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FOREIGN DIRECT INVESTMENT IN INDIAN RETAIL SECTOR

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ABSTRACT

Indian retail industry is one of the sunrise sectors with huge growth potential. According to the Investment Commission of India, the retail sector is expected to grow almost three times its current levels to $660 billion by 2015. However, in spite of the recent developments in retailing and its immense contribution to the economy, retailing continues to be the least evolved industries and the growth of organised retailing in India has been much slower as compared to rest of the world. Undoubtedly, this dismal situation of the retail sector, despite the on-going wave of incessant liberalization and globalization stems from the absence of an FDI encouraging policy in the Indian retail sector. In this paper we study the merits and demirits of Foreign Direct Investment (FDI) with respect to India and its economy.

INTRODUCTION

Foreign Direct Investment (FDI) broadly encompasses any long-term investments by an entity that is not a resident of the host country. Typically, the investment is over a long duration of time and the idea is to make an initial investment and then subsequently keep investing to leverage the host country's advantages which could be in the form of access to better (and cheaper) resources, access to a consumer market or access to talent specific to the host country - which results in the enhancement of efficiency. This long-term relationship benefits both the investor as well as the host country. The investor benefits in getting higher returns for his investment than he would have gotten for the same investment in his country and the host country can benefit by the increased know how or technology transfer to its workers, increased pressure on its domestic industry to compete with the foreign entity thus making the industry improve as a whole or by having a demonstration effect on other entities thinking about investing in the host country. Retail Sector is one of the most important pillars of Indian economy and it is growing at a phenomenal pace. Foreign Direct Investment (FDI) in retail sector plays an integral role in the economic growth. FDI in Multi-brand retail can be seen as an important reform to revive the economy and to ease supply side pressures especially in unorganized sectors.To revive the Indian economy, FDI policy in multi-brand retail is an important reform that would ease supply side pressures and mitigate inflation. Implications of FDI in multi-brand retail sector discussed outweigh the issues related to the new FDI policy reforms.FDI in multi-brand retail can go a long way in improving the efficiency of supply chain, infrastructure facilities, technological advancement and other relevant areas of growth in retail sector. The FDI policy on multi-brand retail creates opportunities for the Micro, Small and Medium Enterprises (MSMEs) to reach out the International markets. Farmers and consumers would benefit from the new entry of organized retailers in multi-brand and would help tame food inflation by improving agri-commodity management.

FOR FDI:

- Causes a flow of money into the economy which stimulates economic activity.
- Employment will increase.
- Long run aggregate supply will shift outwards.
- Aggregate demand will also shift outwards as investment is a component of aggregate demand.
- It may give domestic producers an incentive to become more efficient.
- The government of the country experiencing increasing levels of FDI will have a greater voice at international summits as their country will have more stakeholders in it .

AGAINST FDI:

- Inflation may increase slightly.
- Domestic firms may suffer if they are relatively uncompetitive.
- If there is a lot of FDI into one industry e.g. the automotive industry then a country can become too dependent on it and it may turn into a risk that is why countries like the Czech Republic are "seeking to attract high value-added services such as research and development (e.g. biotechnology)"

HISTIRICAL TRENDS IN FDI IN INDIA

Starting with the market reforms initiated in 1991, India gradually opened up its economy to FDI in a wide range of sectors. The “licence-raj” system was dismantled in almost all the industries. The infrastructure sector which was in dire need of capital welcomed foreign equity. FDI was especially encouraged in ports, highways, oil and gas industries, power generation and telecommunication. Consumer goods and service sector which was once completely off-limits for foreign equity was also gradually opened up. The reserve bank of India set up an automatic approval system which allowed investments in slabs of 50, 51 or 74% depending on the priority of the industry, as defined by the government. The foreign investment limits were slowly raised and some sectors saw the limits raised to 100%.

PRESENT SHAPE OF FDI

The retail industry in India is the second largest employer with an estimated 35 million people engaged by the industry. There has been opening of Indian economy to foreign organization for foreign direct investment through organized retail. The union government has sanctioned 51% foreign direct investment in multi-brand like Wal-Mart, Carrefour, and Tesco. This will make foreign goods and items of daily consumption available locally, at a lower price, to Indian consumers. The new policy will allow multi-brand foreign retailers to set up shop only

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in cities with a population of more than 10 lakhs as per the 2011 census. There are 53 such cities at present. This means that big retailers can move beyond the metropolises to smaller cities. The final decision will however lies with the state governments. Foreign retailers will require a minimum investment US $100 million of which at least 50% of total FDI should be invested in back-end infra-structure which would include capital expenditure on the entire spectrum of related activities including cold chain infrastructure, food processing, refrigerated transportation, logistics. Big retailers will need to source atleast 30% of manufactured or processed products from Indian small industries.

STRUCTURE OF INDIAN RETAIL SECTOR

In 2004, The High Court of Delhi defined the term ‗retail' as a sale for final consumption in contrast to a sale for further sale or processing (i.e. wholesale). A sale to the ultimate consumer. Thus, retailing can be said to be the interface between the producer and the individual consumer buying for personal consumption. This excludes direct interface between the manufacturer and institutional buyers such as the government and other bulk customers. Retailing is the last link that connects the individual consumer with the manufacturing and distribution chain. A retailer is involved in the act of selling goods to the individual consumer at a margin of profit.

Retail Sector can basically be classified in to two segments

1. **Organised**- Organised retailing refers to trading activities undertaken by licensed retailers, that is, those who are registered for sales tax, income tax, etc. These include the corporate-backed hypermarkets and retail chains, and also the privately owned large retail businesses.

2. **Unorganised** -Unorganised retailing, on the other hand, refers to the traditional formats of low-cost retailing, for example, the local kirana shops, owner manned general stores,paan/beedi shops, convenience stores, hand cart and pavement vendors, etc.The Indian retail sector is highly fragmented with 95 per cent of its business being run by Kirana Stores.

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GROWTH AND EVOLUTION OF INDIAN RETAIL SECTOR

The Indian Retail Industry is the 5th largest retail destination and the second most attractive market for investment in the globe after Vietnam as reported by AT Kearney‟s seventh annual Globe Retail Development Index (GRDI), in 2008.The growing popularity of Indian Retail sector has resulted in growing awareness of quality products and brands. As a whole Indian retail has made life convenient, easy, quick and affordable. Indian retail sector specially organized retail is growing rapidly, with customer spending growing in unprecedented manner. It is undergoing metamorphosis. Till 1980 retail continued in the form of kiranas that is unorganized retailing. Later in 1990s branded retail outlet like Food World, Nilgiris and local retail outlets like Apna Bazaar came into existence. Now big players like Reliance, Tata‟s, Bharti, ITC and other reputed companies have entered into organized retail business. The multinationals with 51% opening of FDI in single brand retail has led to direct entrance of companies like Nike, Reebok, Metro etc. or through joint ventures like Wal-mart with Bharti, Tata with Tesco etc.

Evolution of retail sector can be seen in the share of organized sector in 2007 was 7.5% of the total retail market. Organized retail business in India is very small but has tremendous scope. The total in 2005 stood at $225 billion, accounting for about 11% of GDP. In this total market, the organized retail accounts for only $8 billion of total revenue. According to A T Kearney, the organized retailing is expected to be more than $23 billion revenue by 2010. The retail industry in India is currently growing at a great pace and is expected to go up to US$ 833 billion by the year 2013. It is further expected to reach US$ 1.3 trillion by the year2018 at a CAGR of 10%. As the country has got a high growth rate, the consumer spending has also gone up and is also expected to go up further in the future. In the last four years, the consumer spending in India climbed up to 75%. As a result, the Indian retail industry is expected to grow further in the future days. By the year 2013, the organized sector is also expected to grow at a CAGR of 40%. The key factors that drive growth in retail industry are young demographic profile, increasing consumer aspirations, growing middle class incomes and improving demand

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from rural markets. Also, rising incomes and improvements in infrastructure are enlarging consumer markets and accelerating the convergence of consumer tastes. Liberalization of the Indian economy, increase in spending per capita income and the advent of dual income families also help in the growth of retail sector. Moreover, consumer preference for shopping in new environs, availability of quality real estate and mall management practices and a shift in consumer demand to foreign brands like McDonalds, Sony, Panasonic, etc. also contributes to the spiral of growth in this sector. Furthermore, the Internet revolution is making the Indian consumer more accessible to the growing influences of domestic and foreign retail chains. One report estimates the 2011 Indian retail market as generating sales of about $470 billion a year, of which a miniscule $27 billion comes from organized retail such as supermarkets, chain stores with centralized operations and shops in malls. The opening of retail industry to free market competition, some claim will enable rapid growth in retail sector of Indian economy. Others believe the growth of Indian retail industry will take time, with organized retail possibly needing a decade to grow to a 25% share.A 25% market share, given the expected growth of Indian retail industry through 2021, is estimated to be over $250 billion a year: a revenue equal to the 2009 revenue share from Japan for the world's 250 largest retailers., The Economist forecasts that Indian retail will nearly double in economic value, expanding by about $400 billion by 2020. The projected increase alone is equivalent to the current retail market size of France. In 2011, food accounted for 70% of Indian retail, but was under-represented by organized retail. A.T. Kearney estimates India's organized retail had a 31% share in clothing and apparel, while the home supplies retail was growing between 20% to 30% per year. These data correspond to retail prospects prior to November announcement of the retail reform.

SINGLE AND MULTI-BRAND RETAILING

FDI in Single-Brand Retail The Government has not categorically defined the meaning of ―Single Brand‖ anywhere neither in any of its circulars nor any notifications. In single-brand retail, FDI up to 51 per cent is allowed, subject to Foreign Investment Promotion Board (FIPB) approval and subject to the conditions mentioned in Press Note 3 that (a) only single brand products would be sold (i.e., retail of goods of multi-brand even if produced by the same manufacturer would not be allowed), (b) products should be sold under the same brand internationally, (c) single-brand product retail would only cover products which are branded during manufacturing and (d) any addition to product categories to be sold under single-brand would require fresh approval from the government. While the phrase single brand has not been defined, it implies that foreign companies would be allowed to sell goods sold internationally under a single brand, viz., Reebok, Nokia, and Adidas. Retailing of goods of multiple brands, even if such products were produced by the same manufacturer, would not be allowed. FDI in Single brand retail implies that a retail store with foreign investment can only sell one brand. For example, if Adidas were to obtain permission to retail its flagship brand in India, those retail outlets could only sell products under the Adidas brand and not the Reebok brand, for which separate permission is required. If granted permission, Adidas could sell products under the Reebok brand in separate outlets.

FDI in Multi-Brand Retail The government has also not defined the term Multi Brand. FDI in Multi Brand retail implies that a retail store with a foreign investment can sell multiple brands under one roof. In July 2010, Department of Industrial Policy and Promotion (DIPP), Ministry of Commerce circulated a discussion paper on allowing FDI in multi-brand retail. The paper doesn‘t suggest any upper limit on FDI in multi-brand retail. If implemented, it would open the doors for global retail giants to enter and establish their footprints on the retail landscape of India. Opening up FDI in multi-brand retail will mean that global retailers including Wal-Mart, Carrefour and Tesco can open stores offering a range of household items and grocery directly to consumers in the same way as the ubiquitous ‘kirana’ store

CHALLEGES OF RETAILING IN INDIA

In India the retailing industry has a long way to go and to become a truly flourishing industry, retailing needs to cross various hurdles. The first challenge facing the organized retail sector is the competition from unorganized sector. Needless to say, the Indian retail sector is overwhelmingly swarmed by the unorganized retailing with the dominance of small and medium enterprises in contradiction to the presence of few giant corporate retailing outlets. The trading sector is also highly fragmented, with a large number of intermediaries who operate at a strictly local level and there is no ‗barrier to entry', given the structure and scale of these operations (Singhal 1999).The tax structure in India favors small retail business. Organized retail sector has to pay huge taxes, which is negligible for small retail business. Thus, the cost of business operations is very high in India. Developed supply chain and integrated IT management is absent in retail sector. This lack of adequate infrastructure facilities, lack of trained work force and low skill level for retailing management further makes the sector quite complex. Also, the intrinsic complexity of retailing- rapid price changes, threat of product obsolescence, low margins, high cost of real estate and dissimilarity in consumer groups are the other challenges that the retail sector in India is facing. The status of the retail industry will depend mostly on external factors like Government regulations and policies and real estate prices, besides the activities of retailers and demands of the customers also show impact on retail industry. Even though economy across the globe is slowly emerging from recession, tough times lie ahead for the retail industry as consumer spending still has not seen a consistent increase. In fact, consumer spending could contract further as banks have been overcautious in lending. Thus, retailers are witnessing an uphill task in terms of wooing consumers, despite offering big discounts. Additionally, organised retailers have been facing a difficult time in attracting customers from traditional kirana stores, especially in the food and grocery segment.

MERITS AND DEMIRITS OF FDI:

MERITS: Merits-Attracting foreign direct investment has become an integral part of the economic development strategies for India. FDI ensures a huge amount of domestic capital, production level, and employment opportunities in the developing countries, which is a major step towards the economic growth of the country. The effects of FDI are by and large transformative. The incorporation of a range of well-composed and relevant policies will boost up the profit ratio from Foreign Direct Investment higher. Some of the biggest advantages of

FDI enjoyed by India have been listed as under: Economic growth- This is one of the major sectors, which is enormously benefited from foreign direct investment. A remarkable inflow of FDI in various industrial units in India has boosted the economic life of country. Trade- Foreign Direct Investments have opened a wide spectrum of opportunities in the trading of goods and services in India both in terms of import and export production. Products of superior quality are manufactured by various industries in India due to greater amount of FDI inflows in the country. Employment and skill levels- FDI have also ensured a number of employment opportunities by aiding the setting up of industrial units in various corners of India. Technology diffusion and knowledge transfer- FDI apparently helps in the outsourcing of knowledge from India especially in the Information Technology sector. It helps in developing the know-how process in India in terms of enhancing the technological advancement in India. Linkages and spillovers to domestic firms- Various foreign firms are now occupying a position in the Indian market through Joint Ventures and collaboration concerns. The maximum amount of the profits gained by the foreign firms through these joint ventures is spent on the Indian market.

DEMERITS: Demerits of FDI in India: FDI has been a booming factor that has bolstered the economic life of India, but on the other hand it is also being blamed for ousting domestic inflows. FDI is also claimed to have lowered few regulatory standards in terms of investment patterns: The disadvantages of foreign direct investment occur mostly in case of matters related to operation, distribution of the profits made on the investment and the personnel. One of the most indirect disadvantages of foreign direct investment is that the economically backward section of the host country is always inconvenienced when the stream of foreign direct investment is negatively affected. The various disadvantages of foreign direct investment are understood where the host country has some sort of national secret – something that is not meant to be disclosed to the rest of the world. It has been observed that the defense of a country has faced risks as a result of the foreign direct investment in the country. At times it has been observed that certain foreign policies are adopted that are not appreciated by the workers of the recipient country. Foreign direct investment, at times, is also disadvantageous for the ones who are making the investment themselves. Foreign direct investment may entail high travel and communications expenses. The differences of language and culture that exist between the country of the investor and the host country could also pose problems in case of foreign direct investment.

Another major disadvantage of foreign direct investment is that there is a chance that a company may lose out on its ownership to an overseas company. This has often caused many companies to approach foreign direct investment with a certain amount of caution.

CONCLUSION

POSITIVES: Foreign direct investment would allow India to secure foreign infrastructure into India, which would increase India's capital base rapidly. If anything if India can attract FDI in the big picture it's nothing but positive things. China has grown tremendously because of FDI. So, the benefits can be listed as: - Employments opportunities - reduce spoilage and - enable the delivery of affordable products to customers.

NEGATIVES: The negatives are that it can affect local communities, when larger projects come in. It also means subjecting domestic firms to foreign competition which can harm domestic firms, and this isn't necessarily due to incompetence of the domestic firm. Foreign firms may have technology that India has not acquired. On the other hand FDI brings those technologies to India much quicker. The negative impacts: -improper time of allowing FDI in Retail in India because of lack of infrastructure and -taking of revenue and market share by the big foreign giants.

FDI in retail is very much debatable issue which needs to be resolved by taking into consideration the interest of the stakeholders. The decision to allow entry to foreign players in Multi Brand Retail is clearly a game changer for Indian retail sector. By allowing FDI in retail trade, India will significantly benefit in terms of quality standards since the inflow of FDI in retail sector is bound to pull up the quality standards and cost-competitiveness of Indian producers and marketers in all the segments. It will also help in integrating the modern Indian retail market with that of the global retail market

On the other hand, FDI in multi-brand retailing must be dealt cautiously as it has direct impact on a large chunk of population. Foreign capital, if unchecked, may widen the gap between the rich and the poor. Thus, the entry of foreign capital into multi-brand retailing needs to be anchored in such a way that it results in a win-win situation both for India and global players.

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