

## Decoded Policy on Foreign Direct Investment in e-commerce

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### Introduction

On December

26, 2018, the Department of Industrial Policy and Promotion (“DIPP”) vide Press

Note 2 of 2018[1]

(“Press Note”) provided clarity to Foreign Direct Policy (“FDI”) on e-commerce

sector to the consolidated FDI Policy Circular 2017[2] (“FDI Policy”). The Press

Note has brought in certain significant condition changes to the functioning and availing of FDI benefits by the e-commerce entities[3] to ensure level playing by

all the market players in the e-commerce sectors. Press Note maintains status quo on 100% FDI allowed under the automatic route for e-commerce entities engaged in the marketplace based model[4] and no FDI is permitted in inventory based model[5] of e-commerce.

The Press

Note intends to bring a level playing field for e-commerce entities as well as

the brick and mortar retailers by ensuring that the former do not operate unleashed in the market.

The reviewed

policy vide Press Note is stated to come into effect from February 01, 2019.

Vital Vicissitudes in

the FDI Policy

The Press Note focuses on three vital things namely:

1. Control by the e-commerce entity on the vendors or the products being sold on its platform;
2. Fair and non-discriminatory business dealings on the platform by the e-commerce entities; and
3. Exclusive Sale Arrangements.

We have discussed in detail the changes brought in and their possible impact below:

Ownership or Control over the inventory

The Press Note stated that a marketplace based e-commerce entity will not exercise ownership or control over the inventory of a seller and in doing so it will be considered as an inventory based ecommerce entity thereby prohibition on FDI in such entities. Further, the Press Note has provided clarity on what may constitute ‘a control over the inventory’ which is, if more

than 25% purchases of the considered seller are from the marketplace entity or

its group companies[6].

While the earlier policy only provided for ‘ownership’ test to determine whether an entity was operating as a marketplace model or an inventory model, now there would be an ‘ownership’ and ‘control’ test.

This shall have a significant impact on the e-commerce entity wherein same sellers are listed on their platform along with the platforms of their

group companies. Further, it shall be a practical difficulty for the entities to determine the 25% purchase test.

#### Equity Participation

The Press Note has brought in a new restriction on the sellers from selling their products on platform of such marketplace entity that either itself or its group companies have equity participation in the seller or have control over their inventory. This may bring around a major impact on various e-commerce entities that have adequate number of sellers on their platform that

they have equity participation in due to absence of any similar restrictions earlier. However, there seems to be a lack of clarity on the kind of equity participation being referred to in the Press Note. It is important for DIPPP to

clarify whether a direct participation is restricted or both direct and indirect participation is restricted.

#### Responsibility of Seller

The Press Note continues to impose responsibility on the seller for delivery of goods, customer satisfaction and any warranty/guarantee of goods and services sold by the seller.

#### Level Playing Field

Earlier, the FDI Policy only stated that the marketplace entity will not directly and indirectly influence the sale price of goods or services and shall maintain level playing field. The present Press Note has moved a step forward by bringing in various restrictions in the business arrangements and cashback offers to ensure level playing by all the market players.

The Press Note states that in case of services (including but not being limited to logistics, warehousing, advertisement, marketing etc.) being provided by the e-commerce marketplace entity or other entities in which e-commerce marketplace entity has direct or indirect equity participation or common control to any vendor on the platform, such services shall be provided at an arm's length basis. Such providing of services shall be fair and non-discriminatory in nature which has been very clearly defined to mean that similar terms of providing services shall be made available to other vendors in

similar circumstances. Further, a restriction has been imposed on the group companies of the e-commerce marketplace entity from providing cashback offers to buyers that are not fair and non-discriminatory in nature.

The additional restrictions appear as an appreciated move to ensure the local retailers are in par with their e-commerce counterparts. However, while the wordings may be very generic and loosely worded, one can foresee certain practical problems arising from this insertion, such as, the cashback offers which

is required to be fair and non-discriminatory. However, there seems no restriction on various sellers who may want to independently provide for certain cashbacks through the platform. Further, it would be a practical difficulty for marketplace entity to ensure that all offers from varied sellers

are fair and non-discriminatory in nature.

Another ambiguity in the restriction is with regard to the term 'similar circumstances' when providing services to the vendors, as the term plays an important role in determining whether the terms of providing

services

among the vendors are fair and non-discriminatory in nature or not.

#### Exclusive Sale arrangements

The e-commerce marketplace entity is restricted from mandating any seller to sell any product exclusively on their platform. This seems to have been brought in the light of various exclusive sales taking place on the e-commerce platform thereby depriving other market players a fair chance to be

part of the market. What seems to be unclear is whether the restriction is applicable only on the platform of the marketplace entity or on all platforms operated by the marketplace entity as well as its group companies. Further, as

the wording of the Press Note seems to restrict only positive exclusive sale arrangements and therefore, it could be construed that an arrangement between the entity and the seller restricting their sale on various other platform is not covered under this restriction by the Press Note.

We also observe that the restriction is on the marketplace entity from mandating for exclusive sale and this does not cover situations where the seller voluntarily wants to enter into an exclusive sale arrangement.

#### Auditors Report

The Press Note imposes an obligation on the e-commerce marketplace entity to furnish a certificate along with a report of statutory auditor to Reserve Bank of India confirming the compliance of the guidelines as enumerated

in the Press Note by September 30 of every year for the preceding financial year.

#### Clarification from DIPP

DIPP on January 03, 2018 provided 'Response to comments reported in the media on Press Note 2 (2018)' <sup>7</sup>, wherein DIPP stated that various concerns have been raised that Press Note prohibits sale of private label products through marketplace. However, it was clarified that the Press Note does not impose any restriction on the nature of products which can be sold on

the marketplace.

#### Conclusion

The Press Note has brought in various restrictions on the marketplace entity with the intention of ensuring that marketplace entities do not either directly or indirectly operate as an inventory-based model which is currently proscribed by FDI norms. While the restrictions may be interesting in nature, the same may get practically difficult to be in compliance with. Further, the clarification by DIPP has added more confusion than clarification to whether the sale of private labels by the marketplace entities is permitted under the Press Note or not. Therefore, additional clarification from DIPP is still awaited in January to ensure clarity before the Press Note is brought into force.

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[1] <http://pib.nic.in/newsite/PrintRelease.aspx?relid=186804>

[2]

[https://dipp.gov.in/sites/default/files/CFPC\\_2017\\_FINAL\\_RELEASED\\_28.8.17.pdf](https://dipp.gov.in/sites/default/files/CFPC_2017_FINAL_RELEASED_28.8.17.pdf)

[3] As

per Para 5.2.15.2.2 of the FDI Policy, e-commerce is defined as "*buying and selling of goods and services*

*including digital products over digital and electronic network" and e-commerce entity is defined as "a company incorporated under the Companies Act, 1956 or the companies Act 2013 or a foreign company covered under section 2 (42) of the Companies Act, 2013 or an office, branch or agency in India as provided in section 2 (v) (iii) of FEMA 1999, owned or controlled by a person resident outside India and conducting the e-commerce business".*

[4]

The FDI Policy defines the marketplace based model of e-commerce as *"providing of an information technology platform by an e-commerce entity on a digital & electronic network to act as a facilitator between buyer and seller".*

[5]

The FDI Policy defines the inventory based model of e-commerce as *"an e-commerce activity where inventory of goods and services is owned by e-commerce entity and is sold to the consumers directly".*

[6] Group companies means two or more enterprises which, directly or indirectly, are in a position to: (i) exercise twenty six percent or more of voting rights in other enterprise, or (ii) appoint more than fifty percent of members of board of directors in the other enterprise

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