

India's Growth Story

India is the fourth-largest and one of the fastest-growing economies in the world. Some notable numbers:

1. With 1.2 billion people as of 2014, India is the second most populous country in the world. By July 2014, India's population is estimated to approach 1.24 billion (second only to China).⁶
2. In 2013-2014, the GDP real growth rate was estimated to be 4.7%,⁷ and it is projected to rise to over 6% in 2014-2015, 6.6% in 2015-2016, and 7.1% in 2016-2017.⁸
3. By 2015, the Indian economy is expected to be worth US\$2.4 trillion (INR 129 trillion) and, in addition to the recent government reforms (including the raised FDI ceilings for the retail, airline, telecoms, financial, and defense sectors), there is expected to be further growth that would make India the world's fifth fastest-growing economy by 2015.⁹
4. By 2020, India is projected to be the world's third largest middle-class consumer market behind China and the USA and, by 2030, India may even surpass both countries with an aggregated consumer spend projected to be nearly US\$13 trillion.¹⁰

This impressive rate of growth will inevitably lead to increased opportunities for foreign investors aimed to tap into the Indian domestic market.

Franchising in India: The Time is Right

By Erik Wulff and Abhishek Dubé¹

Overview

India's growth and development have been significant. According to the World Bank, since India gained independence in 1947, its life expectancy rates have more than doubled, literacy rates have quadrupled, health conditions have improved, and a sizeable middle class has emerged.² India is now home to globally recognized companies – including in the pharmaceuticals, steel, information technology, and space technology industries – and has become an important voice on the international stage.³

As a result of India's diverse, skilled, and low-cost workforce, its notable economic growth,⁴ efforts to invest in infrastructure,⁵ and legal and economic reforms to ease foreign direct investment (FDI) in single-brand and multi-brand retail (as discussed in Section E below), there has been an increase in the number of cross-border transactions in which foreign franchisors have sought to establish their brands in India. It should be no surprise to foreign franchisors that franchising in India is expected to continue growing at a rapid pace.

Nevertheless, there still remain a number of legal, political, business, and cultural barriers that foreign franchisors must consider before implementing a franchise program in India.

This article discusses India's current market for franchising and some of the applicable laws that govern franchise and the relationships between an international franchisor and an Indian franchisee, along with other concerns that international franchisors may face when trying to establish their brands in India.

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² See generally India Overview, The World Bank, available at <http://www.worldbank.org/en/country/india/overview> (last visited Mar. 27, 2014).

³ Id.

⁴ India's path from poverty to empowerment, McKinsey & Company Global Institute, Feb. 2014, available at http://www.mckinsey.com/insights/asia-pacific/indias_path_from_poverty_to_empowerment (last visited Mar. 30, 2014) (noting that India halved its poverty rate from 45% of the population in 1994 to 22% in 2012).

⁵ India matters: Winning in growth markets, Deloitte UK, 2013, available at <http://www.deloitte.com/assets/Dcom-UnitedKingdom/Local%20Assets/Documents/Market%20insights/International%20Markets/uk-about-india-matters.pdf> (last visited Mar. 30, 2014) (noting that the Indian government is planning to double infrastructure investment to almost US\$1 trillion between 2012 and 2017, with power (31%), telecoms (25%), and road and bridges (12%) receiving the bulk of the investment.)

⁶ See The World Factbook, Central Intelligence Agency, available at <https://www.cia.gov/library/publications/the-world-factbook/geos/in.html> (last visited Mar. 30, 2014).

⁷ Id.

⁸ South Asia, The World Bank, available at <http://www.worldbank.org/en/publication/global-economic-prospects/regional-outlooks/sar>

⁹ EY's Attractiveness Survey: India 2014 Enabling the prospects, Ernst & Young, 2014, available at [http://www.ey.com/Publication/vwLUAssets/EY-attractiveness-survey-India-2014/\\$FILE/EY-attractiveness-survey-India-2014.pdf](http://www.ey.com/Publication/vwLUAssets/EY-attractiveness-survey-India-2014/$FILE/EY-attractiveness-survey-India-2014.pdf) (last visited Apr. 8, 2014).

¹⁰ See Homi Kharas and Geoffrey Gertz, "The New Global Middle Class: A Cross-Over from West to East," Wolfensohn Center for Development at Brookings (2010).

The Right Time for Franchising in India's Marketplace

The franchise business in India is becoming increasingly popular among domestic and international players across many sectors. Consequently, some of the major industries credit successful franchising for their rapid progress in India. According to KPMG India, the key industries with the highest prospects of successfully franchising in India are: (i) retail; (ii) food and beverages; (iii) health, beauty, and wellness; (iv) consumer services; and (v) education and training.¹¹

As a business model, franchising is becoming especially widespread in India's metropolitan areas¹² gaining a firm foothold since the government started loosening financial regulations in the early 1990s to encourage a free-market economy. Notably, in 2009, the Indian government lifted the restriction on foreign franchisors' ability to charge royalty rates above certain levels (stated another way, royalty rates considered by foreign franchisors to be "market") without needing specific governmental approval.¹³ Now, foreign franchisors may charge a lump-sum fee and royalty for the transfer of technology and use of a trademark or brand without any maximum limit through the automatic route.

Today India is home to more than 3,000 brands which adopt the franchising model:

1. Bata, one of the leading footwear companies, was among the first franchisors in India; other pioneers of Indian franchising were NIIT, Apollo Hospitals, and Titan Watches.¹⁴
2. Global franchise companies in India include Barista Lavazza, Baskin Robbins, Booster Juice, California Pizza Kitchen, Chile's, Cinnabon, The Coffee Bean, Domino's, Dunkin Donuts, Hard Rock Café, KFC, McDonald's, Pinkberry, Pizza Hut, Quiznos, Sbarro, Starbucks, Subway, TGI Friday's, Wimpy's, YogurBerry, and Yum Brands.¹⁵
3. Other brands might eventually enter the Indian market, such as Applebee's, Arby's International, Armani

Junior, BannaStrow's Crepes and Coffee, BG Cleaning Systems, Carl's Jr., Carvel Ice Cream, Denny's, Di Bella Coffee, Johnny Rockets, Lipsy, Luxeyard, Mad Over Donuts, Marc Cain, Moe's Southwest Grill, Muffin Break, Panaria, Pollo Tropical, Roberto Cavalli, Schlotzsky's Deli, Spring Air, Triangle, Wendy's, Winkworth, Willy Winkies, Yoforia, and Yogen Fruz.

KPMG India estimates that the franchising industry is expected to quadruple between 2012 and 2017, and will contribute to almost 4% of India's GDP in 2017, growing from a current estimated contribution of 1.4% of GDP.¹⁶ And, according to the Franchising Association of India, an industry association committed to strengthening and promoting the best practices in franchising in India, "business[es] in India are worth US\$13.4 billion in 2012 and [are] expected to witness [an annual growth rate] of 30 percent over the next 5 years."¹⁷

In turn, this is expected to create job opportunities, including both direct and indirect, for an additional 11 million people by 2017.¹⁸ The individual growth and potential of these industries are driving the growth of the overall franchise sector within India.

In fact, as an example of the importance of India from a franchising perspective, we note that the International Franchise Association is in the process of arranging for a delegation to India (possibly in collaboration with the U.S.-India Business Council), tentatively scheduled for late 2014, to further examine and discuss the franchising regime in India.

India Addresses Franchising via a Number of Laws – But No Franchising Law

India has no franchise laws – there is no requirement to register franchise offerings or to provide franchise disclosure documents, and no specific laws restricting franchise terminations, transfers, or other aspects of franchise relationships. Despite this, there are a number of laws that may be implicated by cross-border franchising into India (including laws addressing competition, exchange control regulations, consumer protection, intellectual property, labor, property, and taxation).

¹¹ Collaborating for Growth: Report on Franchising Industry in India 2013, KPMG, available at http://www.kpmg.com/IN/en/IssuesAndInsights/ArticlesPublications/Documents/Collaborating_for_Growth.pdf (last visited Apr. 8, 2014).

¹² See EY's Attractiveness Survey: India 2014 Enabling the prospects, supra note 8 (noting that India's FDI landscape is most prevalent in the National Capital Region [including New Delhi], Bengaluru, Mumbai, Chennai, Pune, and Hyderabad.)

¹³ Press Note 8 (2009 Series), issued by the Ministry of Commerce & Industry, Department of Industrial Policy & Promotion, New Delhi (Dec. 17, 2009) (available at <http://pib.nic.in/newsite/erelease.aspx?relid=56146>) (prior to the issuance of this press note, payments of certain royalties by Indian residents to parties outside of India in connection with transfers of technology and the usage of trademarks and brand names were "automatically approved," provided that such payments did not exceed: (i) a lump-sum of US\$2 million, and royalties of 5% on domestic sales and 8% on exports; and (ii) where no technology was transferred (just use of trademarks and brand name), royalties of 1% on domestic sales and 2% on exports. Higher royalty rates were subject to the prior approval of the Project Approval Board of the Department of Industrial Policy and Promotion.)

¹⁴ See KPMG, supra note 10.

¹⁵ Priya Jashnani, India's Quick Service Restaurant Sector Growing, USDA Foreign Agricultural Service Global Agricultural Information Network (June 10, 2013); KPMG, supra note 10.

¹⁶ See KPMG, supra note 10.

¹⁷ See Franchising in India, Franchising Association of India, available at <http://www.fai.co.in/franchising-in-india.html> (last visited Mar. 29, 2014); KPMG, supra note 10.

¹⁸ Id.

¹⁹ See generally Franchising in India, International Franchise Association, July 2012, available at [http://www.franchise.org/IFA_NEWS/Franchising_in_India\(2\)/](http://www.franchise.org/IFA_NEWS/Franchising_in_India(2)/) (last visited Apr. 1, 2014).

²⁰ Up to 49% is under the automatic route and 49-100% is under the Indian government route "approval route."

Further, below are some key laws that may impact franchising in India:¹⁹

- 1. *The Indian Contract Act, 1982.*** Depending on the choice of law (or other) provision in the franchise agreement, this act may govern the agreement between the foreign franchisor and Indian franchisee. It provides the requirements for all aspects of the franchise agreement (e.g., offer, acceptance, consideration, validity, breach, and termination).
- 2. *The Trademarks Act, 1999; The Designs Act, 2000; The Patents Act, 1970, The Copyright Act, 1957.*** These laws govern trademarks, patents, registered designs, and technical assistance required for franchising agreements. As a trademark license typically is the cornerstone of a franchise relationship, it is important to note that in India, the above statutes provide for protection of trademarks through registration, and the ability to bring infringement actions against third parties to seek injunctions, damages, and an accounting of profits. Criminal sanctions are also available, at least in theory.
- 3. *The Competition Act, 2002.*** The Competition Act prohibits arrangements related to production, supply, distribution, storage, acquisition or control of goods or provision of services that cause or are likely to cause an “appreciable adverse effect” on competition within India. Under the Competition Act, tie-in arrangements, exclusive supply and distribution agreements, and resale price maintenance would be regarded as being anti-competitive if such agreements cause an appreciable adverse effect on competition in India.
- 4. *The Foreign Exchange Management Act, 1999.*** This act, along with its rules and regulations, governs payments in foreign currency. A cross-border franchise arrangement would normally involve such payments (e.g., franchise fees, royalties for use of trademarks and system, training expenses, advertisement contributions, etc.) which can be remitted to the foreign franchisor without any approvals. As discussed in Section C above, the Indian government has lifted a number of the prior restrictions on foreign franchisors’ ability to charge certain fees without needing governmental approval. Guarantees in favor of a foreign franchisor may also require approval of the Reserve Bank of India.
- 5. *Income Tax Act, 1961.*** This act governs the tax aspects of any franchising arrangement in India, and generally provides that a foreign franchisor’s income in the form of royalties or franchise fees would be treated and taxed as business income subject to a tax deduction at the applicable rates. Of course, this would be subject to any tax treaty between India and the relevant country (including withholding tax provisions related to the franchisee’s royalty payments to the foreign franchisor).

- 6. *The Consumer Protection Act, 1986.*** This set of laws provides remedies to consumers in the event of product defects and service deficiencies. Under these laws, because goods and services may be provided by a franchisee, it is possible that consumers could file an action against both the franchisor and the franchisee. In fact, these laws can encourage Indian consumers to file complaints for any defects/deficiencies in the goods or services supplied by the trader/franchisor – which, may result in consumers having claims against franchisors and franchisees. The party that has more control over the business is used to determine which party would be the appropriate party to bring a suit against.
- 7. *The Arbitration and Conciliation Act, 1996.*** This act governs the Indian law of arbitration (and as a result of case law, the evolving landscape of the enforceability of arbitration awards in which the seat of arbitration is outside of India). Part I of the act addresses domestic arbitration and awards and Part II of the act addresses international arbitration and awards. Following the *Bharat Aluminium Co vs. Kaiser Aluminium Technical Service Inc.* decision (“BALCO”), Part I of the act does not apply to foreign seated arbitrations, thereby dissuading parties from approaching Indian courts for interim relief. While arbitration in India continues to evolve, for the time being, it does seem clear (as a result of BALCO), that Indian courts cannot set aside arbitral awards made, or otherwise intervene in arbitrations seated, outside India (and therefore, the Indian courts will give effect to party autonomy and choice of an arbitration seat).

It is Necessary to Keep Track of India’s FDI Policy

In addition to the laws mentioned above, it is important to note that any proposed investment in India would be subject to the FDI policy, released semi-annually by the Department for Industrial Policy and Promotion (which, among other things, determines the permissible levels for foreign investment in India and in which sectors investment is permitted).

In previous years, India’s FDI policy prohibited foreign investment in multi-brand retailing and allowed only up to 51% FDI in single-brand retailing. Over the past couple of years, however, the Indian government has passed FDI policy reforms designed to encourage foreign investment. Now, the FDI policy allows for up to 100% FDI in single-brand retail²⁰ and up to 51% FDI in multi-brand retail.²¹ Further, the government has taken steps to remove barriers to FDI in a range of sectors, including: (a) 100% FDI in aviation, telecoms, asset reconstruction companies, and courier services; (b) 74% FDI in credit information companies; and (c) 49% FDI in power exchanges, stock and commodity exchanges, and depositories.²²

These FDI reforms are notable for franchising because, as a result of liberalizing foreign investment in India (across various sectors), international franchise brands will have greater flexibility in adopting business models that would allow for expansion to India.

Address the Issues That Are Concerning Before Entering the Indian Market

Despite the storied growth and positive growth numbers mentioned above, franchisors should take special care to understand all regulatory, legal, political, and business ramifications of entering the Indian market, including:

1. India is in the midst of the largest democratic election in history. While India has rebounded after the global economic crisis, since 2012 it has experienced a moderate slowdown in economic growth. While we remain optimistic, the result of an uncertain (and close) election will heavily factor into continued growth and future domestic and foreign investment.
2. India's legal system is incredibly slow and there are staggering delays associated with Indian court proceedings – the path to a non-appealable final resolution may be prohibitively long.²³ Among the 185 economies covered by the World Bank's 2013 Doing Business survey, India ranks as #184 in terms of countries in which it is easiest to enforce a contract.²⁴ Further, courts at the lower level may not have the experience to handle complex commercial matters for which foreign franchisors may seek resolution, and such proceedings are not confidential.
3. While FDI restrictions have been relieved in various sectors, India still needs to address its great infrastructure shortfalls (e.g., shortages of utilities, poor roads and bridges), pervasive state control in business activities (e.g., number of permits and licenses that may be required to do business can be overwhelming and overly burdensome for a foreign franchisor), and unequal access to quality education (e.g., areas beyond metropolitan places must continue to develop to sustain growth and a qualified workforce).
4. Excessive government bureaucracy and corruption persists at various levels and has proven to be difficult to curb.
5. While the Indian government continues to reform the FDI policy, more progress is sought from the business community.
6. India has a diverse consumer base and workforce. But because it is not really "one" market, there are often cultural, linguistic, and socio-economic issues that may make it difficult to establish a uniform business model suitable for the entire country.

Conclusion: To Take Advantage of Opportunities in India, First Do Your Homework

Despite certain concerns, the future for franchising in India is bright.

Over the years, India has become an attractive destination for business investments due to the rapid growth of consumerism, globalization, and liberalization. India enjoys a positive economy, large consumer market, and loosening government restrictions. The window of opportunity in India is open.

But foreign franchisors should make sure to conduct a thorough investigation and evaluation of business opportunities (taking into account the many legal, political, business, and cultural barriers that may exist) before committing long-term to franchising in India.

²¹ Franchisee route not allowed in multi-brand retailing, *The Hindu*, June 7, 2013 (last visited Apr. 3, 2014) (noting that despite the fact that India's government relaxed regulations allowing FDI in multi-brand retail, foreign retailers entering the multi-brand segment will not be allowed to franchise their stores, and will have to put 50% of their investments in back-end infrastructure specifically for the chain they are setting up. This in turn may lead foreign retailers to own and operate company stores in India.)

²² See India's FDI Policy, Department of Industrial Policy & Promotion, available at http://dipp.nic.in/English/Investor/FDI_Policies/FDI_policy.aspx (last visited Apr. 1, 2014).

²³ See generally IOL News, *Backlog stalls justice in India* (dated January 21, 2013) (last visited Apr. 1, 2014) (noting that at the end of 2011, more than 32 million cases were pending in Indian courts, according to government data, and 26% of these were more than five years old. India also has an estimated 10.5 judges per 1 million people, and civil cases can take 10 to 30 years before a decision.)

²⁴ See World Bank. 2013. *Doing Business 2013: Smarter Regulations for Small and Medium-Size Enterprises*. Washington, DC: World Bank Group. DOI: 10.1596/978-0-8213-9615-5, available at <http://www.doingbusiness.org/~media/GIAWB/Doing%20Business/Documents/Annual-Reports/English/DB13-full-report.pdf> (last visited Apr. 9, 2014) (also noting that it takes 1,420 days to enforce a contract in India, and commercial disputes before courts in India are among the most lengthy, costly, and complex in the world.)