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After years of deliberations, the (Indian) Union Cabinet has on November 24, 2011 resolved to permit foreign direct investment ("FDI") in multi-brand retail sector in India. The Cabinet has also simultaneously relaxed the FDI limit for single-brand ventures from 51% to 100%.

Following the relaxation, the Parliament of India has witnessed objections by some of the political parties opposing the move. While the relaxation does not need approval of the Parliament, and can be made effective immediately, the Government may wish to take a short breather before formally notifying the policy. The details of policy relaxation discussed below are based on media reports, in absence of any formal notification by the Government in this regard till the time of release of this newsletter.

The recent policy relaxation follows the draft proposal circulated in this regard by the Department of Industrial Policy and Promotion, Ministry of Industry and Commerce, Government of India ("DIPP") seeking inter-ministerial views on the issue. The draft proposal was prepared in view of the feedback received by DIPP to its discussion paper on this subject introduced in 2010. The feedback demonstrated a clear division of views and interests, both in favour of and against permissibility of FDI in multi-brand retail.

The Government consequently adopted a cautious approach and decided to relax the policy in a gradual manner balancing mutually conflicting standpoints. In light of this background, it is not surprising that the permission for FDI in multi-brand retail has come with a number of riders, some of which are:

- FDI in multi-brand ventures can only go up to 51%, with the remaining equity participation from an Indian partner;
- FDI in each venture to be at least USD 100 million;
- At least 50% of the equity investment to be utilized in back-end infrastructure which includes cold chains and warehousing, and does not include investment in land, rentals, stores, etc.;
- At least 30% of manufactured and processed products shall be sourced from small scale units;
- Multi-brand retail stores can operate only in towns with population of 1 million or more; and
- State Governments to have a final say in permitting operations of multi-brand outlets in their respective States.

While relaxing the policy, the Government has protected its first right to procure farm products.

Critical Issues:

Although more regulatory clarity on the recent relaxations and riders is expected within the next few days, the above stated conditions give rise to the following preliminary concerns:

- Whether the minimum investment threshold is too high? It may not deter the leading multi-brand players of the world, but closes the doors for a number of small players at least for now. Whether the Government has indirectly given an autonomy to giant retailers, and removed all competition that they could have had from smaller but segment specific multi-brand retailers?;

- Admittedly, the fear against multi-brand retailing was that the giant retailers can crush the mom and pop stores across India by more efficient and captive supply chain and price management. The policy relaxation however permits these very retailers to enter India, who have been feared the most in the preceding debate;

- The policy relaxation seems to be focused on fast moving consumer goods and food products. The conditions of deploying 50% of the investment in back end infrastructure and of sourcing 30% of manufactured and processed products from small scale units may make FDI impossible in many multi-brand businesses that buy finished high quality products from manufacturers (such as car and bike distributorships, multi-brand luxury boutiques, etc.); and

- Whether by giving decision making power to the State Governments, seeds of long term complications and adverse effects have been sown in the policy. The FDI policy has been uniform for India, and conceptualized by the Central Government. The authority of State Governments can have various repercussions such as (i) demand by the State Governments of decision making power in other sectors as well, (ii) defeat of the concept of inclusive and well spread growth of all the States as the socio-political circumstances of many States may be against liberalization and investments, and (iii) uncertainty for the investors as they can never be sure of the rules and considerations for permission of operations in any State, and whether the permission can be withdrawn with change of the ruling party in the State. Whether approval of the State Government will be general (i.e. for all retailers) or specific (i.e. for each retailer on a case to case basis) also needs to be seen.

Reportedly, the Cabinet has, while permitting 100% FDI in single-brand retail, reiterated that the foreign investor shall be the brand name owner. This move has effectively closed opportunities for private equity and venture capital funds to invest in single-band ventures.

While some of the above issues may be addressed with time, we can expect the businesses to identify newer issues once the policy is notified and thereafter with experience. The policy has met the short term objectives of “making a start from somewhere” and of initiative to arrest inflation, but its benefits would only be significant if it is relaxed with time in a premeditated manner.