

**EASE OF DOING E-COMMERCE BUSINESS IN INDIA: THE FDI
POLICY RELATING TO E-COMMERCE AND ITS IMPACT ON THE
INDIAN ECONOMY**

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ABSTRACT

In recent years, the Indian economy has witnessed significant changes due to an increase in e-commerce. The implications of the surge of e-commerce include various economic, legislative, and social issues. The Department of Industrial Policy and Promotion (DIPP) issued a Press Note in March 2016 to regulate the foreign direct investment (FDI) in the sector. The policy, among other conditions, had put several restrictions on global online retailers in order to maintain a level playing field. The research work seeks to analyse as to whether such restrictions are really necessary in light of the competition issues in e-commerce in the present economic scenario or if they pose as an obstacle in the ease of doing business. Recently, a think tank headed by the Union Minister for Commerce and Industry, Mr. Suresh Prabhu, was set up for the drafting of a national e-commerce policy. The think tank has come up with the first draft of the e-commerce policy which has been shared among the stakeholders for consultations. The draft policy mainly reiterates the provisions relating to competition and FDI issues from the Press Note,

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along with some more restrictions placed on e-commerce companies. The research work examines the draft policy with respect to the relevance of the restrictions imposed under the policy and opines on whether the draft policy is the right way forward.

1. INTRODUCTION

In the recent years, the Indian economy has witnessed significant changes due to an increase in e-commerce. Indian Government's Economic Survey of 2018 revealed that India's e-commerce market has reached \$33 billion, registering a 19.1% growth during 2016-2017.¹ E-commerce is generally used to denote a method of conducting business through electronic means. There is no statutory definition of e-commerce in India. E-commerce has been defined under the FDI policy 2016 as "buying and selling of goods and services including digital products over digital & electronic network".²

The implications of the surge of e-commerce include various economic, legislative, technological, and social issues. There are few inherent distinctions between offline and online retailers. In a country like India, where the technological development is still at a nascent stage, people find it difficult to trust online marketplaces and prefer traditional

¹ Department of Economic Affairs, Ministry of Finance, Govt. of India, *Economic Survey 2017-18* (Jan., 2018), available at <http://mofapp.nic.in:8080/economicsurvey>.

² Department of Indus. Pol'y & Promotion, Ministry of Commerce & Indus., Govt. of India, *Consolidated FDI Policy Circular of 2016*, D/o IPP F. No. 5(1)/2016-FC-1 (June 7, 2016), available at http://dipp.gov.in/English/policies/FDI_Circular_2016.pdf [hereinafter FDI Policy].

outlets. In order to deal with this, online retailers have started offering discounts and promoting their platforms through strategies such as ‘big billion sales’ and ‘cash backs’. However, offline retailers have on several occasions made complaints of anti-competitive practices and predatory pricing against the online retailers alleging that such discounts are provided by these companies through funding by global investors.

In order to address these issues, the Department of Industrial Policy and Promotion (DIPP) issued a Press Note in March 2016³ to regulate the foreign direct investment (FDI) in this sector. The policy, among other conditions, had put several restrictions on global online retailers in order to maintain a level playing field. This research work seeks to analyse whether such restrictions are really necessary in light of the competition issues in e-commerce in the present economic scenario or, if they pose an obstacle in the ease of doing business.

Recently, a think tank headed by the Union minister for Commerce and Industry, Mr. Suresh Prabhu, was set up for the drafting of a national e-commerce policy. The think tank has come up with the first draft of the e-commerce policy⁴ which has been shared among the stakeholders for consultations. The draft policy mostly reiterates the provisions relating to competition and FDI issues from Press Note 3, along with some more

³ Department of Indus. Pol’y & Promotion, *Guidelines for FDI in E-commerce*, Press Note No. 3 (2016 Series), D/o IPP File No.: No. 5/3/2015-FC.I (Mar. 29, 2016) [hereinafter Press Note 3].

⁴ *Electronic Commerce in India: Draft National Policy Framework*, available at <https://www.medianama.com/wp-content/uploads/Draft-National-E-commerce-Policy.pdf> [hereinafter Draft Policy].

restrictions placed on e-commerce companies. The research work examines the draft policy with respect to the relevance of the restrictions imposed under the policy and opines on whether the draft policy is the right way forward.

2. CURRENT FDI POLICY ON E-COMMERCE AND ITS IMPLICATIONS

In a writ petition filed in the Delhi High Court, Retailers Association of India and All India Footwear Manufacturers and Retailers Association had argued that e-commerce companies act as retailers because the payment, delivery, returns and refund are all handled by these companies and that the various e-commerce websites have been continuously dodging the question of FDI violations by camouflaging their business as a “marketplace” when in reality a sale through online forum is akin in character to a sale made by a physical retailer.⁵ The Ministry of Commerce and Industry requested the Enforcement Directorate (ED) and RBI to investigate and examine if e-commerce companies are indeed engaging in retailing activity. It all finally led to the ruling by the Delhi High Court on November 20, 2015, which in turn, led to the release of Press Note 3 by DIPP. The Press Note 3, 2016 issued by the DIPP has distinguished between two models of e-commerce:

⁵ Priyanka Mittal & Sapna Agarwal, *Govt. Faces More Questions on FDI in E-commerce*, LIVE MINT (Dec. 2, 2015), <http://www.livemint.com/Politics/1PrE8sCkWZ0y4d7OrcJMEL/Govt-faces-more-questions-onFDI-in-ecommerce.html>.

Inventory-based model of e-commerce – It is an e-commerce activity where an inventory of goods and services is owned by e-commerce entity and is sold to the consumers directly.

Marketplace-based model of e-commerce – It involves providing an information technology platform by an e-commerce entity on a digital & electronic network to act as a facilitator between the buyer and the seller.

As per the FDI policy, FDI up to 100% under automatic route is permitted in Marketplace/ Business to Business (B2B) e-commerce. No FDI is permitted in Inventory/ Business to Consumer (B2C) e-commerce.

The Press Note further places the following restrictions on B2C e-commerce:

- (i) A manufacturer is permitted to sell its products manufactured in India through e-commerce retail.
- (ii) A single brand retail trading entity operating through brick and mortar stores, is permitted to undertake retail trading through e-commerce.
- (iii) E-commerce entity providing a marketplace will not exercise ownership over the inventory i.e. goods purported to be sold. Such an ownership over the inventory will render the business into inventory-based model.
- (iv) An e-commerce entity will not permit more than 25% of the sales affected through its marketplace from one vendor or their group companies.

- (v) E-commerce entity providing a marketplace will not directly or indirectly influence the sale price of goods or services and shall maintain a level playing field.

It may be noted that the Press Note imposes restrictions on the e-commerce companies relating to influencing of prices of goods and services. Offline retailers have on many occasions accused online retailers of indulging in anti-competitive practices. Allegations have been levelled on companies like Amazon and Flipkart using low prices to boost their revenues and attract customers from the offline market. In light of such allegations, it is pertinent to note various competition issues that have arisen recently in the e-commerce sector.

3. COMPETITION ISSUES IN E-COMMERCE

In the case of *Mohit Manglani v. Flipkart India (P.) Ltd.*,⁶ it was alleged that online portals were indulging in anti-competitive practices in the nature of ‘exclusive agreements’ with sellers of goods/services to sell the selected product exclusively on the selected portal to the exclusion of other e-portals or physical channels. The Competition Commission of India (CCI) held that it seems very unlikely that an exclusive arrangement between a manufacturer and an e-portal will create an entry barrier as most of the products to be sold through exclusive online partners face competitive constraints. It further held that it does not appear that because of these exclusive agreements any of the existing players in the retail

⁶ Mohit Manglani v. Flipkart India Private Limited, Case No. 80 of 2014, C.C.I. 8.

market are getting adversely affected, rather with new e-portals entering into the market, competition seems to be growing.

In the case of *Ashish Ahuja v. Snapdeal.com.*,⁷ deciding on whether online markets constitute a different distributor or whether they are merely an intermediary, the Commission observed that both offline and online markets differ in terms of discounts and shopping experience and buyers weigh the options available in both markets and decides accordingly. If the prices in the online market increase significantly, then the consumer is likely to shift towards the offline market and vice versa. Therefore, these two markets are different channels of distribution of the same product and are not two different relevant markets.

Under Section 4(2) of the Competition Act, 2002, ‘predatory pricing’ means “the sale of goods or provision of services, at a price which is below the cost, as may be determined by regulations, of production of goods or provision of services, with a view to reduce competition or eliminate the competitors”. The basic assumption about predatory pricing is that the firm exercising predatory pricing must be in a dominant position in the market. Online retailers claim that, in spite of growing demand for e-commerce and online retailing, it accounts for less than 2% of the total retail in India. Therefore, none of the online retailers can be said to have a dominant position in the market since, all of them combined are said to have not more than 2% market share of the total retail market. Hence, the complaints that the online retailers are indulging in predatory- pricing do

⁷ *Ashish Ahuja v. Snapdeal.com*, Case No. 17 of 2014, C.C.I. 9.

not have much weight. It should further be noted that such heavy discount sales are limited in products being offered and are for limited period and stock only. Therefore, such a sale cannot be said to be a predatory pricing sale.⁸

In the case of *Jasper Infotech (P) Ltd. v. Kaff Appliances (India) (P.) Ltd.*,⁹ the CCI has observed that any conduct that restricts sales over a distribution channel directly violates competition law. The products sold through online marketplaces must be treated at par with the products sold by authorized distributors through physical stores.

In the case of *Fast Track Call Cab (P) Ltd. v. ANI Technologies (P) Ltd.*,¹⁰ allegations were made against Ola cabs for predatory-pricing, such as offering various unrealistic discounts and rates to lure the customers and unviable incentives to its drivers to establish its monopoly and eliminate otherwise equally efficient competitors. The Commission discarded these allegations and observed that the incentives and discounts are devised as part of competitive strategy to compete with similarly placed aggregators in the market, like Uber. In another order relating to a similar allegation,¹¹ the Commission observed that there exists stiff competition, at least between Ola and Uber, with regard to the radio taxi service industry. Noting that there are various other players, CCI said that

⁸ Ashish Patel, *Major Competition Law Issues in E-Tail Market*, 2 INT'L MULTIDISCIPLINARY RESEARCH J., no. 6, June, 2015.

⁹ *Jasper Infotech v. Kaff Appliances (India)* Case No. 61/2014.

¹⁰ *Fast Track Call Cab v. ANI Tech.*, Case No. 6 of 2015.

¹¹ *Vilakshan Yadav v. ANI Tech.*, Case No. 21 of 2016.

the market is competitive and none of the players can be said to be dominant in the relevant market.

On an analysis of the above case laws, it can be seen that most of the competition issues that arose in these cases were decided in favour of the e-commerce companies by C.C.I. under the Competition Act. When the share of the total online market is very less and there are thousands of products offered by online retailers, it is unnecessary to implement the measures that may foreclose the competition in the online market which may have an appreciable adverse effect on competition in India.

While dealing with competition concerns regarding dominant players, the C.C.I. has observed that market power or dominance in itself is not an antitrust concern; it is the conduct of such players that warrants careful competition scrutiny. It is when the evidence shows that the dominant firm uses its market power to stifle innovation and/ or competition, or exploits the market power to the detriment of its consumers, should a competition agency intervene.¹² The restrictions imposed in the F.D.I. policy on global dominant e-commerce firms such as Amazon and Flipkart are unreasonable as there are enough competitors in the market. The prohibition on providing deep discounts not only impacts e-commerce companies but is also detrimental to the consumers.

¹² Matrimony.com v. Google, Case Nos. 7 & 30 of 2012.

4. LOOPHOLES OF THE PRESS NOTE AND ITS IMPLICATIONS**4.1. NO INVENTORY-LED MODEL**

Removing restrictions in the inventory model can create a boost in local manufacturing as e-commerce players will be able to procure products in bulk, the risk for the manufacturer will get minimized. This would lead to low costs for both the manufacturer and the consumer by eliminating the middlemen.

4.2. NO DISCOUNTS OR ‘BIG BILLION SALES’

According to the press note, e-commerce entities cannot directly or indirectly influence the sale price of goods or services and shall maintain a level playing field. The D.I.P.P. has prohibited discounts, predatory pricing, and ‘big-billion sales’ that made online marketplaces more attractive for consumers when compared to offline stores. While earlier consumers could compare the prices of online marketplaces with offline stores, this option will no longer be available to the consumer, leading to a reduction in the choices for a consumer. Though the aim of the clause is to prevent big players from providing discounts through unfair practices, such restrictions and price controls may lead to the discouragement of investment in the sector. Increased government intervention in matters relating to the price of goods, instead of focus on economic competition and consumer’s choices, might be considered as excessive licensing of the e-commerce market.

4.3. RE-STRUCTURING OF EXISTING E-COMMERCE PLAYERS

D.I.P.P. has clarified that an e-commerce firm will not be permitted to sell more than 25 percent of the sales affected, through its marketplace from one vendor or their group companies. In the marketplace model, any seller can sell his/her goods through the marketplace. This leads to erroneous deliveries and an increase in fraud cases which in turn leads to low quality of service to a consumer. In order to deal with this, Flipkart and Amazon had created a 'primary seller'. For Amazon, Cloudtail India Private Limited is the biggest seller on Amazon India which is a joint venture between Catamaran Ventures and Amazon Inc. Flipkart's largest seller is WS Retail Services, an organization that can be traced back to Flipkart itself. In this manner, Flipkart and Amazon skirted the F.D.I. regulations on inventory-led e-commerce models. With the issuance of the Press Note 3, Amazon and Flipkart will need to stop passing off a quasi-inventory-led model as a marketplace model. Instruments such as Cloudtail and WS Retail Services will slowly have to wind down which might lead to disinvestment in the sector.¹³

5. PROPOSED PROVISIONS UNDER THE DRAFT NATIONAL E-COMMERCE POLICY

The draft national e-commerce policy was tabled in July, 2018 by the e-commerce think tank. The policy states that the overall objective of

¹³ Ravikant Bhardwaj, *Competition Issues in E-commerce Sector in India*, <http://media.leidenuniv.nl/legacy/ravikant-bhardwaj.pdf>.

the national electronic commerce policy is to prepare and enable the stakeholders concerned to fully benefit from the opportunities that would arise from the progressive digitalization of the domestic and global economy. However, it can be seen that the policy imposes certain restrictions for global investor-entities. The draft policy *inter alia*, provides for the following clauses.

5.1. INDIA-FIRST MEASURES

The draft policy initially provided that 49% F.D.I. in inventory model would be allowed for online sale of locally produced goods, as long as ‘Made in India’ products are sold on the platform, the founder or promoter is a resident Indian, the company is controlled by Indian management, and foreign equity does not exceed 49%. However, recently DIPP secretary Ramesh Abhishek speaking on the draft e-commerce policy, at a roundtable organised by the Swadeshi Jagran Manch, has ruled out the same.¹⁴ This poses as a major hurdle to global companies including Amazon and Walmart, who have made major investments in this market in India. While it is important to help medium and small enterprises (MSMEs) and Indian start-ups to raise funds and create an environment for them to grow, introducing obstacles for global investors could lead to slowing down of the e-commerce sector with politically- motivated and unnecessary regulations. Under the policy, the Government seeks to

¹⁴ *DIPP rules out 49% FDI plan in inventory model*, ECONOMIC TIMES (Aug. 29, 2018), <https://economictimes.indiatimes.com/news/economy/policy/dipp-rules-out-49-fdi-plan-in-inventory-model/articleshow/65586549.cms>.

promote local companies through preferential treatment for local products created in India. However, it may be noted that many large, local players such as Paytm, Snapdeal, and Ola also have foreign investors. In light of this, such a provision does not entirely ensure the development of locally-backed and locally-managed start-ups.

5.2. DATA LOCALIZATION

The draft policy provides that the data generated by users in India from various sources including e-commerce platforms, social media, search engines etc. would be required to be stored exclusively in India, and suitable framework would be developed for sharing the data within the country. It further provides that Government will have access to data stored in India for national security and public policy subject to privacy and consent rules. Though protection and privacy of data are of extreme significance, the language of the provision has implications on the ease of doing business.

Moreover, the localisation of data does not in any way guarantee protection or privacy. The draft does not mention any framework with regard to protecting the privacy of users or regulating the government's access to user's data. This clause is not only troublesome for foreign investors but also for local start-ups who may go international. As a result of this provision, local companies may not be able to use global cloud services. Many Indian companies use the facilities of cloud-based storages and solutions like Amazon Web Services, mandating them to store locally

will affect their operational cost and efficiency. The e-commerce sector will be strained for at least two to three years as they would incur extra costs to set up new data centres in India.¹⁵

The provision states that it would be guided by ongoing exercises, including the Report of the Justice Srikrishna Committee. The Personal Data Protection Bill, 2018 which was released by the Srikrishna Committee recently, has recommended that a copy of all personal data be stored in India and only critical personal data, as defined by the Central government, will be stored only in India. However, the draft policy states that all the data collected by e-commerce companies needs to be stored within India. Even the Aadhaar (Targeted Delivery of Financial and other Subsidies, Benefits and Services) Act, 2016, which *inter alia* deals with the legal framework in relation to Aadhaar number and protection of information, nowhere states that the Aadhaar information collected by any entity needs to be stored within India except under Regulation 22 and Schedule A of the Aadhaar (Authentication) Regulations, 2016 which states that the entities are required to store the Aadhaar information within the territory of India, if such information is obtained by it for authentication. Hence, it can be stated that the data localisation clauses provided in the draft policy are unnecessarily stringent and pose difficulties for global e-commerce companies. More clarity regarding what data generated by the e-commerce companies constitutes critical personal

¹⁵ Chanakya Yadav, *Draft of E-Commerce Policy: An Analysis*, <http://www.youngbhartiya.com/article/draft-of-e-commerce-policy-an-analysis>.

data is required to be provided in this regard, in further drafts of the policy.

5.3. RESTRICTION ON DIFFERENTIAL PRICING STRATEGIES

Under the new draft policy, the restriction imposed on e-commerce marketplace, to not directly or indirectly influence the price of sale of goods and services, would be extended to group companies of the e-commerce marketplace. This provision has been reiterated from Press Note 3. It would mean that neither the marketplace nor the group companies of marketplaces such as Amazon and Flipkart can provide big discounts on the goods. In order to strengthen the enforcement of the provisions of Press Note 3, a separate wing would be created in the Directorate of Enforcement to handle grievances related to the implementation of Press Note 3. To further check the price cuts online, the draft policy also prohibits the bulk purchase of branded goods such as electronic products (especially mobile phones), white goods, and branded fashion by related party sellers. The policy may also provide for a 'sunset' clause which will define the maximum duration of differential pricing strategies that are implemented by e-commerce platforms to attract consumers.

As noted above, the restrictions imposed on global companies for attracting consumers through discounts may prove unfavourable to potential global investors. Further, in the long run, even local online retailers might want to secure funding from foreign sources. Deep

discounting is a pricing strategy universally followed to gain more customers, especially in online markets which is still a tiny fraction of the total retail. A policy that restricts discounting will not only harm global investors but also future local start-ups. Local start-ups will not flourish if they cannot offer discounts freely. A smarter way of dealing with ‘deep-pocket’ foreign investors might be to allow online companies to offer price cuts only when their capital is mostly sourced through local entities.¹⁶ This way companies like Amazon or Walmart would be free to offer discounts but they will have to compete with local firms for capital.

6. CONCLUSION

Though the aim of the guidelines formed by D.I.P.P. is to create a level playing field in e-commerce for local entities, too many restrictions may lead to the discouragement of investment in the sector for global investors. Majority of investment in the e-commerce sector in India has been made by foreign entities. Even the major local companies are to some extent, funded through foreign investments. The e-commerce market in India is still at its nascent stage. Excessive licensing and entry restrictions in this scenario may lead to depression in the sector. In these circumstances, it is important that the policy aims to strike a balance

¹⁶ Saubhik Chakrabarti, *View: It's a daft ecommerce policy, will harm future local etailers*, ECONOMIC TIMES (Aug. 2, 2018), <https://economictimes.indiatimes.com/news/economy/policy/view-its-a-daft-ecommerce-policy-will-harm-future-local-etailers/articleshow/65238981.cms>.

between encouraging local players to invest in e-commerce and providing ease in doing business so that the global investors are not deterred.

Online markets are a necessary competition for offline retailers. An important question that arises is – why the government has restricted foreign investments in this sector when it does not have any appreciable adverse effect on competition? When the online retailers are not allowed to provide deep discounts, in a way, it is an attack on the pricing freedom. Moreover, anti-competitive practices and predatory-pricing should be the concern of the Competition Commission and not of D.I.P.P.

The purpose of the Competition Act, among other things, is to promote and sustain competition in markets, to protect the interests of consumers, and to ensure freedom of trade carried on by all participants in markets. Competition law should not be designed only to incentivise local players but also to encourage them in competing at a global level. Therefore, an approach where the possible competition issues are balanced while ensuring that the local players have the necessary support and infrastructure from the government is required.

What India's e-commerce market needs right now, while keeping global investor community interested, is locally backed and managed competitors to entities backed by foreign capital. Indian start-ups need an economic environment providing ample capital-generating possibilities to make up for the lack of local investment in the sector. The government should refrain from enacting a repressive law. It should also try not to

hinder the growth of the e-commerce sector by restricting the investments at its paramount time.