

# FEMA & FDI Rules for E-Commerce Marketplaces: 100% Automatic Route Review

FEMA legislations monitor foreign exchange transactions. In e-commerce, 100% FDI is allowed only under the automatic route for the marketplace model and is, however, fully prohibited for inventory based models. This paper seeks to evaluate 100% automatic route's unconditional nature (2020-2025), identify core FEMA compliance challenges, analyse control and ownership issues, assess enforcement and judicial trends, examine policy achievements and gaps and propose regulatory reforms. The research concentrates on B2C marketplaces that receive foreign investment on an automatic basis.



**Dr. Biranchi Narayan P Panda**

Associate Professor (Law)  
Xavier Law School, XIM University  
Bhubaneswar  
[biranchi@xim.edu.in](mailto:biranchi@xim.edu.in)

## INTRODUCTION

- **Background: Emergence of India's Digital and E-Commerce Economy**

The digital and e-commerce market in India is one of the fastest-growing markets in the world. As of November 2025, the Indian e-commerce market is USD 150 billion and is expected to be around USD 350 to 400 billion by 2030, growing at a CAGR of 19-21%. Some key reasons for this growth include penetration of the internet to over 950 million users, the lowest cost data in the world, rapid adoption of Unified Payments Interface and over 15 billion transactions a month, and government policies like Digital India, ONDC, as well as National Logistics Policy 2023. The pandemic permanently shifted the consumer purchasing power towards online commerce, while the quick-commerce, social-commerce, and live-commerce, Direct to Consumer (D2C) brands, and growing commerce in rural areas added more variation to the line of commerce.

- **Importance of FEMA in Regulating Foreign Capital**

The Foreign Exchange Management Act, 1999 (FEMA) and related legislations such as the Non-Debt Instruments Rules and the Consolidated FDI Policy Statute provide the legal structure for foreign capital inflow. In e-commerce, 100% FDI is allowed only under the automatic route for the marketplace model and is, however, fully prohibited for inventory based

models. Press Note 2 of 2018 and its incorporation into the 2020 FDI Policy introduced a series of restrictive provisions; marketplaces must not own or control inventory, must not influence the price, must ensure the participation in trade in a fair manner, and must not allow any single supplier or its group company to account for more than 25% of total sales. FEMA compliance is crucial to avoiding circumvention and protecting domestic traders from predatory practices and to conducting domestic enforcement through the RBI reporting (FC-GPR, FLA returns, SMF), beneficial ownership disclosure and potential Enforcement Directorate scrutiny.

- **Objectives of the Paper**

This paper seeks:

- to evaluate 100% automatic route's unconditional nature (2020-2025);
- to identify core FEMA compliance challenges;
- to analyse control and ownership issues;
- to assess enforcement and judicial trends;
- to examine policy achievements and gaps and;
- to propose regulatory reforms.

- **Scope of the Study**

The research concentrates on B2C marketplaces that receive foreign investment on an automatic basis. Excluded are inventory-led business models, B2B e-commerce, domestic funded e-commerce platforms, manufacturing-related e-commerce, as well as single brand retail trading. The periods covered include any regulatory change, compliances, and actions taken from January 2020 to November 2025.

## REGULATORY FRAMEWORK GOVERNING FDI IN INDIAN E-COMMERCE

- **FEMA 1999: Statutory Requirements**

The Foreign Exchange Management Act, 1999 (FEMA) is a cornerstone legislation of all cross border trading including Foreign Direct Investment (FDI) into the

country. Replacing the stringent Foreign Exchange Regulation Act, 1973 (FERA), FEMA is a more liberal in approach in regulations to facilitate trade, payments and balanced growth of the foreign exchange market. The section 6 of the central government is empowered to make rules regarding to capital controls including FDI, after consultation with the Reserve Bank of India (RBI). In the case of the e-commerce sector, the FEMA permits investments in marketplace companies via the automatic route, albeit subject to specific sectoral limitations outlined in the Consolidated FDI Policy.

- **Distinguishing Marketplace and Inventory Models**

To avoid foreign multi-brand retail trading, which is otherwise forbidden, India's FDI policy makes a clear delineation between the marketplace model and the inventory-based model. The marketplace model is characterized as a digital network's IT system that functions as a connection between buyers and sellers. This e-commerce entity must not purchase or have any ownership of the items or services that are being transacted. This model is the only one for which 100% FDI is permitted under the automatic route. On the other hand, there is the inventory-based model, where the e-commerce entity, having ownership over the inventory, sells directly to the consumer and thus acts as a retailer. This model is also the one that carries a complete ban on FDI.

The ownership and control of the inventory is where the distinction lies. Control is presumed if a vendor directly purchases or resells more than 25% of their sales to the marketplace operator or any member of its group/wholesale entities. Other requirements include no control over the selling prices, no exclusive contracts with particular vendors, and no discrimination of platform services to any seller on the platform. This framework, established in 2016, and with the release of Press Note 2 of 2018, it aimed at circumventing the subsidization of illogical prices as well as the deep discounting of products.

- **NDI Rules and the 100% Automatic Route**

The first schedule to the Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 (NDI Rules) under FEMA, is responsible for implementing the sectoral FDI caps and conditions. Under the first schedule, 100% FDI is allowed under the automatic route only for marketplace-based e-commerce activities. As long as the required post-investment reporting, like the FC-GPR, is submitted on time, there is no need to seek prior approvals from the government or the RBI.

The automatic route is presumptive and allows foreign investors to invest in equity instruments in the company, which is subject only to adherence to relevant pricing guidelines and other conditions applicable to that sector. However, the route has become highly conditional due to the incorporation of Press Note 2 (2018) safeguards via the subsequent NDI amendments. Downstream investments also have to adhere to the rules on indirect foreign

investment. Any breach, especially recharacterisation as inventory-led, will reclassify the foreign investment as FDI that is prohibited, with all attendant consequences.

- **DPIIT Press Note 3 (2020)**

The fundamental e-commerce FDI regulation continues to emanate from Press Note 2 (2018 series), with effect from 1<sup>st</sup> February 2019 and merged with the 2020 FDI Policy. However, Press Note 3 (2020 Series) of 17<sup>th</sup> April 2020, formalised by NDI Rules amendments effective 22<sup>nd</sup> April 2020, added a crucial cross-sectoral restriction. It moved FDI from entities located in, or whose beneficial owners reside in, countries that share a land border with India (most notably, China) from the automatic to a government approval route.

This effectively removed the 'automatic' character of the 100 percent route from those jurisdictions in the e-commerce marketplace segment, even though the sectoral cap remained unchanged. No e-commerce specific Press Note 3 had been issued as of November 2025, and the 2020 Consolidated FDI Policy (with minor clarifications in subsequent years) remains in effect. Discussions regarding a limited relaxation of the inventory-model for pure export sales have, however, remained inconclusive.

- **FTP Overlaps**

The Foreign Trade Policy 2023 (FTP 2023), which came into effect on 1<sup>st</sup> April 2023, on a permanent basis, adds to the existing Foreign Direct Investment (FDI) rules by encouraging the export of e-commerce by way of duty remission, increased courier limits (10 lakh per shipment), establishment of e-commerce export hubs, and proposed IT streamlining. Expected overlaps include the permission of inventory models based on export of

Indian-origin goods, and this proposed change is under active review by the DGFT and DPIIT as of November 2025. This has always motivated the export of Indian goods and reinforcing the platforms' global partnerships while maintaining the restriction of domestic marketplace-only. FTP's waiver of export obligations and the liberalization of the trade in merchandise also support FDI-sponsored marketplaces in the cross-border marketplace.

## IDENTIFICATION OF CORE LEGAL AND COMPLIANCE ISSUES

- **Whether the 100% Automatic Route is Truly Unconditional**

In theory, the 100% automatic route exists, but in practice, it is illusory for most e-commerce market places. The new conditions implemented after 2018, including the 25 percent vendor cap, the prohibition of price controls, and mandatory compliance certificates every year have changed the conditions to a more conditional route that is heavily regulated and audited. The risk of being recharacterized contentiously to an inventory model is a risk that the DPIIT, RBI and ED control completely. The

route is far from automatic, and in fact, large amounts of FDI are now accompanied by legal opinions and proactive engagement with the DPIIT, making it, for all intents and purposes, a quasi-approval for all but the tiniest foreign players.

- **Determining Control and Beneficial Ownership**

From the perspective of the FDI Policy and the Press Note, which lacks a statutory definition of control, there is a deep-seated definitional ambiguity as to control (unlike the Companies Act/SEBI Takeover Code). Concerning Press Note 2's fiction of  $\geq 25$  percent sourcing control is both too broad and too weak/under-enforced. In this context, the tracing of beneficial ownership is equally troublesome. Chinese investors routed through Singapore or Cayman entities, in and of themselves, even for minority stakes, would attract Press Note 3 scrutiny. The situation creates a lack of certainty on compliance and has led to a freeze of several funding rounds.

- **Marketplace-Seller Relationship Issues**

Indian online marketplaces have excelled at structuring their business relations to gain the most favourable terms possible. Long-standing preferred sellers and now their latest replacements have always enjoyed outsized benefits, including discriminatory visibility and lower commissions, along with guaranteed buyback deals disguised as marketing development funds.

- **Dependence on Single Sellers**

It is now almost impossible to contain the 25 percent market share restriction as it applies to certain segments that accommodate high-frequency selling, like fashion and mobile phones, to segments targeting flash sales and exclusives. That rule has only led to increased costs for sellers from legal fees and from having to keep and maintain detailed accounting systems, and it has led to increased market concentration of the larger sellers, which alone can afford to maintain a compliant operation. Rather than protect small sellers, it has led to their market departure in higher numbers.

- **Reporting and Documentation**

The degree of oversight experienced at the reporting stage is clearly excessive. Annual e-commerce compliance certificates (every September 30) entail statutory auditors forming opinions on difficult issues of control and fair pricing, which the courts themselves can struggle with. FC-GPR or FLA filings that are delayed by days result in fees that compound by the crores.

- **Impact of Press Note 3 (2020)**

Press Note 3, although remaining a blunt instrument, has had a greater detrimental impact on Indian start-ups than on the Chinese investors. While supposed to be a safeguard for national security, within the e-commerce and fintech sectors, the phenomenon stagnated or blocked at least \$10B of already committed capital (2020- 2025). Domestic players lost their Chinese limited partners and had to force secondary sales at a significant loss. After five years, the process for approval continues to be slow and self-contradictory for the narrative of India being an easy country to do business with, as it provides very little actual security to the e-commerce sector.

## ANALYSIS OF FEMA COMPLIANCE ISSUES

- **Administrative Interpretation**

A distinctive characteristic of FEMA compliance in Indian e-commerce is the prominence of administrative fiat over the statutory text. Neither FEMA 1999 nor the NDI Rules mention "control over inventory" or "influence over sale price, yet the DPIIT, RBI, and Enforcement Directorate (ED) have attempted to fill these gaps through circulars, FAQs, and interpretations based on raiding that are quasi-legislative in effect. *For example*, in 2021-2023, DPIIT clarified that predictive pricing algorithms and deep-learning based promotions, even without mandatory discounting, would be viewed as controlling price for a sale.

- **Marketplace vs Inventory Models in Practice**

In practice, the binary distinction has collapsed into a spectrum of grey. However, the CCI Forensics (2020-2024) has shown that the new 'preferred sellers' continued receiving 100% buy-back guarantees, zero-commission listings, pre-negotiated margin and functionally replicated the inventory without legal title. The dominance of the logistics and captive payment gateways further skews the market, leaving third-party sellers constructively monopolized. The 25 percent cap is routinely bypassed through seller fragmentation, whereby a single economic beneficiary is operating 40-50 SPVs, each contributing less than that percent.

- **Analysis of Group Company and Beneficial Ownership Tests**

The "group company" test under Press Note 2 lacks considerable specification. Group classification can be triggered with as low as 1% common shareholding without a low bound for "common control." Traceable beneficial ownership is a "look through" as detailed in Section 90 of the Companies Act, 2013, but in practice, ED extends a look-through to Mauritius and Singapore shell companies. This has led to a Singapore-based fund with 0.8% Chinese LP exposure being subjected to Press Note 3 scrutiny for a 2023 Series C round, which is simply not appreciable. Other investors are being penalised, it seems, for financially venturing rather than gaining operational control. This is, however, also a reason as to why it incentivises so many to invest, but it also avoids transparency, as it allows investors to bypass beneficial ownership by using convertible notes rather than equity. As a result, this in turn distorts capital structures and increases the risk of default.

- **NDI Reporting**

All NDI reporting is such a big compliance issue. NDI reporting and the SMF part of it expects downstream investment reporting within 30 days. However, e-Commerce players have about 200-300 investee sellers. Any minor mistake in reporting, downstream investments, or flat returns, and the company get show-cause notices and penalties in crores. The Reserve Bank of India 2023-2025 order on compounding shows a clear pattern that technical delays get compounded on a claim maximum, while the other substantive violations that people are settling drastically after long negotiations. The

yearly e-Commerce compliance certificate has no control over inventory that statutory auditors have to sign, which exposes the auditors to professional risk outside the field of accountancy. This has driven up audit fees and caused a shortage of willing certifiers, acting essentially as a non-tariff barrier to new FDI.

- **Linkages with Competition & Consumer Laws**

In the Indian e-commerce industry, violations of the FEMA rarely are standalone violations, as they almost always intertwine with concerns of competition and consumer protection, resulting in a multiplier effect of regulatory risk. As a consequence of the Consumer Protection (E-Commerce) Rules, 2020, new obligations in the FDI, including transparency, fairness, and addressing grievance, are mirrored with the same responsibilities being imposed on marketplace players.

## POLICY EVALUATION (2020–2025)

- **Achievements**

India's e-commerce Foreign Direct Investment policy for the marketplace-only, 100% automatic route (with Press 2 Note conditions), achieved the first benchmark between 2020-2025. There was a dramatic increase in FDI inflow into the sector, from USD 4.4 billion in FY20 to over USD 9 billion FY25. There was also a significant increase in rural penetration with over 60% of GMV in non-metro transactions. Press Note 3, 2020 also aligned FDI with national security by safeguarding sensitive capital from border-sharing countries.

- **International Comparisons**

India's policy is much more restrictive than those of its peers. In China, there is 100 percent FDI in both marketplace and inventory models (with value-added telecom licence requirements). The US has no sectoral FDI restrictions in their e-commerce, and manages it only through antitrust policy. Indonesia (2020-2025) had local shareholding and data localization requirements, but was the first to loosen inventory restrictions compared to India. In Vietnam, the operational conditions are very lax and there is 100 percent foreign ownership. No other country has such a liberal combined with such microscopically detailed restrictive policy, and such high levels of enforcement as India. It has not produced the open Western market, or the Chinese decisive liberalization which was aimed to balance protectionism, but a barrage of litigation. The end results have been bad for consumers and small retailers, while leading to an inefficient market.

## RECOMMENDATIONS FOR REFORM

- **Simplifying Marketplace Restrictions**

It is important to allow some models to apply only to the exports of Indian-origin goods under a simple notification route (as has been assured repeatedly since 2021) with mandatory 100 percent export obligation and compulsory GST invoicing to prevent domestic leakages. The regulatory framework for quick commerce would be put off a different sub-category which would refer to dark stores and private labels and which would be subject to 100% automatic FDI subject to a cap of 49% of total GMV to ensure innovation and fair competition.

- **Transparency without Overregulation**

There should be a change from the post-raid phase to having transparency from the start, and from current regulations as the focus should be to have an online and real-time public repository of the top 50 sellers, by volume/revenue, with real-time public transparency on each marketplace homepage.<sup>31</sup> In addition, real-time public self-certification compliance dashboards must be submitted to the DPIIT (which need to be published online at the same time). Replace the current annual statutory auditor certificates, to the extent they remain farcically with real independent third-party audits from empaneled SEBI forensic audit firms to promote safeguard consistency.<sup>32</sup> For audit transparency, the statutory 2-year moratorium on ED (enforcement directorate) investigations should apply to compliant entities.

- **Role of Company Secretary and FDI Compliance Checklist**

The role of Company Secretary (CS) stands firm as the compliance officer for e-commerce marketplace under the India's Foreign Direct Investment (FDI) and Foreign Exchange Management Act, 1999 regulations. Further to its capacity, the primary role of CS is to safeguard the company against any regulatory violations and therefore all contractual arrangements with sellers must be reviewed in order to ensure over pricing or inventory management and monitors related-party transactions. Additionally, the CS as compliance officer, must ensure all timely statutory returns such as Form FC-GPR and Annual Return on Foreign Liabilities and Assets (FLA) with RBI under the FEMA and FDI-related matters. Starting from the record keepings, advising management to overseeing corporate governance standards, it has to deal and update the legal and financial risks with board and management directly on all matters related to foreign investment, regulatory compliance and governance in the e-commerce domain. The CS must act as a bridge between the board and foreign investors talking with confidence about the existing laws and facilitate smooth and steady growth of e-commerce business under the 100% automatic FDI route. Finally, a dedicated FDI compliance folder definitely should be maintained that includes; board resolutions, shareholders' approvals, FC-GPR fillings, Annual FLA return and annual reports for better governance and to respond any inspections and audit by RBI.

## CONCLUSION

The automatic route for FDI in e-commerce marketplaces in India has been liberalized since 2016, and subsequently adjusted through Press Note 2 (2018) and Press Note 3 (2020). It has brought in considerable and much-needed foreign investment targeting the market for the period 2020 - November 2025.

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