India Permits 100 Percent Foreign Investment in E-Commerce Marketplaces (March 2016).pdf

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India Permits 100% Foreign Investment in E-Commerce Marketplaces

In Press Note No. 3 released on March 29, 2016, the Government of India (“GOI”) announced that 100% foreign direct investment (“FDI”) is now permitted in e-commerce “marketplaces” in India, subject to certain stringent caveats.

India’s e-commerce sector is poised for dramatic growth over the next few years (largely driven by exploding Internet and smartphone penetration in India, among other market catalysts such as evolving e-payment systems) and continues to attract significant FDI inflows from global e-commerce companies and private equity firms worldwide. However, prior to the new FDI rules, there was lack of clarity under India’s existing Consolidated FDI Policy Circular 2015 (“FDI Policy”) regarding the permitted FDI in this sector. While the FDI Policy permits up to 100% FDI in India’s business-to-business (B2B) e-commerce but not in India’s business-to-consumer (B2C) e-commerce, certain aspects of the FDI Policy created ambiguity and uncertainty for foreign investors as well as India’s emerging e-commerce players. The new FDI rules bring much-needed clarity regarding the contours of the FDI Policy vis-à-vis India’s e-commerce sector.

The new FDI rules are summarized below:

- **100% FDI permitted in e-commerce marketplace model.** Under the new rules, up to 100% FDI under the automatic route (i.e., without any prior approval from GOI) is permitted only in India’s “marketplace” model of e-commerce, also referred to as the B2B model. According to the new rules, this is a model in which the e-commerce entity provides an information technology or trading platform on “a digital and electronic network” (which include TV, mobile and online channels) to act as a facilitator between the buyer and seller. Such entity does not itself own the inventory or sell directly to consumers. In return for providing the trading platform to sellers, it earns commissions from sellers.

- **No FDI permitted in “inventory” model of e-commerce.** The new rules reiterate the previously existing policy that no FDI is permitted in India’s “inventory” model of e-commerce, also referred to as the B2C model. According to the new rules, this is a model in which the e-commerce entity owns the inventory of goods and services and sells directly to consumers.

  - A foreign single brand entity with permission to sell through brick-and-mortar stores in India (which is allowed via the automatic route for up to 100% FDI) is permitted to engage in retail e-commerce activities and sell products to customers through online channels
  - An Indian manufacturer (investee) with foreign investment that is controlled by an Indian entity is permitted to sell its products to customers through retail e-commerce and online channels provided that it makes 70% of the products in house and sources the remainder from local Indian companies
  - A manufacturer is permitted to sell to customers through retail e-commerce its products manufactured in India

- **E-commerce marketplace must comply with certain new conditions.** The new rules impose a number of onerous conditions on the e-commerce marketplace entity that must be complied with for access to FDI. These conditions are geared towards preserving the true nature of the marketplace model including, among other things,(i) leveling playing field with India’s brick-and-mortar retailers, (ii) providing greater transparency relative to sellers and their
online offerings, (iii) curtailing the monopoly of big online vendors and creating more opportunities for small to medium enterprises to sell goods online, and (iv) curtailing the marketplace entity’s ability to leverage affiliated entities for sales or otherwise influence online pricing/discounting practices that potentially undercut India’s traditional distribution channels. The new conditions are:

1. The entity cannot exercise ownership over inventory, as any such ownership will render it into an “inventory” based model in which no FDI is currently permitted in India.
2. The entity cannot permit more that 25% of total sales made through its marketplace from a single vendor or a group company.
3. The entity can only enter into transactions with sellers registered on its platform on B2B basis.
4. The entity cannot directly or indirectly influence the sale price of goods or services and must “maintain level playing field.”
5. The entity must make sure that any goods and services made available through its marketplace for sale to consumers must clearly provide the name, address and other contact details of the seller.
6. Any after sale support, delivery of goods to consumers and customer satisfaction must be the responsibility of the seller and cannot be assumed by the entity. That said, the entity is free to provide certain support services to sellers as noted below.

- **E-commerce marketplace may provide ancillary services to sellers.** The new rules expand the scope of the “marketplace” model beyond the trading platform by permitting the marketplace entity to provide certain support services to sellers such as warehousing, logistics, order fulfillment, call center, payment collection and other services. The entity may also, at its option, facilitate payments for sale between sellers and customers in conformity with the applicable regulatory guidelines.

**Implications for US Investors**

In recent years, a number of India’s emerging e-commerce companies have leveraged “hybrid” operating models (a mix of marketplace and inventory) to grow and scale operations and attract foreign investment. With the new FDI rules in place, one can expect to see restructuring of these existing e-commerce models to be compliant with the FDI norms and avoid triggering hefty penalties under India’s foreign investment laws.

The new rules undoubtedly present significant opportunities for US e-commerce companies and private equity firms looking to tap India’s thriving e-commerce sector, but challenges still exist. For US investors keen to enter or expand in India’s e-commerce sector, it is vital to fully assess the impact of the new rules and Indian’s changing regulatory framework on their current and planned investments and operating models in India and devise their India entry strategy to fit the changing operating environment so as to avoid pitfalls and be well-positioned to capitalize on emerging opportunities in India’s rapidly growing e-commerce sector.

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