Wed, Mar 30 2016. 09 55 AM IST

Govt defines e-commerce marketplace rules, allows 100% FDI

DIPP has also come out with the definition of e-commerce, inventory-based model and marketplace model

The government notification on e-commerce models is expected to redefine the way online retail is done in India. Photo: iStockphoto

New Delhi: The government on Tuesday allowed 100% foreign direct investment (FDI) in online retail of goods and services under the so-called "marketplace model" through the automatic route, seeking to legitimize existing businesses of e-commerce companies operating in India.

It also notified new rules which could potentially end the discount wars, much to the disappointment of consumers. This is because the rules now prohibit marketplaces from offering discounts and capping total sales originating from a group company or one vendor at 25%.

This could, however, level the playing field with offline stores, which have witnessed a slump in footfalls corresponding to the increase in e-commerce.

So far, India has allowed 100% foreign investment in business-to-business (B2B) e-commerce but none in retail e-commerce—i.e., business-to-consumer, or B2C.

Even so, Indian e-commerce companies such as Flipkart and Snapdeal have been following the marketplace model—which was not defined—and attracting large foreign investments. Marketplaces essentially act as a platform connecting sellers and buyers.

This has led to allegations from time to time by brick-and-mortar stores that Indian e-commerce companies were flouting existing policy norms to gain an unfair advantage, given that the government does not allow FDI in multi-brand retail companies.

It led to a legal challenge in the Delhi high court, even as the model came under the scrutiny of the authorities such as the Enforcement Directorate.

The government, conscious that the sector has seen a big inflow of FDI, has opted for caution.

"An explicit position from the government on where it stood with reference to e-commerce has been long overdue. In that sense, it is good that some clarity has been provided," said Vivek Gupta, partner, BMR Advisors, pointing out that close to $10 billion in funding has been committed to the sector.

"The government had very little elbow room to really state a policy position. And hence, it has chosen to bless the marketplace model with some safeguards that the marketplace should not act like the retailer," he added.

According to the press note issued by the department of industrial policy and promotion (DIPP), a marketplace model is an information technology platform run by an e-commerce entity on a digital and electronic network to act as a facilitator between buyer and seller.

However, DIPP has prohibited FDI in e-commerce companies that own inventories of goods and services and sell directly to consumers using online platforms.

The marketplace e-commerce companies will be allowed to provide support services to sellers on their platform such as warehousing, logistics, order fulfilment, call centre and payment collection.

The new policy also mandates such e-commerce companies to display contact details of the sellers online. The warranty/guarantee of products or services sold online will also be borne by the sellers, not the e-commerce company.

Amazon funds discounts by sellers indirectly through a route it calls “promotional funding”. This it how it works: Amazon recommends the amount of discounts to its sellers on products, but doesn’t force them to adopt these prices. Sellers, however, go along as Amazon finances the discounts.

Flipkart’s largest seller WS Retail Services Pvt. Ltd easily generates more than 25% of the company’s sales while Cloudtail India Pvt. Ltd, the biggest seller on Amazon India, contributes even more.

Flipkart has been gradually reducing WS Retail’s business over the past 15 months as it shifts to a marketplace model. Following the new regulations, Flipkart may have to accelerate its transition.

Cloudtail India, a joint venture between Amazon.com Inc. and N.R. Narayana Murthy’s Catamaran Ventures, is now the key growth driver for Amazon India, generating at least 40% of the company’s sales in some months, Mint reported on 29 October. Cloudtail is particularly dominant in electronics and fashion sales, two of the three largest categories for Amazon India (run by Amazon Seller Services Pvt. Ltd). The new regulations mean Amazon India may have to find new sellers on its platform.

“While a seller may sell goods at a discount, marketplaces have now been prohibited from funding discounts through bonus schemes, marketing cost reimbursement, etc. Accordingly, there is a strong possibility that prices of products online will revert to levels that are comparable with offline prices. This could make online marketplaces less attractive to shoppers and investors,” said Stephen Mathias, partner, Kochhar and Co., a law firm.

Rajnish Wahi, senior vice-president, corporate affairs and communication, Snapdeal, said the guidelines recognize the transformative role that e-commerce marketplaces will play in the Indian market.

“True marketplaces like Snapdeal have democratized commerce, providing millions of businesses a platform to sell beyond their geographic boundaries. It is a comprehensive announcement which will pave the way for accelerated growth of the sector in India,” he said.

Flipkart and Amazon didn’t immediately respond to emails seeking comment.

The share of e-commerce in retail is expected to jump from 2% in 2014 to 11% in 2019, while the share of physical, organized or modern retail is expected to shrink from 17% to 13%, according to a report by property consultant Knight Frank India Pvt. Ltd and the Retailers Association of India (RAI).

Interestingly, the e-commerce regulations come at a time when the finance ministry is finding ways to tax e-commerce activities such as downloading of songs, movies and books, online consumption of news, software downloads and online sale of goods and services.

The government in the budget allowed 100% FDI in marketing of food products produced and manufactured in India. In November last year, the government also allowed a manufacturer to sell its products manufactured in India through retail e-commerce.

Two retail associations representing brick-and-mortar retailers, the RAI and the All India Footwear Manufacturers and Retailers Association, have approached the Delhi high court arguing that online retail companies have gained an undue advantage by being allowing access to FDI through which they are able to provide deep discounts that traditional retailers cannot match.

They also argued that the present retail policy of the government does not allow such e-commerce companies to directly sell to customers, but that, in the garb of the marketplace model, such online companies are directly selling to customers, violating rules.

In an affidavit submitted before the Delhi high court on 21 December, DIPP said the current FDI policy neither permits FDI in B2C e-commerce nor recognizes the marketplace model in e-commerce followed by companies such as Flipkart, Snapdeal and Amazon.