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Foreign Direct Investment in Retail Sector in India: Opportunities And Challenges

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Abstract

On November 24, 2011, The Union Cabinet of the Indian Government approved a proposal of allowing 51 per cent FDI in the multi-brand retailing in India and 100 per cent FDI in the Single-brand. The United States suggest that FDI in organized retail could help tackle Inflation, particularly with whole sale prices. As a result the Indian government has stalled the implementation of this proposal which has temporarily washed off the wishes of the global retail player awaiting a bite of the Indian retail Market. FDI should be opened in a gradual phased manner, allowing a lead- time for the Indian retailers to strengthen their position. India's retail sector remains off–limits to large international chains especially in multi-brand retailing. A number of concerns have been raised about opening up the retail sector to FDI in India. The first concern is the potential impact of large foreign firms on employment in the retail sector. A second related concern raised in the DIPP's report is that opening up FDI would lead to unfair competition and ultimately result in large- scale exit of incumbent domestic retailers, especially the small family-owned business.

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1. INTRODUCTION

The liberalization of Foreign Direct Investment (FDI) policy of the Indian Economy in 1991, that has made most business sectors in India eligible to receive foreign investment. It has opened up front doors to many a multinational corporation. India's middle class has greatly expanded in number and also increased their purchasing power. But over the year, unlike other major emerging economies, India has been slow to open its retail sector to foreign investment. Recently, the government however suggest that this may be about to change global super market chain stores such as WAL-MART (United States), Carrefour (France), Marks & Spencer and Tesco (United Kingdom) and Shoprite (South Africa) may finally be allowed to set up shops in India. In the recent times FDI in retailing has been the most heard buzzword in the Indian Corporate World, And finally the big news seems to have arrived. India is ready to open up the doors for FDI in retailing.

2. THE CASE OF FOREIGN DIRECT INVESTMENT IN INDIAN RETIAL

World Bank defined FDI as "Foreign direct investment (FDI) or foreign investment can refer to the net inflow of funds to acquire a long- term management interest in an enterprise operating in a foreign economy. It is accumulation of equity, reinvestment of retained earnings, other long-term sources of capital.

According to a recent survey by UNCTAD India is a projected as the second most attractive destination for FDI (only after China) for multinational corporations during the years 2010-2012. As per the data, the sectors such as telecom, services, infrastructure and computer hardware & software attract the FDI the most. The leading sources of FDI are from the economies such as the U.S., the U.K., Singapore and Mauritius.

The Indian retail market is currently unorganized and highly fragmented, with an estimated 13-15 mn outlet countrywide. The overall retail market is expected to grow at a CAGR of about 11-13 per cent by 2020-21, with the organized retail market expanding at 21-24 percent.

Table-1: Share of organized retail in India

Year	1999	2002	2005	2009	2010	2013 (expected)
Total Retail (in Billion INR)	7000	8250	10000	18450	19500	24000
Organized Retail (in Billion INR)	50	150	350	920	1350	2400
Share of organized retail (%)	0.70	1.80	3.50	5.00	7.00	10.00

Table: - 1 depicts the growth of the share of organized retail in the overall retail in India over years. From the table, it can be clearly understood that in India, the growth of organized retail has been steadily rising since 1999 and is expected to continue in the years to come. This growth can be attributed to changes in FDI policy in Retail trade.

3. TYPES OF RETAILING IN INDIA

(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, these 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 the same way as the ubiquitous "Kirana Store".

The approval for single and multi brand includes a set of riders for the foreign investors amid at ensuring that the foreign investment make a genuine contribution to the development of Indian infrastructure and logistic, at the same time facility integration of small retailers in to the upgraded value chain.

Table -2: A Comparison of norms under Single-brand and Multi-brand in India

Parameters	Multi-brand	Single-brand
Ownership/investment Requirement	Minimum investment of us $ 100 million by the foreign investor.	The foreign investor should be an owner of the brand.
Investment towards-back infrastructure	At least 50% of the investment by the foreign company to be in back-end infrastructure.	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) giving 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 produced 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.
Approval of State Govt. Required	While the proposals on FDI will be sanctioned by the center approvals from each State Govt. Would be required.	Same

Note-1:- Back-end infrastructure will include capital expend there are all activities, excluding that a front end units.

FDI provides the financial resources for investment in the host country and there by augments the domestic saving efforts. It also provides the much needed foreign exchange to help bridge the balances of trade deficit.

4. PRESENT SHAPE OF FOREIGN DIRECT INVESTMENT

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 and up to 100% in single brand retail like Gucci, Nokia and Reebok. This will make foreign goods and items of daily consumption available locally, at a lower price, to Indian consumer. The new policy will allow multi-brand foreign retailers to set up shop only in cities with a population of more than 10 lakhs as per the 2011 census there are 53 such cities. This means that big retailers will be required to put up 50% of total FDI in back-end infrastructure excluding that on front-end expenditures. Expenditure on land cost and rentals will not be counted for the purpose of back-end infra-structure. Big retailers will need to source at least 30% of manufactured or processed products from small retailers. The Government will go for surprise checks and if found irregularities than the deed will be broken with a second of time. Home grown retailers have not muscles and the reach to go for the big same line Subiksha and Vishal retail. They have expanded their retail chain but did not have the resources to manage the back-end across several cities. If we look rationally at the FDI in retail sector then it will be a win-win situation for all.

5. OPPORTUNITIES OF FOREIGN DIRECT INVESTMENT IN RETAIL SECTOR

1. The policy decisions of the Government of India to allow India to have a presence of international brands, through different routes, namely, franchise, joint venture, manufacturing and distribution is a positive signal for the nation’s preparedness to align with the global retail scenario.
2. Another encouraging factor is that India is considered a favoured country for investing by overseas corporate. This is evident from the fact that not a single corporate has approached the World Bank group’s Multilateral Investment Guarantee Agency (MIGA) for non-commercial risk cover for making investment into the country.
3. India has displaced US as the second-most desired destination for Foreign Direct Investment (FDI) in the world after China according to AT Kearney’s FDI confidence index that traced investor confidence among global executives to determine their order of preferences.
4. The ongoing process of modernization, the inbuilt transparency of the democratic system and the inclination to share managerial innovations make India a sought location for overseas corporate.
5. The last 200 years of world development shows that sharing of resources, men, materials and capital has benefit all nations. The flow of FDI is most likely to widen the opportunities in employment and in due course reduction inequalities in income. The gap between the world’s

rich and poor countries largely comes down to the financial and physical assets that create wealth.

6. In the context of FDI in retail sector, while favouring it, the confederation of Indian industry (CII) has recommended a phased approach in relatively less sensitive sectors to begin with garments, life style products, house ware and entertainment etc.
7. The 21st century marks a significant change in the composition of FDI flows. The services sector has overtaken the manufacturing sector in the flow of FDI in most of the nations. Thus, FDI has become an important channel for delivery of services across borders for emerging economies as well as developed ones.
8. As services become increasingly tradable, FDI in these industries can forge a strong link with exports of emerging economies. Multinationals operating in such services as banking, telecommunications and trade enhance the efficiency of home grown providers in myriad ways, contributing to the export competitiveness of these economies services sectors. With both FDI and trade rising rapidly in services, FDI has an important role in promoting the sector's globalization in other emerging economies.
9. Foreign investment can bring a ***"ripple effect"*** through host economies in many ways. It can finance current account deficits through its on investment or offset other financial transactions, such as increases in reserves or capital outflows. It makes a net addition to developing nation's productive resources, without causing deterioration to the current account. FDI represents a net capital gain or even ***"crowd in"*** domestic investment through a number of channels, such as transfer of technology and key expertise that does not exist in host countries. FDI is likely to spur domestic investment in India's retail sector as existing players partner with such foreign giants as Wal-Mart to open stores.
10. The study results suggest that FDI actually crowds in domestic investment and delivers a positive impact on the current account the difference between effect on the savings and investment. The data support the nation that FDI should be the preferred form of foreign investment. Countries also woo foreign investors with tax breaks and subsidies. Fiscal incentives are doubtlessly a good way to promote FDI.
11. The favourable policy initiatives of the Government of India with reference to FDI added to the acceptability of FDI flows are as follows:-
    - **Change of Route: -** FDI has been allowed up to 100 per cent under the automatic route for distillation and brewing of potable alcohol, manufacture of industrial explosives, manufacture of hazardous chemicals of the standard Urban Area limits requiring industrial license under the IDRI Act, 1951.
    - **Increase in Equity caps: -** FDI caps have been increased to 100 per cent and automatic route extended to coal and lignite mining for captive consumption, setting up of infrastructure relating to marketing in petroleum and natural gas sector and exploration and mining of diamonds and precious stones.
    - **FDI in new Activities:** - FDI has been allowed up to 100 per cent on the automatic route in power trading and processing and warehousing of coffee and rubber.
    - **Removal of Restrictive Conditions: -** Mandatory disinvestment conditions for Business to Business, e-commerce have been dispensed with.

6. THREATS OR CHALLENGES OF FOREIGN DIRECT INVESTMENT IN RETAIL SECTOR

1. FDI flows may displace the unorganized retailers because of their superior financial strengths. It will disrupt the current balance of the economy, rendering millions of small retailers temporarily jobless by closing the limited opportunity available to them.
2. The competition in the absence of proper regulatory guidelines may induce unfair trade practices in the retail.
3. The possibility of emerging monopoly in certain segments and cartels cannot be over ruled.
4. The intense competition for land is likely to escalate prices of real estates and domestic entrepreneurs.
5. FDI may have wage and productivity spillovers in the host country. If multinationals pay more than domestic firms, it may force the latter to raise wages. If foreign investors transfer technology to domestic firms, FDI would also help make workers more efficient.
6. FDI tends to make up a greater share of capital inflow in places investors might otherwise avoid. Most likely, such countries may be compelled to pay premium for FDI through tax breaks and other incentives.
7. In times of extreme financial crises, FDI may be accompanied by distress sales of domestic assets, which could be harmful. Thus, capital flight cannot be ruled out. Even in normal times, FDI can be reserved or diminished through domestic borrowing by affiliates of multinational corporations and repeat ration of founds.
8. Too much FDI may not be beneficial through ownership and control of domestic companies, foreign firms learn more about the host country's productivity and they could over invest, at the expense of domestic producers.

7. CONCLUSION

It may be concluded that FDI should be opened in a gradual phased manner, allowing a lead-time for the Indian retailers to strengthen their position. India's retail sector remains off–limits to large international chains especially in multi-brand retailing. A number of concerns have been raised about opening up the retail sector to FDI in India. The first concern is the potential impact of large foreign firms on employment in the retail sector. A second related concern raised in the DIPP's report is that opening up FDI would lead to unfair competition and ultimately result in large- scale exit of incumbent domestic retailers, especially the small family-owned business.

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