FDI issues for e-commerce companies in India
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India is continually being recognised as a major market globally. While it is important to safeguard the interests of domestic traders and entrepreneurs, it is essential to encourage a market where the customer is king and not one where policies prevent access to superior goods and services at competitive prices. Online shoppers in India are not only growing in number but are also making increasingly sophisticated choices and global players have a lot to offer to meet this demand. Thus, measures should be taken to gradually prepare domestic players for foreign competition while the economy is opened up further.

The e-commerce segment in India, estimated at approximately USD 20 billion now, has grown at a CAGR of 37% from 2009 and is expected to grow ten fold by 2030. The online market space in the country is burgeoning in terms of offerings ranging from travel, hotel reservations, movies and books to the likes of matrimonial services, electronic gadgets, fashion accessories and even groceries. Although there is a horde of goods and services being offered, there are a few that dominate the market far more than the others. Online travel agencies enjoy a whooping 71% share in the sector, with e-retail in tow at a low 16%. While e-commerce is promoting the birth of creative business models like those of BookMyShow and Paytm, it is also giving a boost to traditional trading businesses.

A continuous increase in the internet using population in the country has given a further boost to the e-commerce industry. India stands to have the third largest internet user base in the world, with a total of 352 million users. According to a recent Goldman Sachs report on internet users in India, the country is poised to see more people join the internet over the next few years than any other, with the number expected to cross the one billion mark fuelling the ecommerce market size to an estimated USD 300 billion by 2030.

The e-commerce segment is still at a nascent stage and has immense potential to grow. For this, like any industry, it needs capital and quality-enhancing competition. Foreign direct investment (FDI) is one such source which brings in both.

Indian FDI Policy – The Existing Regime

Foreign direct investment in India is regulated under the Foreign Exchange Management Act, 1999 (FEMA). The Department of Industrial Policy and Promotion (DIPP), Ministry of Commerce and Industry, Government of India makes policy pronouncements on FDI through Press Notes and Press Releases which are notified by the Reserve Bank of India (RBI) as amendments to Foreign Exchange Management (Transfer or Issue of Security by Persons Resident Outside India) Regulations, 2000.

Although e-commerce has not been defined under any statute, it is generally understood as a method of conducting business through electronic means rather than through conventional physical means. This term takes into account not just the act of purchasing goods and/or availing services through an online platform, but also all other activities that are associated with any transaction such as delivery, payment facilitation, supply chain and service management. Paragraph 6.2.16.2 of the Consolidated FDI Policy gives the following understanding of e-commerce for the purpose of FDI:

“E-commerce activities refer to the activity of buying and selling by a company through the e-commerce platform. Such companies would engage only in Business to Business (B2B) e-commerce and not in retail trading, inter-alia implying that existing restrictions on FDI in domestic trading would be applicable to e-commerce as well.”

The policy lays down separate provisions for FDI in e-commerce in the B2B segment and B2C segment:

**B2B e-commerce:** As per Paragraph 6.2.16 of the Consolidated FDI policy, 100% FDI is permitted under the automatic route (i.e., without any prior approval of the government) for wholesale trading businesses, inclusive of B2B e-commerce.

**B2C e-commerce:**

**Trade:** Although retail business has been opened up to foreign investors, with 100% FDI being allowed in single brand retail trading (up to 49% under the automatic route and with prior approval of the government over and above that) and 51% in multi-brand retail trading (with prior approval of the government), these relaxations have
not been extended to the e-retail sector. The policy specifically prohibits any amount of FDI in retail trading by means of e-commerce, limiting the benefits of foreign investment in retail only to brick-and-mortar stores.

**Services:** An understanding of the above provisions makes it safe to say that these restrictions are only specific to trading of goods. The Consolidated FDI Policy does not impose any restrictions separately on foreign investment in businesses providing services through e-commerce platforms, granting online service providers a visible benefit over goods traders. Online service providers like Olacabs and Zomato have been part of some of the biggest investment deals of 2014. Clearly leading the online market (online travel agencies alone account for 71% of the market), online service providers are dominating the new-age lifestyle of the smartphone population. Planning your day has never been easier (or one may say more difficult, since you’re spoilt for choices) – while BookMyShow and Zomato take care of your movie and restaurant needs, Uber gives you the comfortable ride back home. Some of the online services gaining immense popularity include travel and accommodation reservations, banking, financial, payment, matrimony and beauty services, among many others.

While foreign investors eagerly await similar relaxations in e-retail, they have made their mark in the online B2B segment. The various structures through which they operate to participate in the Indian e-commerce market, while complying with the parameters and restrictions of the policy are:

1. **Platform Approach (Marketplace)**
   Under this model, instead of selling its own goods and services, the FDI investee company provides a trading platform for Indian buyers and sellers. It functions purely as an online marketplace whereby sellers can canvass their products to potential customers and secure sales through the Indian company. They are not permitted to own any inventory.

   International e-commerce frontrunners such as Amazon operate in India through this model.

2. **Distinct Company Model**
   Plainly operating in wholesale business, the foreign investor can enter the e-commerce market by setting up a distinct wholesale trading entity. The company can maintain an online B2B platform and own inventory of goods to be sold to “business customers”.

   The policy permits the B2B Trading Company to sell goods to its group companies. However, it poses a further limitation – such wholesale trade with group companies taken together should not exceed 25% of the total turnover of the wholesale venture.

3. **Technology Provider**
   100% FDI via the automatic route is allowed for companies providing IT/IT-enabled services. These companies can provide technical and platform-related assistance to enable the retail entity to go online. This kind of a set-up may be considered by established retail player to venture into e-commerce. An arm's length distance has to be maintained between the associate entities while transacting.

   Although foreign investors have obtained a significant share of the B2B e-commerce segment operating through these structures, there will remain a lot of unexplored potential for them to grow in the Indian economy until the e-retail sector is liberalised, too. Though foreign investors have seen and supported a considerable amount of debate over this issue in recent years, there have been no changes in the policy in their favour yet.

**To Permit or Not To Permit - Ongoing discussions on the FDI Policy for e-commerce**

As stated earlier, the FDI Policy for e-commerce is different with respect to the B2B segment and B2C e-retail segment. Inflow of FDI has without a doubt accelerated the growth of the economy as a whole and, hence, it comes as no surprise that many are campaigning for the acceptance of FDI in the B2C e-retail segment also.

While there is no denying that allowing FDI in the e-retail sector will bring with it increased competition for the domestic industry, it is believed to be an important step. Many associations such as the Confederation of Indian Industry (CII), Federation of Indian Chambers of Commerce and Industry (FICCI) and National Association of Software and Service Companies (NASSCOM) are of the view that 100% FDI should be allowed in B2C e-commerce, saying that retail businesses should not be classified based on channels such as offline stores and
online. Supporting them are certain multinational e-commerce companies. Although the arrival of foreign investors would challenge the dominance of Indian players in the e-retail segment, it would bring along its own benefits to the economy such as:

- Improvements in supply chain, distribution system and warehousing, giving a boost to the infrastructure development in the country.
- Decrease in the need for middlemen, leading to lower transaction costs, reduced overheads and reduced inventory and labour costs.
- Induction of best global business practices, resulting in better work culture, customer service and competitive pricing.

Balancing the debate are a few others who have made strong oppositions to FDI in e-retail. These mainly include some big Indian e-tailers and associations representing small retailers, such as the Confederate of All India Traders (CAIT). Their argument is that the Indian e-commerce industry is still in its nascent stage. Existing domestic players have not yet explored their full potential and they need to be nurtured and given a platform to create their market. If FDI is allowed in the e-retail segment also, it may seriously hamper the growth of the domestic industry. Major concerns include:

- Predatory pricing by large e-tailers who enjoy economies of scale and will have more bargaining power.
- FDI giving way to e-commerce giants may lead to monopolies in the e-commerce, logistics and retail sectors.
- The infrastructure created by major e-commerce players will be captive and the government will not be able to achieve its objective of creating back-end infrastructure.
- Currently, e-tailers in India are selling products much below the actual price of the manufacturer. If FDI in e-retail is allowed, MNCs may resort to large-scale dumping of their cheaper products in India from all over the globe.

Various steps can be taken to ensure that the e-retail sector does not miss out on the benefits of foreign investment, while also safeguarding the interests of domestic players. To begin with, the transition should be done in a phased manner, such as by restricting foreign investment to financial form only. The Indian e-commerce industry has been developed by PEs and VCs eagerly investing in start-ups of first-time entrepreneurs. The year 2014 saw investments to the tune of approximately USD 6 billion. Flipkart alone received investments from PE funds of around USD 1.9 billion. Other players keeping up in the race were Snapdeal (USD 0.9 billion), Olacabs (USD 0.25 billion) and Quikr (USD 0.15 billion) among others. Strategic investment, although discouraged at the moment, can be allowed over a period of 3–4 years in a phased manner, giving enough time for domestic players to establish themselves in the market.

**Conclusion**

Not very different from the e-retail situation was the story of traditional retail trade. The liberalisation of the sector was preceded by a long series of debates wherein many opposed allowing FDI in retail trade. Today, brick-and-mortar stores enjoy 100% FDI under single brand retail trading and 51% FDI under multi-brand retail trading (with necessary government approvals). Foreign competition has only ensured that the consumers receive a better class of products and services from both domestic and foreign companies. Businesses are constantly trying to improve the quality of their offerings to gain that competitive edge in the market. The question we ask now is what is so bad about that? We need to promote a market where the customer is king and not one where policies prevent the inflow of superior goods and services. Yes, it is important to safeguard the interests of our own traders and entrepreneurs. Thus, measures should be taken to slowly prepare domestic players for foreign competition while we open our economy to the global market.

The number of online shoppers in India is only growing and global players have a lot to offer. It only seems fair that we do not deny our consumers the privilege of being spoilt with choices. India is continually being recognised as one of the major markets globally and the world has its eyes on us. The country is gradually coming to a stage where it is rubbing shoulders with global leaders in various sectors. We sincerely hope that e-retail will not hold back.
About us

SKP is a long established and rapidly growing professional services group located in six major cities across India. We specialise in providing sound business and tax guidance and accounting services to international companies that are currently conducting or initiating business in India as well as those expanding overseas. We serve over 1,200 clients including multinationals, companies listed on exchanges, privately held and family-owned businesses from more than 45 countries.

From consulting on entry strategies to implementing business set-up and M&A transactional support, the SKP team assists clients with assurance, domestic and international tax, transfer pricing, corporate services, and finance and accounting outsourcing matters, all under one roof. Our team is dedicated to ensuring clients receive continuity of support, right across the business lifecycle.