FOREIGN DIRECT INVESTMENT IN INDIAN RETAIL SECTOR

Track: Economic Reforms

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ABSTRACT:

On 20th September, 2012 the Government of India has approved 51% FDI in Multiband retail and 100% (revised) in Single Brand retail sector through Government Route with some riders. Govt. of India is firm to implement the FDI in multi Brand Retail' Agitation and Bandhs have been called by some political parties. Prime Minister of India has explained to the Nation the necessity and obligation under WTO agreement to allow FDI in Retail Sector. There is a mixed response about FDI in retail sector. Still some of the states are either not in favour of the FDI or indecisive on the issue as they feel that FDI in retail is harmful to local retailers in India. Everyone has the reasons for supporting or opposing the issue.

Retail is one of the largest sectors of Indian economy the unorganized retail sector in India occupies 97% of the retail business and the rest 3% is contributed by the organized sector. The unorganized retail sector contributes about 13% to the GDP and absorbs 6% of our labour force. Hence the issue of displacement of labour consequent to FDI Retail Sector is of primal importance in India

Introduction

India is the founder member of World Trade Organization and signatory to its General Agreement on Trade in Services (GATS). This agreement includes wholesale and retailing services and all member countries are required to open up the retail trade sector to foreign investment. There were initial reservations towards opening up of retail sector arising from fear of job losses, procurement from international market, competition and loss of entrepreneurial opportunities. However, the government in a series of moves has opened up the retail sector slowly to Foreign Direct Investment (FDI) in India.

REVIEW OF LITERATURE

Retail modernization: Retail modernization in developing countries and its effect on the broader food system has been a major focus of research since the early 2000s. The most visible banner for this work has been the ―supermarket revolution‖. Supermarkets existed in Latin America from at least the 1960s1, but began to grow much more rapidly in that region during the economic boom and opening to Foreign Direct Investment (FDI) of the 1990s. Growth began later in East/Southeast Asia and Central Europe, followed by selected countries of Africa (Reardon et al, 2004). This growth, together with new procurement practices that the firms work to apply, has lead to a rash of studies attempting to document and anticipate the impacts of these firms on existing actors in the food system, and to draw policy implications for governments and donors

In India, market reform and opening to FDI, along with prospects for 7% yearly growth in retail sales in a market of 1.2 billion people have generated billions of dollars of planned investment in supermarkets by local and multi-national firms, including Wal-Mart and Carrefour. Yet supermarket shares in India are currently very low (around 2%), due to the country‘s massive and complex small retail sector. Supermarkets there face the 20/20/20 challenge: they must grow their food sales by 20% a year for 20 years just to reach a 20% market share. Such unprecedented growth would still leave more traditional channels holding 80% of the food market.

Objective Of The Study And Methodology

The objective of our study is to analyze the current retail scenario in India, investigate the controversial views and evaluate the likely challenges and threats of FDI in both single and multi- brand retail in India. The whole paper is based on descriptive arguments, comparative study and analytical logic developed through the understandings from various research papers, reports, books, journals, newspapers and online data bases.

Background Of Fdi In Retail Sector In India

- During nineties Mr. P V Narsimha Rao lead Govt. allowed limited FDI in retail and as a result "Dairy Farm" a MNC made entry in India.
- In 1997, FDI in cash and carry (wholesale) with 100 percent ownership was allowed

under the Government approval route. It was brought under the automatic route in 2006.

- NDA Government was willing to introduce FDI in retail sector in May, 2002 but it could not materialize due to unknown reasons.
- 51% Foreign Direct investment in single brand retail was also permitted in 2006.
- In 2011 100% FDI was allowed in Single Brand retail withholding the FDI in Multi Brand Retail due to various political reasons.

- 100 % FDI in Single Brand (with revised guidelines) and 51% in Multi-Brand retailing with some conditions have now been allowed in India w.e.f. 20th Sept., 2012 with an option to the state Governments to allow or not to allow the FDI in retail sector in their states.

WHAT IS FDI?

FDI refers to capital inflows from abroad that is invested in or to enhance the production capacity of the economy. It can be a subsidiary, joint venture or merger or acquisition and includes Greenfield and Brownfield projects. So, Foreign Direct Investment is an investment made by a foreign company or entity into a company or entity based in another country. Foreign direct investments differ substantially from indirect investments such as portfolio flows, wherein overseas institutions invest in equities listed on a nation's stock exchange. Entities making direct investments typically have a significant degree of influence and control over the company into which the investment is made. Open economies with skilled workforces and good growth prospects tend to attract larger amounts of foreign direct investment than closed, highly regulated economies. OECD has defined FDI as investment by a foreign investor in at least 10% or more of the voting stock or ordinary shares of the investee company.

WHAT IS RETAIL?

Retail is a French word which means to “cut it again” and essentially mean a sale to the consumer for direct consumption. 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). Thus the retail is an 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

DIVISION OF RETAIL SECTOR:

The retail industry is mainly divided into:-

1) Organized Retail Sector

2) Unorganized Retail Sector

Organized 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 hyper markets and retail chains, and also the privately owned large retail businesses. It covers only 3% of retail Business.

Unorganized retailing 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 (street sellers) and pavement vendors etc. and covers almost 97% of the retail Business. The sector is the largest source of employment after agriculture, and has deep penetration into rural India generating more than 12 per cent of India"s GDP

Evolution of Indian Retail Industry

It is interesting to focus on the evolution of the retail sector in India. Historically they evolved as a source of entertainment (in the form of village fairs, melas etc.) which was within the rural reach. Later on these were transformed Mom and Pop/ Kirana stores which are of traditional variety neighbourhood shops. Then came the government supported PDS outlets, khadi stores, cooperatives etc. Finally shopping malls, supermarkets, departmental stores etc has brought a great revolution to the Indian retail market.

A Comparison of Norms under Single-brand and Multi-brand Retail in India

Parameters	Multi-brand	Single-brand
Ownership/ Investment Requirement	Minimum investment of US$ 100million by the foreign investor	The foreign investor should be an owner of the brand
Investment towards back- end infrastructure	At least 50% of the investment by the foreign company to be in back-end infrastructure1	No condition
Location of stores	Stores to be restricted to cities with a population of one million or more (53 cities as per 2011 Census); given constraints around real estate, retailers are allowed to set up stores within 10 km of such cities	No condition
Sourcing	At least 30% of manufactured items procured should be through domestic small and medium enterprises (SMEs)	In respect of proposals involving FDI beyond 51%, 30% sourcing would mandatorily have to be done from domestic SMEs and cottage industries artisans and craftsmen

Sales	No Condition	Products to be sold should be of a „single brand" (only those brands which are branded during manufacturing) only; sold under the same brand name internationally
Approval of State Government s required	While the proposals on FDI will be sanctioned by the Centre, approvals from each State Government would be required	While the proposals on FDI will be sanctioned by the Centre, approvals from each State Government would be required

Source: Press Information Bureau, ICRA

[Note: 1 Back-end infrastructure will include capital expenditure on all activities, excluding that on front-end units; i.e. it will include investment made towards processing, manufacturing, distribution, design improvement, quality control, packaging, logistics, storage, warehouse, agriculture market produce infrastructure, etc. Expenditure on land cost and rentals, if any, will not be counted for purposes of back-end infrastructure]

Entry Options for Foreign Players Prior to FDI Policy (2006)

Although prior to Jan 24, 2006, FDI was not authorized in retailing, most general players had been operating in the country. Some of entrance routes used by them have been discussed in sum as below:-

(a) Franchise Agreements:

It is an easiest track to come in the Indian market. In franchising and commission agents" services, FDI (unless otherwise prohibited) is allowed with the approval of the Reserve Bank of

India (RBI) under the Foreign Exchange Management Act. This is a most usual mode for entrance of quick food bondage opposite a world. Apart from quick food bondage identical to Pizza Hut, players such as Lacoste, Mango, Nike as good as Marks as good as Spencer, have entered Indian marketplace by this route.

(b) Cash And Carry Wholesale Trading:

100% FDI is allowed in wholesale trading which involves building of a large distribution infrastructure to assist local manufacturers. The wholesaler deals only with smaller retailers and not Consumers. Metro AG of Germany was the first significant global player to enter India through this route.

(c)Strategic Licensing Agreements:

Some foreign brands give exclusive licences and distribution rights to Indian companies. Through these rights, Indian companies can either sell it through their own stores, or enter into shop-in-shop arrangements or distribute the brands to franchisees. Mango, the Spanish apparel brand has entered India through this route with an agreement with Piramyd, Mumbai, SPAR entered into a similar agreement with Radhakrishna Foodlands Pvt. Ltd.

(d) Manufacturing and Wholly Owned Subsidiaries:

The foreign brands such as Nike, Reebok, Adidas, etc. that have wholly-owned subsidiaries in manufacturing are treated as Indian companies and are, therefore, allowed to do retail. These companies have been authorised to sell products to Indian consumers by franchising, internal distributors, existent Indian retailers, own outlets, etc. For instance, Nike entered through an exclusive licensing agreement with Sierra Enterprises but now has a wholly owned subsidiary, Nike India Private Limited

Current Position and FDI Norms in Indian Retail

In 2010, the Indian retail market was valued at $435 billion of which the share of modern retail was 7 per cent. The sector is expected to grow to $535 billion by 2013 with the share of modern retail at 10 per cent. In 2007, India was ranked the twelfth largest consumer market and it is expected to be the fifth-largest consumer market by 2025 after the US, Japan, China and the UK (McKinsey & Company 2007). In 2010, India attracted the largest number of new retailers among emerging and mature markets (CBRE 2011). According to study conducted by ICRIER, total retail business in India will grow at 13% annually, from US $322 billion in 2006-07 to US $590 billion in 2011-12 and further US $1 trillion by 2016-17 (figure-2)

Figure-(2)

Size of Indian retail(in US $ bn)

Discussion:

Here discussion is based on FDI retail in India as follows:

(a) Single Brand- Single brand implies that foreign companies would be allowed to sell goods sold internationally under a „single brand‟, viz., Reebok, Nokia and Adidas. 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.

(b) Multi Brand- FDI in Multi Brand retail implies that a retail store with a foreign investment can sell multiple brands under one roof. 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.

The approval for single and multi brand includes a set of riders for the foreign investors, aimed at ensuring that the foreign investment makes a genuine contribution to the development of Indian infrastructure and logistics, at the same time facilitating integration of small retailers into the upgraded value chain.

While the minimum capital requirement of US$ 100 million is unlikely to be an issue for the large foreign players vying to enter India in the supermarket/ hypermarket segment, it could make it difficult for foreign investors planning to enter specialty formats such as music, mobile, electronics goods, among others, as these formats require relatively lower investments. Further, the approval requirements from State Governments could limit the cities that FDI backed retailers can operate in. The current opposition raised by a number of political parties, if persists, may pose a major roadblock in the entry of the foreign retailers in India. Besides restricting the number of cities these retailers can operate in, it could also lead to problems in creating supply chain efficiency

FDI IN MULTI BRAND RETAIL:

The government has also not defined the term Multi Brand. 51% FDI in Multi Brand retail implies that a retail store with a foreign investment can sell multiple brands under one roof with the following conditions:

1. FDI in multi brand retail trading, in all products, will be permitted, subject to the following conditions: Fresh agricultural produce, including fruits, vegetables, flowers, grains, pulses, fresh poultry, fishery and meat products, may be unbranded

2. Minimum amount to be brought in, as FDI, by the foreign investor, would be US $ 100 million. 3. At least 50% of total FDI brought in shall be invested in 'backend infrastructure' within three years of the first tranche of FDI, where back-end infrastructure' will include capital expenditure on all activities, excluding that on front-end units; for instance, back end infrastructure will include investment made towards processing, manufacturing, distribution, design improvement, quality control, packaging, logistics, storage, ware-house, agriculture market produce

4. Infrastructure etc. Expenditure on land cost and rentals, if any, will not be counted for purposes of back end infrastructure.

5. At least 30% of the value of procurement of manufactured! Processed products purchased shall be sourced from Indian 'small industries,,which have a total investment in plant & machinery not exceeding US $ .1.00 million.

6. This valuation refers to the value at the time of installation, without providing for depreciation. Further, if at any point in time, this valuation is exceeded, the industry shall not qualify as a 'small industry' for this purpose. This procurement requirement would have to be met, in the first instance, as an average of five years' total value of the manufactured! processed products purchased, beginning 1st April of the year during which the first tranche of FDI is received.

7. Thereafter, it would have to be met on an annual basis.

8. Self-certification by the company, to ensure compliance of the conditions at serial nos. (ii), (iii) and (iv) above, which could be cross-checked, as and when required. Accordingly, the investors shall maintain accounts, duly certified by statutory auditors.

9. Retail sales outlets may be set up only in cities with a population of more than 10 lakh as per 2011 Census and may also cover an area of10 kms around the municipal/urban agglomeration limits of such cities; retail locations will be restricted to conforming areas as per the Master/Zonal Plans of the concerned cities and provision will be made for requisite facilities such as transport connectivity and parking; In States/ Union Territories not having cities with population of more than 10 lakh as per 2011 Census, retail sales outlets may be set up in the cities of their choice, preferably the largest city and may also cover an area of 10 kms around the municipal/urban agglomeration limits of such cities. The locations of such outlets will be

restricted to conforming areas, as per the Master/Zonal Plans of the concerned cities and provision will be made for requisite facilities such as Transport connectivity and parking.

Some of the critics on FDI retail in india:

Critics of FDI feel that liberalization would jeopardize the unorganized retail sector and would adversely affect the small retailers, farmers and consumers and give rise to monopolies of large corporate houses which can adversely affect the pricing and availability of goods. They also contend that the retail sector in India is one of the major employment providers and permitting FDI in this sector can displace the unorganized retailers leading to loss of livelihood. The major threats to the domestic retailers in India are specified below:

1. Domination of Organized Retailers- FDI in single-brand retail will strengthen organized retail in the country. These organized retailers will tend to dominate the entire consumer market. It would lead to unfair competition and ultimately result in large-scale exit of domestic retailers, especially the small family managed outlets (local “mom and pop” stores will be compelled to close down).

2. Create Unemployment- Retail in India has tremendous growth potential and it is the second largest employer in India. Any changes by bringing major foreign retailers who will be directly procuring from the main supplier will not only create unemployment on the front end retail but also the middleman who have been working in this industry will be thrown out of their jobs.

3. Loss of Self Competitive Strength- The Indian retail sector, particularly organized retail, is still under- developed and in a nascent stage and that, therefore the companies may not be able to compete with big global giants. If the existing firms collaborate with the global biggies they might have to give up at the global front by losing their self competitive strength.

4. Indirectly Leads to Increase in Real Estate Cost- It is obvious that the foreign companies which enter into India to open up their malls and stores will certainly look for places in the heart of the cities. There shall be a war for place, initiated among such companies. It will result in increase in the cost of real estate in the cities that will eventually affect the interest of the ordinary people who desire to own their houses within the limit of the cities.

5. Distortion of Culture: Though FDI in Indian retail will indirectly or directly contribute for the enhancement of Tourism, Hospitality and few other Industries, the culture of the people in India will slowly be changed. The youth will easily imbibe certain negative aspects of foreign culture and lifestyles and develop inappropriate consumption pattern, not suited to our cultural environment.

Suggestion :

Market liberalization, a growing middle-class, and increasingly assertive consumers are sowing the seeds for a retail transformation that will bring more Indian and multinational players on the scene. India is tipped as the second largest retail market after China, and the total size of the Indian retail industry is expected to touch the $300 billion mark in the next five years from the current $200 billion. But the recent debate has centered on the issue of whether FDI in retail in India will be a “boon or a bane”. Many studies and surveys were conducted to analyze the impact of FDI in retail sector in various segments of the economy. According to a policy paper prepared by the Department of Industrial Policy and Promotion (DIPP, 2010), FDI in retail must result in backward linkages of production and manufacturing and spur domestic retailing as well as exports. According to the World Bank, opening the retail sector to FDI would be beneficial for India in terms of price and availability of products. While FDI in multi-brand retail has been opposed by several in the past citing fears of loss of employment, adverse impact on traditional retail and rise in imports from cheaper sources like China, adherents of the same indicate increased transfer of technology, enhanced supply chain efficiencies and increased employment opportunities as the perceived benefits.

The following may be regarded as major perceived benefits of allowing FDI in retail in India:

1. Capital Infusion- This would provide an opportunity for cash-deficient domestic retailers to bridge the gap between capital required and raised. In fact FDI is one of the major sources of investments for a developing country like India wherein it expects investments from Multinational companies to improve the countries growth rate, create jobs, share their expertise, back-end infrastructure and research and development in the host country.

2. Boost Healthy Competition and check inflation- Supporters of FDI argue that entry of the many multi- national corporations will obviously promise intensive competition between the different companies offering their brands in a particular product market and this will result in availability of many varieties, reduced prices, and convenient distribution of the marketing offers.

3. Improvement in Supply Chain- Improvement of supply chain/ distribution efficiencies, coupled with capacity building and introduction of modern technology will help arrest wastages (in the present situation improper storage facilities and lack of investment in logistics have been creating inefficiencies in food supply chain, leading to significant wastages).

4. Improvement in Customer Satisfaction- Consumers in the organized retail will have the opportunity to choose between a numbers of internationally famous brands with pleasant shopping environment, huge space for

product display, maintenance of hygiene and better customer care. There is a large segment of the population which feels that there is a difference in the quality of the products sold to foreign retailers and the same products sold in the Indian market. There is an increasing tendency to pay for quality and ease and access to a "one-stop shop" which will have a wide range of different products. If the market is opened, then the pricing could also change and the monopoly of certain domestic Indian companies will be challenged.

5. Improved technology and logistics- Improved technology in the sphere of processing, grading, handling and packaging of goods and further technical developments in areas like electronic weighing, billing, barcode scanning etc. could be a direct consequence of foreign companies opening retail shops in India,. Further, transportation facilities can get a boost, in the form of increased number of refrigerated vans and pre-cooling chambers which can help bring down wastage of goods.

6. Benefits for the Farmers- Presumably, with the onset of multi-brand retail, the food and packaging industry will also get an impetus. Though India is the second largest producer of fruits and vegetables, it has a very limited integrated cold-chain infrastructure. Lack of adequate storage facilities causes heavy losses to farmers, in terms of wastage in quality and quantity of produce in general, and of fruits and vegetables in particular. With liberalization, there could be a complete overhaul of the currently fragmented supply chain infrastructure. Extensive backward integration by multinational retailers, coupled with their technical and operational expertise, can hopefully remedy such structural flaws. Also, farmers can benefit with the "farm-to fork" ventures with retailers which helps (i) to cut down intermediaries ; (ii) give better prices to farmers, and (iii) provide stability and economics of scale which will benefit, in the ultimate analysis, both the farmers and consumers.

7. Creation of More And Better Employment Opportunities- The entry of foreign companies into Indian Retailing will not only create many employment opportunities but, will also ensure quality in them. This helps the Indian human resource to find better quality jobs and to improve their standard of living and life styles on par with that of the citizens of developed nations.

Conclusion

The government has added an element of social benefit to its latest plan for calibrated opening of the multi-brand retail sector to foreign direct investment (FDI). Only those foreign retailers who first invest 50% of FDI amount in the back-end infrastructure development within three years from the date of first tranche of FDI received would be allowed to set up multi brand retail outlets in the country. The idea is that the firms must have already created jobs for rural India before they venture into multi-brand retailing. It is presumed the advantages of allowing unrestrained FDI in the retail sector evidently outweigh the disadvantages attached to it and the same can be deduced from the examples of successful experiments in countries like Thailand and China where too the issue of allowing FDI in the retail sector was first met with incessant protests, but later turned out to be one of the most promising political and economical decisions of their governments and led not only to the commendable rise in the level of employment but also led to the enormous development of their country‟s GDP. It is pertinent to note here that it can be safely contended that with the possible advent of unrestrained FDI flows in retail market, the interests of the retailers constituting the unorganized retail sector will not be gravely undermined, since nobody can force a consumer to visit a mega shopping complex or a small retailer/Local Vegetable Market. Consumers will shop in accordance with their utmost convenience, where ever they get the lowest price, maximum variety, and a good consumer experience. The Industrial policy 1991 had crafted a trajectory of change whereby every sectors of Indian economy at one point of time or the other would be embraced by liberalization, privatization and globalization. 51% FDI in multi-brand retailing through Govt. route and allowing the 100% FDI in single brand retail is in that sense a steady progression of that trajectory. But the government has by far cushioned the adverse impact of the change that has ensued in the wake of the implementation of Industrial Policy 1991 through safety nets and social safeguards. Conditions like minimum US$ 100 million investment, 50% investment of FDI in backend infrastructure, 30% sourcing of material from the Small Scale Industry, entry in the cities with 1 million populations, Government route for approval of FDI are certainly the points which will restrain the entry of the non-serious investors. Approval of FDI in retail sector will not only fulfill the India‟s commitment to WTO‟s GATS agreement but will also encourage the local players to be more competitive and quality oriented. Consumers will also get benefit as they will have the variety of products to choose from at the competitive prices. In short, FDI in retail sector may boost the socio economic development of the entire country if implemented wisely carefully while signing the agreements with the Foreign Investors.

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