infrastructure can also be achieved by initiatives undertaken by the Government and that this may not be the most efficacious solution. Further, the policy does not mention whether such investment in back-end infrastructure is required to be made in only such States/ Union Territories, which have specifically consented to the implementation of the multi-brand retail policy or can also be in the States/ Union Territories which have not consented to the policy.
Foreign multinational players in the retail sector will resort to anti-competitive practices and predatory pricing	Supporters believe that the requirement of proposals for FDI in multi-brand retail being cleared only under the Governmental route and the legal framework of the Competition Act is sufficient machinery to prevent and curb anti-competitive practices and predatory pricing by the foreign multinational players in the retail sector.	The opposition is of the view that due to economies of scale, operational efficiency increased capital and other advantages, foreign multinational giants will create monopoly/ oligopoly in the Indian retail sector by offering products at reduced prices which cannot be matched by the local retailers.

Issue	View of supporters	View of opposition
Detrimental effect on business of local retailers	Supporters disregard the theory that the entry of multinationals in the retail sector will pose a threat to the business of local retailers since they believe that local retailers enjoy the advantage of strategic location, which may be difficult to match by large retailers as they will have to invest exorbitant sums of money to acquire mammoth land or rent retail space in prime locations. That apart, local retailers offer convenience based facilities such as home delivery and personalised services to regular customers, which will help retain customers in the long run.	The opposition believes that the entry of multinationals in the retail sector will have a detrimental effect on the business of the small and medium sized retailers in the unorganized retail sector as they will not be able to keep pace with the multinational players in the organized retail sector due to cost and other advantages.
Effect of growth of organised retail sectors on employment opportunities	Supporters advocate that the growth of the organised retail sector will help create employment opportunities in the back-end and front-end operations of the retail sector.	However, the opposition is of the view that the growth of the organized retail sector will create imbalance in the skilled and unskilled employment sectors as it will largely recruit skilled and semi-skilled labour.
Consumers to benefit from the entry of foreign giants in the multi-brand retail sector	Increase in competition in the retail sector will also provide a twofold advantage to consumers' inasmuch that consumers would have a plethora of product options to choose from under a single roof and retailers will resort to competitive pricing and constant innovation of products and offers to increase sales.	The opposition strongly contends that supply of essential commodities should not be controlled by foreign players as they may resort to monopolistic practices.
General effect of growth and development of the organised retail sector	Supporters of the multi-brand retail policy advocate that the entry of foreign retail giants in India will not only lead to modernisation of practices but also result in an increase in the productivity and supply chain and distribution efficiency which will, in turn, help keep prices in check.	On the other hand, the opposition is of the view that the businesses of the small local and mid-sized retailers will be adversely impacted by the growth of organised retail in India.

New requirement “*Minimum investment of UD$100 million of which 50% shall be in back-end infrastructure*”

Conditions of Policy

The said Press Note no. 5 of 2012 lays down a number of conditions subject to which FDI in multi-brand retail is permitted. A few of the noteworthy conditions are discussed below.

At the outset, since FDI in multi-brand retail has been capped at 51% under the Governmental route, this would essentially mean that the foreign retailer can only set up its operations in India with a local partner.

Furthermore, the policy mandates a minimum investment of US $100 million by the foreign investor, out of which, at least 50% of such investment shall be made in back-end infrastructure such as cold-storage chains and warehouses within a timeframe of 3 years from the date of receipt of first tranche of such investment.

Additionally, it is also mandatory that the foreign retailer sources at least 30% of the value of procurement of manufactured/ processed products from Indian small industries who have a total investment in plant & machinery not exceeding US$ 1.00 million.

Another important condition is with respect to the locations in which the retail sales outlets may be set up. As per the policy, retail sales outlets may be set up only in cities with a population of more than 10 lakh as per 2011 Census within the limits specified therein and in case of States/ Union Territories which do not have cities with population of more than 10 lakh as per 2011 Census, retail sales outlets may be set up in any city, preferably the largest city within the limits specified therein.

Moreover, although companies with FDI are now permitted to undertake multi-brand retail trading in India subject to compliance with the stipulated conditions, they are not permitted to undertake retail trading by means of e-commerce by virtue of an express prohibition under the said Press Note No.5 of 2012.

Lastly, it may also be pertinent to note that since trade and commerce within a State is a State subject under Entry 26 of List - II of the Seventh Schedule of the Constitution of India, the said Press Note No.5 of 2012 is only an enabling policy and the implementation of the policy has been left to the discretion of the State Governments and Union Territories, which can take their independent decisions in regard to implementation of the policy.

This essentially means that notwithstanding the liberalisation of the multi-brand retail FDI policy, States/ Union Territories can exercise discretion whether or not to permit (*with or without any additional conditions*) multi-brand retail outlets to operate within

Ten States/Union Territories have already accorded their consent to permit FDI in Multi Brand Retail

their territory and as such, retail outlets can only be set up in those States/ Union Territories which have consented to the implementation of the policy within their territory. Further, such retail sales outlets will have to be established in compliance with the applicable laws and regulations of the relevant States/ Union Territories.

Until now, the 10 States/ Union Territories which have accorded their consent to permit FDI in multi-brand retail within their territory are Andhra Pradesh, Assam, Delhi, Haryana, Jammu & Kashmir, Maharashtra, Manipur, Rajasthan, Uttarakhand and Daman & Diu and Dadra and Nagar Haveli (Union Territories). Interestingly, all these States/Union Territories are Congress ruled.

Our View

While the opening up of the multi-brand retail sector to foreign retail giants may have its share of disadvantages, the potential advantages that these foreign retailers would bring in terms of investment, modernisation, quality, reduced cost and development of the organised retail sector may prove to be more far reaching. Moreover, this decision of allowing FDI in multi-brand retail also brings a ray of hope for many existing cash-strapped Indian retailers such as Subhiksha who propose to raise FDI for servicing their debt and reviving their dying operations.

However, in the wake of the current political uproar surrounding the liberalisation of FDI in multi-brand retail sector and further owing to an ambiguous policy, foreign retailers are wary to set up operations in India and are adopting a wait and watch approach till such time there is further clarity on the implementation of the policy and its legal position.

Since the overall benefits of the entry of such foreign giants to the retail sector and economy in general cannot be negated, one of the only probable solutions to the much debated issue in the control of the Indian Government is the regulation of the operations of the foreign players in the multi-brand retail sector.

This may be brought about by framing suitable and elaborate conditions to the already existing policy which will ensure that the interests of the local retailers are adequately protected, while at the same time bringing much needed clarity to the foreign multinationals in the interpretation of the somewhat ambiguous conditions under the policy.

For instance, the conditions with respect to location of the foreign multi-brand retail stores can be made more specific so as to ensure that such stores are located in areas which though reasonably accessible to consumers, are not so placed that they eat away into the business of the local retailers.

Similarly, the sourcing and investment conditions can be more clearly defined so as to create a balancing act by addressing both the concerns of the opposition and the challenges faced by the foreign retailers in the implementation of the conditions.

As such, successful implementation of FDI in the multi-brand retail policy will largely depend on the policy reforms made by the Government in this sector and only time will tell whether or not this decision of the Government proves to be a blessing or a curse to the retail sector and the economy in general.

-Karishma Jumani

AREAS OF PRACTICE

| Capital Markets | Private Equity | Mergers and Acquisitions | Corporate Litigation & Arbitration | Projects |
| Real Estate & Trust | Corporate & Commercial | Banking & Finance | Structuring |

CONTACT US

Address: 204-207 Krishna Chambers
59 New Marine Lines
Churchgate Mumbai 400020
Maharashtra, India

Telephone: (+91-22)-40961000

Facsimile: (+91-22)- 40961010

Email: dejure@rajaniassociates.net