FDI IN RETAIL SECTOR IN INDIA

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Abstract - FDI in retail has been contentious issue and may face resistance, given the perceived political scenario. FDI will be a defining moment for Indian retail and how government policies effect the retail industry is given briefly to the end. In this research paper, we take a peek into the organized retail sector of India. The word ‘Retailing’ refers to any activity that involves the direct sale to an individual customer or end user. In this dynamic environment of today the globe the international community is ready to integrate itself with the Indian economy. The govt. encouraged by the outcome of economic policy of 1991 in India, has proposed retail reforms mainly as 100% FDI in the retail sector in India. The current paper scrutinizes the relationship of Foreign Direct Investments with the Indian Retail Sector. However, the Indian government must take timely and prudent actions to contain this revolution & safeguard the health of the Indian retail sector to stabilize themselves against competition from the giant players of the global economy in the present state of slowing growth, stubborn inflation & widening fiscal deficit in the country.

Keywords: fiscal deficit economy, economic policy, employment

I INTRODUCTION

The word ‘Retailing’ refers to any activity that involves the direct sale to an individual customer or end user. Retailing has been the most active and attractive sector of the last decade. While the retailing industry itself has been present throughout the history in our country India is making a landmark revolution in the retail space in the world and Asia in particular. India's strong economic growth and rising disposable incomes of middle class and lower middle class made big business houses venture in to this business, many businesses are coming from US and Europe. The Government's decision to allow foreign Direct Investment and businesses in to this sector has attracted foreign companies to establish their businesses in India. Now foreign retailers will be able to own their own stores in India for the first time as part of a major government liberalization of business. Till 2006 foreign companies were allowed to operate franchises by the government to protect the indigenous companies. Now new regulations may allow foreign companies to hold up to 100%. But the Indian government is going ahead with new reforms which may create millions of job in the near future while safeguarding the interest of domestic firms.

Division of Retail Industry – Organized and Unorganized Retailing

The retail industry is mainly divided into:- 1) Organized and 2) 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 hypermarkets and retail chains, and also the privately owned large retail businesses.

Unorganized 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 97 per cent of its business being run by the unorganized retailers. The organized retail however is at a very nascent stage. The sector is the largest source of employment after agriculture, and has deep penetration into rural India generating more than 10 per cent of India’s GDP

FDI Policy in India
FDI as defined in Dictionary of Economics (Graham Bannock et.al) is investment in a foreign country through the acquisition of a local company or the establishment there of an operation on a new (Greenfield) site. To put in simple words, FDI refers to capital inflows from abroad that is invested in or to enhance the production capacity of the economy. Foreign Investment in India is governed by the FDI policy announced by the Government of India and the provision of the Foreign Exchange Management Act (FEMA) 1999. The Reserve Bank of India (‘RBI’) in this regard had issued a notification, which contains the Foreign Exchange Management (Transfer or issue of security by a person resident outside India) Regulations, 2000. This notification has been amended from time to time. The Ministry of Commerce and Industry, Government of India is the nodal agency for motorising and reviewing the FDI policy on continued basis and changes in sectoral policy/ sectoral equity cap. The FDI policy is notified through Press Notes by the Secretariat for Industrial Assistance (SIA), Department of Industrial Policy and Promotion (DIPP). The foreign investors are free to invest in India, except few sectors/activities, where prior approval from the RBI or Foreign Investment Promotion Board (‘FIPB’) would be required.

**FDI Policy with Regard to Retailing in India**

It will be prudent to look into Press Note 4 of 2006 issued by DIPP and consolidated FDI Policy issued in October 2010 which provide the sector specific guidelines for FDI with regard to the conduct of trading activities.

- **a)** FDI up to 100% for cash and carry wholesale trading and export trading allowed under the automatic route.
- **b)** FDI up to 51 % with prior Government approval (i.e. FIPB) for retail trade of ‘Single Brand’ products, subject to Press Note 3 (2006 Series).
- **c)** FDI is not permitted in Multi Brand Retailing in India.

**II LITERATURE REVIEW**

Mohanty & Panda (2008) opines about retailing as a sector of India occupies important place in the socio-economic growth strategy of the country. India is witnessing retailing boom being propelled by increasing urbanization, rising purchasing power parity (PPP) of ever growing India’s middle class, changing demographic profiles heavily titled young population, technological revolution, intense globalization drive etc.

Sahu (2010) describes that a rise in consumer confidence, improvement in profitability and aggressive expansion plans signal better tidings for listed players in the organized retail space. Moreover, analysts believe listed retailers could attract foreign investments by spinning off their subsidiaries into separate companies which can provide a great opportunity for the improvement of this sector.

Gellner (2007) explains in this context that in most retail meetings and/or publications, hardly ever is there any talk on problems that modern retail formats are encountering doing business in India. There is a significant profitability challenge, to deliver the brand promise in terms of quality and geographic spread in line with the growth in consumer demand.

Nagesh (2007) describes that Indian retailing will see a sea of change in the next five years, driving consumption boom never seen in the history of any country. From a drought situation we will see a flood of modern retail, So Indian retail will be on a steady ground of sustained growth year after year and thereafter.

Wohlgenant and Mullen (1987) and Bessler and Akleman (1998) focused on issues of price spreads in an attempt to quantify the effects of various shifts in the demand and supply on, the retail-to-farm price ratio, derived demand elasticity’s, and ultimately, the farmers share of retail food expenditures.

Goodwin and Holt, 1999 ; Azzam, 1999; Paul, 1998

That farm level prices have not kept up with changing prices at the retail level led to research into this area as observers questioned the extent to which retail-level shocks are realized at the farm level. An overall concern in this area is whether pricing patterns in food markets are cost or demand driven. Since both prices and costs are involved, understanding both these aspects is critical.

Akash (2009) says that Retail business in India, as anywhere else in the world, plays a crucial role in an economy. Retail in India has the potential to add value over Rs 2,00,000 crore ($45billion)business by the year 2010 generating employment for some 2.5 million people in various retail operations and over10 million additional workforce in retail support activities including contract production and processing, supply chain and logistics, retail real estate development and management.

Gibson, CEO Retail Association of India opines (2007) that modern retailing today is growing faster than expected while the current growth rate is around 30 percent, the sector is expected to grow at 40- 50percent on a year basis. Shiv kumar, Executive Director and leader of Retail and Consumer Practices Price Warehouse Co-operatives,(2009)also holds the opinion that retailing is the next sunrise segment of the economic development of the country.

Eales and Unnevehr, 1993

With this research, researchers tried to account for apparent shifts in demand due to structural changes in supply. An example of such changes in supply that shifted the supply curves for meat steadily outward are increased pork and broiler feed efficiency, higher beef carcass dressed weights, and the beef herd liquidation following feed price escalations in the early 1970’s. Such
factors would have contributed to a false appearance of demand growth, when the converse was true in some meat industries, particularly in the beef sector. Mishra (2008) says, there is a hectic activity in the sector in terms of expansion, entry of international brands and retailers as well as focus on technology, operations, infrastructure and processes. All these present a tremendous opportunity in this high growth industry.

Yuvarani (2010) opines that according to a study the size of the Indian Retail market is currently estimated at Rs 704 crores which accounts for a meager 3% of the total retail market. As the market becomes more and more organized the Indian retail industry will gain greater worth. However, the future is promising, the market is growing, government policies are b Goodwin and Holt, 1999; Azzam, 1999; Paul, 1998

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Biyani (2007) describes that we are on the cusp of change wherein a huge, multicultural India is transforming from a socialist economy to a consumption-led, creative economy. The scope and depth of change that is taking place due to the revolutionary retail market with a gigantic opportunity for marketers and retailers, not only in large cities but also in small towns. So retailing can play a significant role in creating the India of tomorrow.

Kearney (2007) explains that the retail sector provides a unique platform to India. Government, both central and state, need to engage with the sector and utilize its potential for social development. So the Indian market and its consumers poised for a retail consumption explosion that will continue for future.

Douma, Pallatiattha and Kabir (2006) investigated the impact of foreign institutional investment on the performance of emerging market firms and found that there is positive effect of foreign ownership on firm performance. They also found impact of foreign investment on the business group affiliation of firms.

Aggarwal, Klapper and Wysocki (2005) observed that foreign investors preferred the companies with better corporate governance. Investor protection is poor in case of firms with controlling shareholders who have ability to expropriate assets. The block shareholders affect the value of the firm and influence the private benefits they receive from the firm. Companies with such shareholders will find it expensive to raise external funds.

Yin-Hua and Woidtke (2005) found that when Company boards are dominated by members who are affiliated to the controlling family, investor protection will be relatively weak and it is difficult to determine the degree of separation of management from ownership. They also observed that firm value is negatively Related to board affiliation in family controlled firms. Li (2005) observed that in case of poor corporate governance the foreign investors choose foreign direct investment (FDI) rather than indirect portfolio investment. It is generally believed that FDI could be better protected by private means.

Ways of introducing FDI in Indian Retail Industry

Consequently, they are forced to succumb to breaking and entering via either of the following routes:

1. Franchise Agreements – Authority to approve lies with Reserve Bank of India
2. Cash and Carry Wholesale Trading – it is not retailing in essence but leads to it ultimately and is expected to bring in huge sums of money based on the high investments required get it started
3. Strategic Licensing Agreements – Foreign players can enter into an agreement with the locals and license them to distribute their products/services
4. Manufacturing and Wholly Owned Subsidiaries – Foreign brands can manufacture in India and thereby be treated as “Indian” companies. 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 authorized 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.

5. 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 3that (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.
6. 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.

Foreign Investor’s Concern Regarding FDI Policy in India

For those brands which adopt the franchising route as a matter of policy, the current FDI Policy will not make any difference. They would have preferred that the Government liberalize rules for maximizing their royalty and franchise fees. They must still rely on innovative structuring of franchise arrangements to maximize their returns. Consumer durable majors such as LG and Samsung, which have exclusive franchisee owned stores, are unlikely to shift from the preferred route right away. For those companies which choose to adopt the route of 51% partnership, they must tie up with a local partner. The key is finding a partner which is reliable and who can also teach a trick or two about the domestic market and the Indian consumer. Currently, the organized retail sector is dominated by the likes of large business groups which decided to diversify into retail to cash in on the boom in the sector – corporate such as Tata through its brand Westside, RPG Group through Food world, Pantaloons of the Raheja Group and Shopper’s Stop. Do foreign investors look to tie up with an existing retailer or look to others not necessarily in the business but looking to diversify, as many business groups are doing? An arrangement in the short to medium term may work wonders but what happens if the Government decides to further liberalize the regulations as it is currently contemplating? Will the foreign investor terminate the agreement with Indian partner and trade in market without him? Either way, the foreign investor must negotiate its joint venture agreements carefully, with an option for a buy-out of the Indian partner’s share if and when regulations so permit. They must also be aware of the regulation which states that once a foreign company enters into a technical or financial collaboration with an Indian partner, it cannot enter into another joint venture with another Indian company or set up its own subsidiary in the ‘same’ field without the first partner’s consent if the joint venture agreement does not provide for a ‘conflict of interest’ clause. In effect, it means that foreign brand owners must be extremely careful whom they choose as partners and the brand they introduce in India. The first brand could also be their last if they do not negotiate the strategic arrangement diligently.

Concerns for the Government for only Partially Allowing FDI in Retail Sector

A number of concerns were expressed with regard to partial opening of the retail sector for FDI. The Hon’ble Department Related Parliamentary Standing Committee on Commerce, in its 90th Report, on ‘Foreign and Domestic Investment in Retail Sector’, laid in the Lok Sabha and the Rajya Sabha on 8 June, 2009, had made an in-depth study on the subject and identified a number of issues related to FDI in the retail sector. These included:

- It would lead to unfair competition and ultimately result in large-scale exit of domestic retailers, especially the small family managed outlets, leading to large scale displacement of persons employed in the retail sector. Further, as the manufacturing sector has not been growing fast enough, the persons displaced from the retail sector would not be absorbed there.

- Another concern is that the Indian retail sector, particularly organized retail, is still under-developed and in a nascent stage and that, therefore, it is important that the domestic retail sector is allowed to grow and consolidate first, before opening this sector to foreign investors.

Analogists of FDI in retail sector oppose the same on various grounds, like, that the entry of large global retailers such as Wal-Mart would kill local shops and millions of jobs, since the unorganized retail sector employs an enormous percentage of Indian population after the agriculture sector; secondly that the global retailers would conspire and exercise monopolistic power to raise prices and monopolistic (big buying) power to reduce the prices received by the suppliers; thirdly, it would lead to asymmetrical growth in cities, causing discontent and social tension elsewhere. Hence, both the consumers and the suppliers would lose, while the profit margins of such retail chains would go up.

By allowing FDI in retail, India may soon be looking at a modern version of the “farangi (foreign) take over on Indian economy”. There is no doubt that investments of such huge magnitude and potential can revolutionize the Indian Retail Sector, it must be ascertained that the change serves India more than the investors. India has to choose between customer satisfaction and employment opportunities. Given the circumstances, it is evident that India will go for the latter and delay a shift in its market to a time when the foreign investors can’t hurt the livelihood of the traditional retailers and the economy is adequately prepared for implementation of FDI in Retail policy.

Rationales behind Allowing FDI in Retail Sector
FDI can be a powerful catalyst to spur competition in the retail industry, due to the current scenario of low competition and poor productivity.

The policy of single-brand retail was adopted to allow Indian consumers access to foreign brands. Since Indians spend a lot of money shopping abroad, this policy enables them to spend the same money on the same goods in India. FDI in single-brand retailing was permitted in 2006, up to 51 per cent of ownership. Between then and May 2010, a total of 94 proposals have been received. Of these, 57 proposals have been approved. An FDI inflow of US$196.46 million under the category of single brand retailing was received between April 2006 and September 2010, comprising 0.16 per cent of the total FDI inflows during the period. Retail stocks rose by as much as 5%. Shares of Pantaloons Retail (India) Ltd ended 4.84% up at Rs 441 on the Bombay Stock Exchange. Shares of Shopper’s Stop Ltd rose 2.02% and Trent Ltd, 3.19%. The exchange’s key index rose 173.04 points, or 0.99%, to 17,614.48. But this is very less as compared to what it would have been had FDI up to 100% been allowed in India for single brand.

The policy of allowing 100% FDI in single brand retail can benefit both the foreign retailer and the Indian partner – foreign players get local market knowledge, while Indian companies can access global best management practices, designs and technological knowhow. By partially opening this sector, the government was able to reduce the pressure from its trading partners in bilateral/ multilateral negotiations and could demonstrate India’s intentions in liberalizing this sector in a phased manner.

Permitting foreign investment in food-based retailing is likely to ensure adequate flow of capital into the country & its productive use, in a manner likely to promote the welfare of all sections of society, particularly farmers and consumers. It would also help bring about improvements in farmer income & agricultural growth and assist in lowering consumer prices inflation. 

Apart from this, by allowing FDI in retail trade, India will significantly flourish in terms of quality standards and consumer expectations, since the inflow of FDI in retail sector is bound to pull up the quality standards and cost-competitiveness of Indian producers in all the segments. It is therefore obvious that we should not only permit but encourage FDI in retail trade.

Lastly, it is to be noted that the Indian Council of Research in International Economic Relations (ICRIER), a premier think tank of the country, which was appointed to look into the impact of BIG capital in the retail sector, has projected the worth of Indian retail sector to reach $496 billion by 2011-12 and ICRIER has also come to conclusion that investment of ‘big’ money (large corporate and FDI) in the retail sector would in the long run not harm interests of small, traditional, retailers. 

In light of the above, it can be safely concluded that allowing healthy FDI in the retail sector would not only lead to a substantial surge in the country’s GDP and overall economic development, but would inter alia also help in integrating the Indian retail market with that of the global retail market in addition to providing not just employment but a better paying employment, which the unorganized sector (kirana and other small time retailing shops) have undoubtedly failed to provide to the masses employed in them.

Industrial organizations such as CII, FICCI, US-India Business Council (USIBC), the American Chamber of Commerce in India, The Retail Association of India (RAI) and Shopping Centers Association of India (a 44 member association of Indian multi-brand retailers and shopping malls) favor a phased approach toward liberalizing FDI in multi-brand retailing, and most of them agree with considering a cap of 49-51 per cent to start with.

The international retail players such as Wal-Mart, Carrefour, Metro, IKEA, and TESCO share the same view and insist on a clear path towards 100 per cent opening up in near future. Large multinational retailers such as US-based Wal-Mart, Germany’s Metro AG and Woolworths Ltd, the largest Australian retailer that operates in wholesale cash-and-carry ventures in India, have been demanding liberalization of FDI rules on multi-brand retail for some time.

Thus, as a matter of fact FDI in the buzzing Indian retail sector should not just be freely allowed but per contra should be significantly encouraged. Allowing FDI in multi-brand retail can bring about Supply Chain Improvement, Investment in Technology, Manpower and Skill development, Tourism Development, Greater Sourcing From India, Up gradation in Agriculture, Efficient Small and Medium Scale Industries, Growth in market size and Benefits to government through greater GDP, tax income and employment generation.

Prerequisites before allowing FDI in Multi Brand Retail and Lifting Cap of Single Brand Retail

FDI in multi-brand retailing must be dealt cautiously as it has direct impact on a large chunk of population. Left alone foreign capital will seek ways through which it can only multiply itself, and unthinking application of capital for profit, given our peculiar socio-economic conditions, may spell doom and deepen the gap between the rich and the poor. Thus the proliferation of foreign capital into multi-brand retailing needs to be anchored in such a way that it results in a win-win situation for India. This can be done by integrating into the rules and regulations for FDI in multi-brand retailing certain inbuilt safety valves. For example FDI in multi–brand retailing can be allowed in a calibrated manner with social safeguards so that the effect of possible labor dislocation can be analyzed and policy fine tuned accordingly. To ensure that the foreign investors make a genuine contribution to the development of infrastructure and logistics, it can be stipulated that a percentage of FDI should be spent towards building up of back end infrastructure, logistics or agro processing units. Reconstituting the poverty stricken and
stagnating rural sphere into a forward moving and prosperous rural sphere can be one of the justifications for introducing FDI in multi-brand retailing. To actualize this goal it can be stipulated that at least 50% of the jobs in the retail outlet should be reserved for rural youth and that a certain amount of farm produce be procured from the poor farmers. Similarly to develop our small and medium enterprise (SME), it can also be stipulated that a minimum percentage of manufactured products be sourced from the SME sector in India. PDS is still in many ways the life line of the people living below the poverty line. To ensure that the system is not weakened the government may reserve the right to procure a certain amount of food grains for replenishing the buffer. To protect the interest of small retailers the government may also put in place an exclusive regulatory framework. It will ensure that the retailing giants do resort to predatory pricing or acquire monopolistic tendencies. Besides, the government and RBI need to evolve suitable policies to enable the retailers in the unorganized sector to expand and improve their efficiencies. If Government is allowing FDI, it must do it in a calibrated fashion because it is politically sensitive and link it (with) up some caveat from creating some back-end infrastructure.

Further, To take care of the concerns of the Government before allowing 100% FDI in Single Brand Retail and Multi-Brand Retail, the following recommendations are being proposed:

- Preparation of a legal and regulatory framework and enforcement mechanism to ensure that large retailers are not able to dislocate small retailers by unfair means.
- Extension of institutional credit, at lower rates, by public sector banks, to help improve efficiencies of small retailers; undertaking of proactive programme for assisting small retailers to upgrade themselves.
- Enactment of a National Shopping Mall Regulation Act to regulate the fiscal and social aspects of the entire retail sector.
- Formulation of a Model Central Law regarding FDI of Retail Sector.

III CONCLUSION

The extraordinary role played by retail sector throughout the world in increasing productivity of consumer goods and services are commendable. And it is also becoming a major industry by creating millions of employment opportunities to people directly and indirectly is greatly admired. Retailing industry becoming one of the most dynamic sectors in India with numerous players jumping into this market makes it competitive and lucrative. Though organized retail sector is serving the needs and aspirations of high end and middle class customers but ignoring the common man's needs and aspirations are lamentable. So, the organized sector should look at the common mans needs, and his ability, affordability and go ahead, then only the aim of giving world class quality products at affordable prices to common man dream will come true, thereby contribute to the economic growth and up lifting the standard of living there by serving humanity.

The Retail Industry in India has come forth as one of the most dynamic and fast paced industries with several players entering the market. But all of them have not yet tasted success because of the heavy initial investments that are required to break even with other companies and compete with them. The India Retail Industry is gradually inching its way towards becoming the next boom industry. The Retail Industry in India has come forth as one of the most dynamic and fast paced industries with several players entering the market. But all of them have not yet tasted success because of the heavy initial investments that are required to break even with other companies and compete with them. The India Retail Industry is gradually inching its way towards becoming the next boom industry.

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