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Some Issues on FDI in Retail Sector in India

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ABSTRACT

In the era of globalization, Foreign Direct Investment (FDI) plays a vital role in the economy of any country. Large consumer market, cheap and sufficient human force, increasing improvement of infrastructure facilities are some of the important factors that attracts the foreign business giants to invest in India. India is also one of the few markets in the world which offers high prospects for growth and earning potential practically in all areas of business (World Bank, 2004; OECD, 1999). Retail Sector in India is one of the fast growing sectors with huge growth potential. FDI in retail sector is a debatable issue in India in recent years. Foreign Direct Investment (FDI) in retail sector in 1997 where 100% FDI in cash and carry with prior government approval was given by the Government of India. 51% investment in a single brand retail outlet was permitted in 2006. FDI in Multi-Brand retailing is prohibited in India though Government proposed to allow 51% FDI in this type of retail in 2011-12. This paper tries to find out the prospects of Foreign Direct Investment along with the pros and cons of FDI in retail sector in India.

1. Introduction

In the modern age of liberalization, Privatisation and globalization, foreign direct investment (FDI) has gaining a tremendous importance for the economy, especially for the developing and under-developed countries. The retail sector is one of the most crucial and extremely potential sectors of the Indian Economy. As a signatory to World Trade Organization's General Agreement on Trade in Services, which include wholesale and retailing services, India had to open up the retail trade sector to foreign investment. In 1997, FDI in cash and carry (wholesale) with 100% ownership was allowed under the Government approval route. It was brought under the automatic route in 2006. 51% investment in a single brand retail outlet was also permitted in 2006. In 2012, Government has allowed FDI upto 51% in multi-brand retail trade. Many foreign retail giants along with the domestic big retail players are interested to enter into retail sector in India due to some favourable factors, such as, increase in the incomes of the consumers, availability of resources, low cost of labour, fast developing economy and liberal policy of the Government.

2. Definition of FDI and retail

According to the Dictionary of Economics (Graham Bannock et.al) FDI is as investment in a foreign country through the acquisition of a local company or the establishment there of an operation on a new (Greenfield) site.

The High Court of Delhi (2004) defined 'retail' as a sale for final consumption as against the sale for further sale or processing (i.e. wholesale).In other words, we can say that it is a process of sale to the ultimate consumer and the transaction between the producer and the individual consumer buying for personal consumption.

However, the word 'single brand' has not been defined, it implies that companies of foreign countries carrying business in India would be allowed to sell goods under a 'single brand', viz., LG, Samsung, and Adidas. FDI in 'Single brand' retail means that a retail store with foreign investment can only sell one brand.

The government has also not defined the term Multi Brand. FDI in Multi Brand retail implies that a retail outlet having a foreign investment can sell goods of multiple brands in that store. .

3. Present Structure of Retail Market in India

Indian Retail market is considered as one of the fast growing five retail market in the world. Indian retail market holds the fifth position in terms of business in the world (Dikshit Anand). It also makes a significant contribution about 32-35% of GDP to the Indian economy and marked the growth rate of more than 40% in the last 5 years (Rajiv kumar). 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.

Indian retail industry is mainly classified into two groups:

I. **Organised Retail Market:** In this type of retailing, retailers who are registered under the Income tax Act, Sales Tax Act, and VAT etc. carrying out their businesses. Retail chain, supermarkets, large retail businesses are examples of organised retailing.
II. **Unorganised Retail Market**: Retailers are not registered by any Act and often maintain their accounts according to their own convenience. These types of Traditional businesses are small in size, based on consumer relation with bargaining power. Local *kirana* shops, general stores owned by individuals, convenience stores etc are the examples of unorganised retailing. However, 94% of the total businesses are being carried by the unorganised retailers. At present, modern retail sector (organised) make a business of 26 USD Billion as against 453

USD Billion of the traditional, unorganised retail sector (Technopak research, 2011).

4. Reasons for introducing FDI in retail in India

I. Huge demand of branded goods.
II. Change of attitude of consumers: Consumer class expected to grow from approx 50 million at present to 583 million by 2025.Organised retail will grow much faster rate than traditional retail.
III. E-retailers increasing the presence
IV. Favourable demographic profile to consume new and modern products.

According to World Fact Book, 2011 population within the age group of 0-14 & 15-35 (the targeted consumers of multinationals) in India are 29.7% & 44.9% respectively.

5. FDI policy in Indian Retail Sector

I. FDI up to 100% for cash and carry wholesale trading and export trading allowed under the automatic route.
II. FDI up to 51% with prior Government approval for retail trade of 'Single Brand' products. (100% allowed vide notification dated 11/Jan/2012).
III. FDI is not permitted in Multi Brand Retailing in India. In November, 2011, Ministry of Commerce, releases a press note specifying the major tenants of proposed FDI policy in multi-brand retail and in September,2012, Union Cabinet passes and enacts the new policy allowing upto 51% FDI in multi-brand retail sector.
IV. Multi-brand retail trading through e-commerce is not permissible for the companies with FDI. However, Indian retailers can exercise the option of e-trading for another route of sales.

6. Prospected Changes in FDI Policy of Retail Sector India

1. In multi-brand sector 51% of FDI will be allowed,
2. The retailers (both single and multi-brand) will have to collect at least 30% of their goods from small and medium sized Indian suppliers.
3. The opening of retail competition (policy) will be within parameters of state laws and regulations.
4. Retail stores can open up their outlets only in those areas having a population of more than 10 lakhs. Out of approximately 7935 towns and cities in India, 53 qualify such criteria.
5. Multi-brand retailers must bring minimum investment of US$ 100 million. Half of this must be invested to build infrastructure facilities such as cold chains, refrigeration, transportation, packaging etc. to reduce post-harvest losses and provide remunerative prices to farmers.

7. Advantages

1. **Job Opportunity:** Organized retail will need workers. In USA, the 80% of the retail sector is organised and it employs 13-16% of the work-force of that country. In China, the employment in both retail and wholesale trade increased from 4% in 1992 to about 7% in 2001, post reforms and innovative competition in the retail sector in that country. In India, retail industry contributes more or less 14% of GDP and provides 7% of the total workforce in the country (Gupta Rupali, 2012).
2. **Control over food inflation:** Foreign big retail players such as Walmart, Carrefour, Metro and other global retail companies are already have operations in many countries for over 30 years. They run their businesses according to the business ethics and principles and they have managed to keep a check on the food inflation through their healthy competitive practices (http://www.indiaretailbiz.com/blog/2009/07/02).
3. **Fair Price**. The intermediaries operating as per traditional business practices do not have transparency in their pricing. According to some of the reports, an average Indian farmer realizes only one-third of the price, which a final consumer pays.
4. **Help to the farmers**. The prices of the commodities will be automatically checked. The business giants collect food grains; vegetables etc directly from the farmers and sell quality products to the buyers comparatively at low price and fresh than the traditional retail systems. As per the FDI policy, 30% of the total purchases by these mega giant retailers have to be made from the small retailers. Existing cash and carry model in Punjab is one of the examples of this policy.
5. **Reduction in wastage**. Due to lack of proper organisation of the sector, 40% of the production does not reach the ultimate consumer. According to a report published in the Times of India, 42% of the children below the age group of 5 are malnourished. Food often gets rot in farm, in-transit and in antiquated state-run warehouses. Cost-cautious and highly competitive retailers will try to avoid such wastage and looses and they will try to make the products available at lowest prices, hence making food available to the weakest and poorest segment of Indian society.
6. **Development of infrastructure:** India is already operating in the budgetary deficit. Neither the Government of India nor the Indian domestic investors are capable to satisfy the growing needs (schools, hospitals, transport, and infrastructure) of the ever growing Indian Population. Hence foreign capital inflow will enable us to create a heavy capital base.
7. **Increase in Foreign Exchange Reserves:** As per Government's proposal in increasing the FDI in retail the each retail giant is required to invest a minimum of 100 million dollars. Each retail giant is expected to open at least 15 stores across India and to open each store it may require 10- 15 million dollars which can total in billions of dollars in Forex reserves.
8. **Investment in other sectors:** Growth of retail sector in India has been beneficial for the allied industries such as logistics and air conditioning. Foreign and Indian companies working in sectors such as airlines, air conditioning, logistics, smart card makers are all tieing up with retailers to be a part of the growth.

8. Disadvantages

1. **Unfavourable attitude**: The unorganised portion of total retails sector is 97% as compared to US, which is only 20%. These large sections of domestic businessmen do not allow the multinationals in the markets to avoid the competition.
2. **Fear of Monopoly**: Foreign Multinationals can afford to lower the prices in initial stages in order to knock-out the competition and become a monopoly and later on raise the prices. This kind of phenomenon was evident earlier in the case of soft-drinks. Eviction of Campa Cola by Pepsi and Coca Cola is one such example.
3. **Insufficient supply of skilled labours and professionals**: India has enormous labour power but they do not have required knowledge to work at the organised manner. In India, the retail trade business is not considered as a reputed profession and it is mostly carried-out by the family members). Such people are generally not academically and professionally qualified.
4. **Low productivity**: A study conducted by McKinsey shows that the retail productivity in India is very low as compared to its international peers.
5. **Fear of job loss**: The operations in big stores are highly automated and employ very less work-force and they can sell products at low cost and the small, independent stores will be compelled to close, leading to massive job losses.

9. Conclusion

The nature of the FDI depends on the country's or jurisdiction's needs and policies. FDI is not restricted to developing countries. For example, lagging regions in the France, Germany, Ireland, and USA have for a half century maintained offices to recruit and incentives FDI primarily to create jobs. China, starting in 1979, promoted FDI primarily to import modernizing technology, and also to leverage and uplift its huge pool of rural workers.The rules of the game (globalization) have been designed for the most part by the advanced industrial countries, or more accurately, by special interests in those countries, for their own interests, and often do not serve well the interests of the developing world, and especially the poor. Government should support the retail sector not only by strengthen the Indian companies but also allow the international companies to take participation in this sector. The emerging market of India is an attractive destination for multinational companies. With second largest population in the world and huge countryside is certainly making the place even more attractive Small retailers will not be crowded out, but would strengthen market positions with the innovative strategies rather their traditional business plans. In order to save the domestic small retailers are indigenous market, of India's plan for further opening up of the economy, it is advisable to open up the export oriented sectors and a higher growth of the economy could be achieved through the growth of these sectors.

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