Foreign Direct Investment in Retail:
Opportunities and Challenges in India

Siby Abraham, Assistant Professor, Department of Economics, Sacred Heart College, Thevara, Kochi-13. Email: sibyabrahamc@gmail.com. Cell: +91 - 9497202040.

Abstract

The Government of India's decision to approve 51percent FDI in Multi Brand Retail and 100 percent (revised) in Single Brand retail sector has generated widespread enthusiasm for some and distress for others. Some say that FDI in the retail sector will lead to upgradation of technology, better utilisation of human resources, creation of job opportunities, development of rural infrastructure and thereby economic growth. But those who oppose have concerns about the loss of entrepreneurial and employment opportunities, exit of small domestic retailers due to stiff competition and distortion of urban cultural development. This paper presents an overview of the Indian retail sector, opportunities of expansion of FDI in retail and the major challenges encountered.

Key Words**:** FDI, Single Brand Retail, Multi-brand Retail, Opportunities and Challenges.

Foreign Direct Investment in Retail: Opportunities and Challenges in India

Abstract

The Government of India's decision to approve 51percent FDI in Multi Brand Retail and 100 percent (revised) in Single Brand retail sector has generated widespread enthusiasm for some and distress for others. Some say that FDI in the retail sector will lead to upgradation of technology, better utilisation of human resources, creation of job opportunities, development of rural infrastructure and thereby economic growth. But those who oppose have concerns about the loss of entrepreneurial and employment opportunities, exit of small domestic retailers due to stiff competition and distortion of urban cultural development. This paper presents an overview of the Indian retail sector, opportunities of expansion of FDI in retail and the major challenges encountered.

Key Words**:** FDI, Single Brand Retail, Multi-brand Retail, Opportunities and Challenges.

I. Introduction

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. OECD has defined FDI as an investment by a foreign investor in at least 10 percent or more of the voting stock or ordinary shares of the investee company.

Retail is a French word which means to "cut it again" and essentially mean a sale to the consumer for direct consumption. It is defined as all activities involved in selling goods or services directly to the final consumer for their personal, non-business use via shops, market, door-to-door selling, and mail-order or over the internet where the buyer intends to consume the product. 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.

FDI provides a win – win situation to both the host and the home countries. The “home” countries want to take the advantage of the vast markets opened by industrial growth. On the other hand the “host” countries want to acquire technological and managerial skills and supplement domestic savings and foreign exchange. Developing nations accepted FDI as a sole visible panacea for all their financial, capital, entrepreneurship and technological scarcities. The government of India in a series of moves has opened up the retail sector slowly to Foreign Direct Investment (FDI) in India. 100 percent FDI in Single Brand (with revised guidelines) and 51 percent in Multi-Brand retailing with some conditions have now been allowed in India w.e.f. 20th September, 2012 with an option to the state Governments to allow or not to allow the FDI in retail sector in their states. Government of India is firm on implementing the FDI policy in retail sector as it feels that FDI is beneficial for the economic growth of the country and the rights of the local retailers have been protected by this.

II. Indian Retail Sector: An Overview

Retail is one of the largest sectors of Indian economy. The unorganized retail sector in India occupies 97 percentages of the retail business and the rest 3 percent is contributed by the organized sector. The unorganized retail sector contributes about 13 percent to the GDP and absorbs 6 percentage of our labour force. India is ranked as the third most attractive nation for retail investment among 30 emerging markets that have domestic companies like the Future Group, Tata’s Westside, Reliance Fresh, Raheja Group, Pantaloon, Lifestyle, Food World, Bharti Retail etc. competing for market share. Economic liberalization has sown the seeds for a retail transformation in India that will bring more MNCs like Wal-Mart (U.S), Carrefour (France), Marks & Spencer and Tesco (U.K), and Shoprite (South Africa).

According to the Investment Commission of India, the retail sector is expected to grow to almost three times from its current levels to $660 billion by 2015. According to A.T.

Kearney's Annual Global Retail Development Index (GRDI) for the year 2012, India has been placed at fifth rank (after Brazil, Chile, China and Uruguay) on the basis of retail investment attractiveness. The growing Indian market has attracted a number of foreign retailers and domestic corporate to invest in this sector. However, in spite of the recent advancements in retailing and its huge contribution to the economy, retailing is still among the least evolved sectors and the growth of organised retailing is immensely slower compared to the rest of the world. Food retail trade accounts for 63 per cent of total retail sales in the economy and thus, is a very large segment of the total economic activity of our country. It holds a vast employment potential and hence, attracts the attention of government and foreign major retailers. Enhancing the efficiency and improving the food retail sales would have a cascading effect on employment and economic activity in the rural areas for the marginalised workers.

Mckinsey&Company (2007) studied that the Indian retail market size is estimated to be US$ 450 billion. Retailing accounts for 14 to 15 percent of its GDP and constitutes as one of the top five retail markets in the world by economic value. Also with 1.2 billion people, India is one of the fastest growing retail markets in the world. The retail industry in India is the second largest employer with an estimated 35 million people engaged by the industry. The Indian retail industry is generally divided into two major segments – organized retailing and unorganized retailing. 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 3percent of retail business. Unorganized retailing refers to the traditional formats of low-cost retailing, for example, the local kirana shops, owner manned general stores, pan shops, convenience stores, hand cart (street sellers) and pavement vendors etc. and covers almost 97 percent 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.

D.Gandhikumar (2013) observes that India's retail sector worth around $500 billion is the front end of millions of farmers and small, medium and large producers. Only 5-8 percent is in the organized sector. Therefore the number of people employed in the retail sector as well as in its back-end supply chains is huge. The retail sector in India is organized into three categories. According to the Department of Industrial Policy and Promotion (DIPP) of the Government of India, single-brand retail comprises those retailers selling products of a ‘single brand’ only, such that products should be sold under the same brand internationally; and single-brand product retailing covers only products which are branded during manufacturing. In this category, FDI is allowed to the extent of 51 per cent. From 2006 to March 2010, around 94 foreign firms applied to invest through the single-brand route of which 57 were approved. Consequently, the percentage increase in FDI flows in the retail sector between 2008 and 2010 was even higher than that in sectors such as the services sector, trading and telecommunications, which have a much higher share in the country's overall FDI (DIPP, 2010). In contrast, no FDI is allowed in the multi-brand retail category. This includes all firms in organized retail that seek to stock and sell multiple brands, such as large international retailers like Wal-Mart and Carrefour. This is the sector that is most under dispute. The third segment, called ‘cash and carry’, refers to wholesale retail. The government defines this segment as the “sale of goods and merchandise to retailers, industrial, commercial, institutional or other professional business users or to other wholesalers and related subordinated service providers”. In India, FDI of 100 per cent is permitted in this segment. As per the ‘cash and carry' structure commonly employed in India, the wholesale and retail entities are maintained as separate entities without any cross-shareholdings. The retail entity is owned and controlled by the Indian partner while the wholesale entity can be owned by the foreign partner up to 100 per cent. Wal-Mart, for example, has already established a successful presence in this category of wholesale operations by entering into a joint venture with Bharti Enterprises Ltd. of India. The new entity, Bharti-Wal-Mart, is in operation with stores opening around the country. The yardstick used to determine whether an operation is wholesale or not is the type of customers to whom the sale is made and not the size and volume of sales.

III. Objectives of the Study and Methodology

The objective of the present study is to analyze the current retail scenario in India, investigate the controversial views of the various stakeholders and evaluate the likely challenges and threats of FDI in both single and multi-brand retail in India. It also aims to review current policy and regulations with regards to foreign investors so as to gain an understanding of the current position on FDI, as well as an overview of the Indian system. The whole paper is based on descriptive arguments, statistical data, case studies and analytical logic developed through the understandings from various research papers, reports, books, journals, newspapers and online data bases.

IV. Policy Implications of FDI in Retail

Government of India permits 100 percent FDI in single brand retail and 51 percent in multi-brand retail. Foreign retailers will only be allowed to set up shop in cities with a population of more than one million. Individual state governments are empowered to take decision on allowing foreign supermarket chains. They can also choose where to allow foreign chains to open in states where there are no cities with such a big population. Foreign retailers have to source almost a third of their processed goods and manufactured from industries with a total plant and machinery investment of less than $1 million. The Government also instructs that 30 percent of the sourcing is to be done from micro and small industries whose investment in plant and machinery not exceeding US$ 1million.

V. Perceived Opportunities

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. *Enhance 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 homogeneous products at reduced prices. Evidence from the United States suggests that FDI in organized retail could help tackle inflation, particularly with wholesale prices. In India 95 percent retail is in the un-organized sector that means only

5 percent is in organized sector. Local chains like Big Bazar and Spencers haven't dealt a deathblow to small retailers. So, the FDI in retail won't affect them either.

3. *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. The stage is now set when Indian consumers will have the luxury of world class opportunity of shopping to meet the requirements of daily life. 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. Big retailers will often allow discounts on selected items which will facilitate the consumers and they can end up with marginal bargains.

4. *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.

5. *Benefits for the Farmers*: The biggest beneficiary of FDI in retail would be farmers who will be able to improve their productivity. The farmers will not only be able to increase their output but will also get better rewards in terms of supplying to organized retailers by tying up long term contracts with them. The foreign retailers will purchase raw materials from the farmers and various other goods from the original producer directly. The farmers across India's 6,00,000 villages stand to gain with higher profits and better market access. The farmers would be getting good prices for their harvest. The original producers will get a higher price since the profit will flow to them directly, leaving behind the middle men.

6. *Creation of More and Better Employment Opportunities*: There will be huge job opportunities in the country with the entry of foreign multi nationals into Indian retail space. 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. The job opportunities will vary from ordinary workers to specialized officers. The employment

opportunities will be open in retail sales, retail floor manager, cold chains, warehousing, logistics etc. The new jobs will created in front end and back end leading to a positive impact on economy.

7. *Proper tax system*: The organized sales with computerized billing system will also yield more revenue through commodity taxes like VAT and service tax to the government. Thus tax buoyancy of the economy would increase.

8. *Partnership opportunity*: Indian retailers have reason to be happy with foreign direct investment in the retail sector because it is a partnership opportunity that involves a lot of learning that could take them to higher profitability. The central government is planning to have 51 percent foreign investment; this means the foreign retailers need partners for the rest investment to gain market.

9. *Distribution system*: It has been estimated that 30-35 percent of India's total production of fruits and vegetables is wasted every year due to inadequate cold storage and transport facilities. Almost half of this wastage can be prevented if fruit and vegetable retailers have access to specialized cold storage facilities and refrigerated trucks. The organized retail will bring in efficient practices that will help farmers in the procurement process, reduce wastage with efficient storage system and will finally cut the losses.

10. *Knowledge enhancement:* FDI in retail will make way for inflow of knowledge from international experts. The growth of the organized retail in India will be a 'sunrise' for the management educational institutes as their requirement will be increasing.

VI. Viable Challenges

Critics of FDI feel that liberalization would topple 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 outlets.

2. *Create Unemployment:* Retail in India has tremendous growth potential and it is the second largest employer in India. Opening up FDI may lead to unfair competition and ultimately result in large-scale exit of incumbent domestic retailers, especially the small family-owned business. 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. *Possible 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.

VII. Conclusion

It is presumed that 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. Evidence from the United States suggests that FDI in organized retail could help tackle inflation, particularly with wholesale prices. It is also expected that technical know-how from foreign firms, such as warehousing technologies and distribution systems, for example, will lend itself to improving the supply chain in India, especially for agricultural produce. 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. Consumers will shop in accordance with their utmost convenience, wherever 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 percent FDI in multi-brand retailing through government route and allowing the 100 percent 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 percent investment of FDI in backend infrastructure, 30 percent 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 fulfil 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 and carefully while signing the agreements with the Foreign Investors.

References

Berman B., Evans J.R. (2007), Retail Management- A strategic approach, Prentice Hall of India Private Limited, Tenth edition.

Bhattacharyya, R (2012), The Opportunities and Challenges of FDI in Retail in India, IOSR Journal of Humanities and Social Science, Volume 5, Issue 5, PP 99-109, available at www.Iosrjournals.Org

Bisaria, G (2012), Foreign Direct Investment in Retail in India, International journal of Engineering and Management Research, Vol. 2, Issue-1, pages: 31-36.

Chari, A. & Raghavan, M. (2011), Foreign Direct Investment in India’s Retail Bazaar: Opportunities and Challenges, working paper.

Dutt, S. (2006), 'India in a Globalized World', Manchester University Press.

Gandhikumar, D (2013), FDI in Retail: Is 30% local sourcing feasible? , Business Line, 12.10.2013.

Kaushik, K. R. & Dr. Bansal, K.K. (2012), Foreign Direct Investment in Indian Retail Sector Pros and Cons, International Journal of Emerging Research in Management &Technology ISSN: 2278-9359.

Mahadevaswamy, G.H. & Nalini, R.(2013), FDI in Multi-Brand Retailing: A Case Study of Mysore, Indian Journal of Marketing, vol.43, no.8, pages: 5-13.

Sarkar, A. (2013), Understanding FDI in Retail: What can Economic Principles Teach Us? Economic and Political Weekly, vol.XLVIII no.1, pages: 12 - 17.

Sinha, P. & Singhal, A (2013), FDI in Retail in India: An Empirical Analysis, MPRA Paper No. 46833, available at http://mpra.ub.uni-muenchen.de/46833/