

Restricting franchising is self-defeating

The move will hurt the very domestic trading community it seeks to protect.

The recent news of the government's intent (not yet formulated as a regulation) to restrict foreign brands from entering India through the franchise model is shocking, as it violates the trade policy and trade covenants of India. Worse, it goes against the very argument of protecting the mass domestic trading community whose interests were sought to be protected through the FDI ban in third party retailing.

My inference from reading the government's intent to prohibit retail through the franchising route is that it may no longer be possible for even a fully Indian company to import and retail branded goods under a territorial exclusivity agreement with a foreign manufacturer. Even a subsidiary of a foreign company would no longer be able to import and distribute its own parent company's products in India, without investing 51 per cent or less in any exclusive retail outlet selling these products.

Franchising also refers to a licence arrangement for use of the brand legends and formats for products which are prepared, made, processed, finished or served at the outlet. Thus, a Baskin & Robbins is a franchise outlet — the franchisee prepares the end product at the outlet and uses specified and licensed materials, logos and formats approved by and belonging to the franchiser (brand). Similarly, McDonald's, Barista and Starbucks would qualify for the franchise definition. Franchising can also mean pure licensing of IPR and have nothing to do with retailing per se. For instance, a children's apparel or shoemaker using a Walt Disney character on its products under licence from the master franchisee in India would be a franchisee, but its retail is absolutely independent of the brand itself.

Compare this with a Lladro or a Swarovski exclusive outlet that is not owned or invested in by Lladro or Swarovski and uses licensed logos and formats approved by and belonging to the brand, but sells products made in Spain at the brand's designated manufacturing facilities. This distinction is critical. If exclusive single brand outlets were to be called franchise outlets, as seems to be the case from the government's intent, then even a third party Bata, LG or Maruti showroom would be franchised outlets — they sell only a single brand's products.

If news reports are to be taken at face value, then even existing exclusive

importers would be barred from selling foreign brands, without an equity investment (with a cap of 51 per cent) from the brands themselves. Even a firm like LG Electronics India, which manufactures some goods in India, cannot import LG-branded televisions from Korea or China and sell them through its authorised exclusive showrooms in India — LG does not invest in or own these outlets which are third party businesses/franchisees. Similarly, Reebok and Nike cannot import sports-shoes and sell them at their exclusive outlets. Nor can a car manufacturer like Hyundai or BMW sell fully imported products into India through authorised dealers (will a car dealer not qualify as an exclusive franchisee of a foreign brand?)

So, what is this restriction all about? Perhaps the government is concerned about the disguised entry of foreign brands into Indian retail through 'benami' arrangements where independent parties are signed up to front retail operations which are indirectly funded and managed and controlled virtually by the brands themselves. If indirect control is the concern, is it limited to retail which is still in its nascence? Restricting franchise arrangements in order to better regulate FDI in retail is like throwing the baby with the bath water. Franchising cannot suddenly be treated as a culprit, considering that this model was in existence much before investment liberalisation in the retail sector.

Does the government actually intend that all foreign brands proposed to be sold on exclusive retail outlets in India will now require compulsory investments from the brand owners, and a 49 per cent Indian partner? If so, then it will be seen as a new trade barrier, violating India's trade arrangements and I suspect it would be successfully challenged at the WTO. The fact is that retail investment regulations have ignored long-standing trade policy provisions:

Since 1999, under the present trade policy, there have been no restrictions on the import of (all but a very small negative list of) goods. This allows any Indian entity to import foreign products, including consumer durables, FMCG products and so on, for own consumption or onward distribution to other parties.

There is no restriction, nor is any prior approval required, for an Indian entity to become a representative, indenting agent or importer, distributor of foreign goods or brands, or to appoint further agents, dealers and retailers downstream.

The trade liberalisation clock cannot be turned back, unfortunately; Indian importers cannot be forced not to import branded goods. Therefore, if the government now feels that franchising is an easier option for foreign brands to enter India, the folly lies in the discrepancy between its own trade and

Restrictions on franchise outlets can cause more harm than good. The restrictions would disadvantage exclusive sales outlets vis-à-vis multi-brand outlets- which clearly do not fall under the definition of franchise outlets.

This would compel foreign brands to move into hypermarket formats or multiple specialty formats, instead of having exclusive standalone outlets, including in a hotel arcade. Clearly, this is a discrimination even against the most upmarket standalone retailers, many of whom have built good reputations as exclusive outlets. Take the case of successful models like Johnson Watch or P Orr & Sons, which have been exclusive sales and service points for world- renowned watch brands like Rolex. Are we to assume that henceforth, Rolex watches should only be sold in non-exclusive outlets along with other brands, or only in retail outlets in which Rolex has a 51 per cent investment?

The consequence of this can actually be dangerous when read with another important investment whammy: the Press Note Number 1 (2005), which requires foreign partners to obtain a 'no objection certificate' from existing Indian partners in respect of multiple ventures in the same or related field. If a foreign company initially sets up single brand retail outlets in one state with a local partner, and then wishes to expand nationally, it has no choice if the Indian partner does not wish to invest further. To invest in another location, it would need another JV partner and Press Note 1 necessitates the consent of existing partners for subsequent approvals. This means that foreign brands would be forced to partner only with large players with pockets deep enough to bankroll a national presence.

Logically, the government should only be concerned with transparency and the arms-length basis of franchise or agency arrangements to ensure that franchises are not fronts for the brand. Existing accounting and financial controls such as transfer pricing and related party transactions can adequately take care of such concerns, in my view. That having been established, there should be no attempts to distort the market to favour only large Indian retail conglomerates and commercial real estate owners.

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