



## FDI IN MARKETPLACE BASED E-COMMERCE

December 2018

The Department of Industrial Policy and Promotion (“**DIPP**”) has amended the consolidated FDI Policy through Press Note 2 dated December 26, 2018 (“**PN 2**”). This amendment will come into force from February 01, 2019 and impacts all marketplace based e-commerce entities that are operating in India. The offline brick and mortar retailers had been long lobbying for a level-playing field with the large e-commerce players and it appears that PN 2 is a direct consequence of this.

The key amendments carried out are:

**1. Cap on vendor purchases:** PN 2 states that inventory of any vendor would be deemed to be controlled by an e-commerce marketplace if more than 25% of purchases of such vendor are from the marketplace entity or its group companies. It further states that if the marketplace has control over the inventory of any vendor, it will render the business into an inventory based e-commerce model which, as per the FDI Policy, cannot have any FDI. Prior to PN 2 and as the FDI Policy stands till February 01, 2019, a marketplace entity is restricted from selling more than 25% of the sales value in a financial year through a single vendor or its group companies.

A simple reading of the amendment raises some critical questions/thoughts, namely:

- PN 2 makes reference to 25% of purchases of the seller. Is this by quantity or value and will its computation be done on a financial year basis? As mentioned above, the current FDI policy links the 25% threshold with the sales value in a financial year.
- PN 2 is no longer concerned with the total sales of the marketplace but with total purchases of the seller. The presumption is that if a seller purchases more than 25% of its total purchase from the marketplace or any of its group companies, the marketplace would be deemed to control the inventory. In other words, the onus of compliance is on the seller (*which may or may not have any FDI and, in fact, may be an LLP, partnership or proprietorship*) but the consequence of non-compliance would be on the marketplace. Non-compliance could result in a liability of up to 3 times the amount involved. Further, compliance with PN 2 presupposes that each seller will accurately disclose its total purchases to the marketplace for the latter to compute the 25%. Practically, this will be challenging since the seller may not be selling online but offline as well.
- While the underlying rationale is to deter marketplaces from setting up separate entities to route products back on their platform, there are *bonafide* sellers that undertake B2B purchases from the marketplace to eventually sell online on multiple unrelated platforms as well as through offline stores. Such *bonafide* sellers are likely to suffer the most as they will have to start looking at alternate sources

of purchasing inventory which will eventually increase the cost of goods sold. Further, private labels set up by sellers that have been procuring their entire inventory from the marketplace will have to re-think ways for the label to survive. In essence, PN 2 has, de facto, put restrictive terms and conditions on FDI in B2B trade.

**2. Prohibition on sale by related entities:** PN 2 also states that if an e-commerce marketplace entity or its group companies have “equity participation” in another entity or control the inventory of such entity, such entity would not be permitted to sell its products on the marketplace. This blanket ban is likely to upset companies like Amazon and Flipkart the most since they have, either directly or indirectly, set up joint ventures that undertake retail sale on their platform.

Let us take Amazon as an example. In order to better manage inventory, supply chain and sale, Amazon, through its group companies, set up multiple joint ventures in India. These joint ventures are some of the largest sellers on Amazon’s marketplace and contribute almost all of its total sales on it. With effect from February 01, 2019, these joint ventures will not be able to sell on Amazon’s marketplace platform. What is likely to be Amazon’s recourse? Here are some thoughts:

- Amazon, through its group companies, may be looking to explore possibilities of giving working capital loans to some of its key sellers in order to fund their inventory and share analytics from its marketplace so that the inventory can be efficiently managed and utilized. Of course, Amazon may want these sellers to sell only on Amazon’s marketplace but PN 2 also prohibits exclusivity (*discussed below*). In fact, it may not be surprising if companies like Amazon and Flipkart open their own non-banking financial institutions to ensure liquidity amongst their key sellers.
- The terms of B2B supply contracts executed by Amazon and its group companies will have to be carefully evaluated since any restrictive covenants imposed on sellers, due to the restrictions set by PN 2, may also trigger competition law. None of these agreements can limit markets for sellers or force them to sell on the marketplace at pre-agreed prices.
- Further, the expression “equity participation” is vague. DIPP will have to clarify whether such “equity participation” includes both, direct and indirect participation. For instance, if the marketplace holds a minority stake in a seller entity which is controlled by the Indian partner, will a subsidiary of this seller entity qualify within the scope of “equity participation” if it decides to sell on the marketplace?

**3. Prohibition on exclusivity:** PN 2 states that an e-commerce marketplace entity will not mandate any seller to sell any product exclusively on its platform. This could have a direct bearing on exclusive deals that are often promoted on e-commerce platforms. For example, One Plus mobile phones have always been exclusively sold on Amazon. Going forward, marketplaces will have to re-assess such partnerships. Notwithstanding this, the language in PN 2 is ambiguous and could be interpreted differently as well.

- As per the language in PN 2, the onus is on the marketplace not to “mandate” any seller to sell exclusively on its platform. However, what happens if it is the seller (say, One Plus) who wants to exclusively sell? Parties may contractually agree that the exclusivity mandate stems from the seller and not from the marketplace.

**4. Fair and non-discriminatory services:** PN 2 envisages that an e-commerce marketplace must provide support services such as logistics, warehousing, advertisement/marketing, payment collection, etc to all sellers on “fair” and “non-discriminatory” terms. Cash back provided by group companies also has to be “fair” and “non-discriminatory”. It further states that if the aforementioned services are not made available to other vendors in “similar circumstances”, the services would be deemed unfair and discriminatory.

- Expressions such as “fair”, “non-discriminatory” and “similar circumstances” bring with them enough subjectivity, allowing companies to adopt creative interpretations. For instance, what may be construed as “fair” for a certain category of products or for a seller doing high volumes may not necessarily be “fair” for another unrelated category or for a seller doing low volumes. Further, it will be difficult to ascertain if two product categories or sellers operate in “similar circumstances”. We will have to wait and watch if the DIPP will clarify this ambiguity in the future.

**5. Enforcement mechanism:** Brick and mortar players have constantly been critical of the lack of enforcement measures taken by the government against large e-tailers to ensure compliance with the FDI policy. For instance, regulators were often accused of poor enforcement of the rule which restricted the marketplace from selling more than 25% of its total sale value from a single seller. With PN 2, marketplace entities will have to furnish to the RBI a certificate along with a report from their statutory auditor confirming compliance with the FDI Policy. This report will have to be submitted by September 30<sup>th</sup> every year. Any non-compliance will not only expose the marketplace to liabilities but will also hold the auditors accountable.

To conclude, PN 2 has clearly brought joy to offline retailers but created an uncertain environment for e-commerce companies. While it is unclear whether DIPP engaged in any consultation with the stakeholders before notifying the amendments, it will certainly have to answer and clarify a lot of questions as 2019 sets in. After all, the timing of PN 2 is also curious with less than 6 months before India’s next (big) general elections!

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