

ClientAlert

India Practice

July 2013

Foreign Investment in Multi-Brand Retail Trading in India: Government issues clarifications

In September 2012, the Government of India (**Gol**) permitted foreign direct investment (**FDI**) up to 51% of the equity of Indian entities engaged in multi-brand retail trading (**MBRT**) in India ([see our earlier alert of October 2012](#)).

In view of the significant political opposition to this decision, FDI in this sector was subject to various conditions. These conditions included (a) obtaining prior Gol approval for all such investments, (b) investing a minimum of US\$100 million in the Indian MBRT entity, with at least 50% of such FDI to be invested in back-end infrastructure within 3 years; (c) the Indian MBRT entity sourcing locally (from small industries) at least 30% of the manufactured/processed products purchased by it; and (d) the Indian MBRT entity engaging in retail trade only in specific states and union territories in India that have approved FDI in MBRT (currently 12 states and union territories out of 35 in India have approved FDI in MBRT) and only in cities and towns having a minimum population of 1 million.

With a view to addressing some of the ambiguities in these conditions, the Gol issued several clarifications on June 7, 2013. Certain key clarifications are summarized below:

- Minimum Local Sourcing:** The manufactured/processed goods sourced by the Indian MBRT entity from small industries to comply with the 30% local sourcing requirement must be distributed only through its front-end retail stores. Other forms of distribution such as exports or domestic wholesale distribution will not satisfy the requirement.

For this purpose, an entity will qualify as a 'small industry' if it is certified as such by the district industries center.

The minimum local sourcing requirement only applies to manufactured and processed products, and does not apply to the procurement of fresh produce.

- Investment in Back-end Infrastructure:** To satisfy the requirement that at least 50% of the FDI must be invested in back-end infrastructure (processing, manufacturing, logistics, supply chains, etc.), such investment must be in greenfield assets (and not by way of acquisition of existing back-end infrastructure assets). FDI in a wholesale trading business or in other infrastructure companies in India will not satisfy this requirement.

Front-end and back-end infrastructure may be held by separate entities and the back-end entity may even be owned 100% by the foreign investor (while the front-end entity would be subject to the 51% FDI cap).



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- **Other Restrictions on Business Activities:** An Indian MBRT entity that has received FDI cannot undertake wholesale trading even though India permits 100% FDI in wholesale trading business, nor can it engage in any form of e-commerce.

Such front-end retail stores must be 'company owned and company operated' and should not be operated pursuant to franchise arrangements. Investments in front-end stores should also be greenfield investments and should not be by way of acquisition of existing stores.

- **State Government Approval:** Individual state governments may add additional conditions within their respective states for the operation of front-end retail stores owned by an Indian MBRT entity that has received FDI. However, even if a state government has not approved FDI in MBRT, investments in back-end infrastructure in such state will be counted towards the minimum investment requirement.

Implications of these Clarifications

These clarifications set out additional, and in some instances more onerous, conditions that foreign investors in the Indian MBRT sector will have to adhere to. A number of these clarifications themselves have many ambiguities and will likely delay the implementation by foreign investors of their investment plans in this sector. Business models may need to be reconsidered in light of these clarifications and investors need to anticipate additional changes in the future that may force further modifications to their business plans.

The Gol is also reconsidering certain conditions relating to the MBRT sector, specifically (a) sourcing restrictions among group companies, (b) the requirement to invest in back-end infrastructure within 3 years, and (c) the requirement of 30% local sourcing from small industries. Clarifications in this regard are awaited.

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