

Impact of foreign direct investment in Indian retail sector: Challenges and opportunities

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Abstract

Retailing is one of the India's largest private industries. Liberalization in FDI has caused a massive restructuring in retail industry. The benefit of FDI in retail industry superimposes its cost factors. Opening the retail industry to FDI will bring forth benefits in its terms of advance employment, organized retail stores, availability of quality products at a better and cheaper price. It is to be noted that there is a prevalent widespread opposition, especially by the left parties towards FDI retail in India. May be in 1990s employing safeguard to protect the domestic retailers was the need of the day. Almost more than one and a half decades down the line there is a need for Foreign Direct Investment in retail trade.

Keywords: FDI, Retail Sector, India

1. Introduction

Widespread liberalization and deregulation of financial markets, cross-border mergers and acquisitions (M&As), increasing role of investors willing to invest abroad, rapid advances in modern telecommunication and computer network – have all resulted in a tremendous upsurge of international capital flows in India, particularly private capital flows, as compared to official capital flows over the last two decades. Among the various forms of foreign investment, foreign direct investment (FDI) flows are usually preferred over other forms of external finance because they are non-debt creating, non-volatile and their returns depends on the performance of projects financed by the investors. In fact, 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. Moreover, in order to overcome the deficiencies of all kinds of resources viz. financial, capital, entrepreneurship, technological know- how, skills and practices, access to markets-abroad - in their economic development, developing nations accepted FDI as a sole visible panacea for all their scarcities.

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. Being encouraged by India's growing retail boom many multinational companies also started to enter India's retail market. According to the Investment Commission of India, the retail sector is

expected to grow almost three times its current levels to \$660 billion by 2015. FDI in the retail sector can expand markets by reducing transaction and transformation costs of business through adoption of advanced supply chain and benefit consumers, and suppliers (farmers). Opposition to liberalizing FDI in this sector raises concerns about employment losses, promotion of unhealthy competition among organized domestic retailers resulting in exit of small domestic retailers from the market and distortion of urban cultural development.

2. Indian Retail Sector: An Overview and Current Position

2.1 Meaning of retail

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. 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. Retailing involves a direct interface with the customer and the coordination of business activities from end to end- right from the concept or design stage of a product or offering, to its delivery and post-delivery service to the customer.

2.2 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 (figure-1)

Evolution of Indian Retail

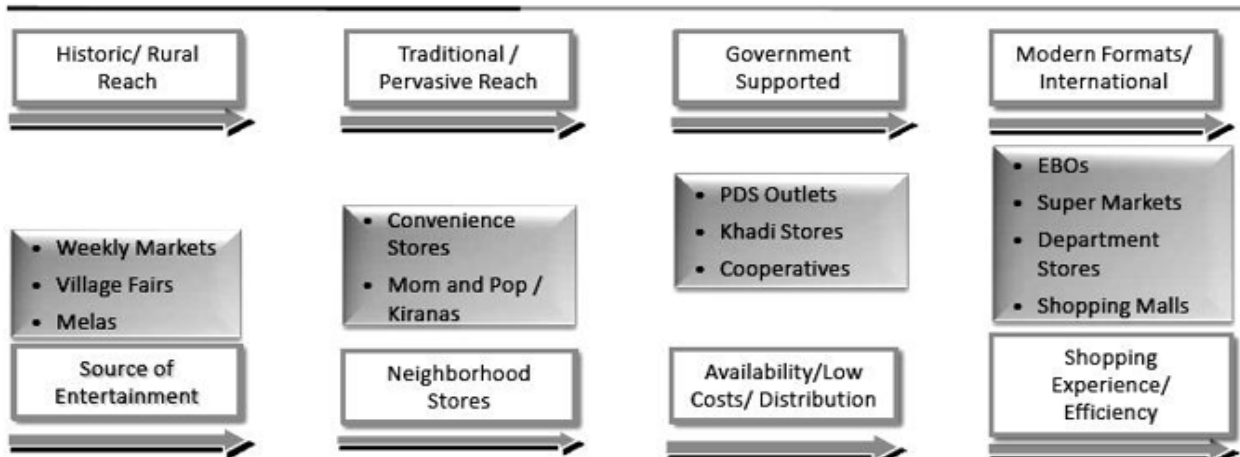


Fig 1

2.3 Distinction of Indian Retail

The Indian trading sector, as it has developed over centuries, is very different from that of the developed countries. In the developed countries, products and services normally reach consumers from the manufacturer/producers through two different channels: (a) via independent retailers (vertical separation) and (b) directly from the producer (vertical integration). In India, however, the above two modes of operation are not very common. Small and medium enterprises dominate the Indian retail scene. The trading sector is highly fragmented, with a large number of intermediaries. So also, wholesale trade in India is marked by the presence of thousands of small commission agents, stockiest and distributors who operate at a strictly local level. Retail giants like US-based Wal-Mart and French Carrefour are very keen to enter in the segment. Bharti Enterprises and Wal-Mart Stores entered into

a joint venture in August 2007 and started cash-and-carry stores named 'Best Price Modern Wholesale' in 2009.

2.4 Division of Indian Retail Industry

The Indian retail industry is generally divided into two major segments – organized retailing and unorganized retailing.

(a) 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.

(b) 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 and pavement vendors, etc.

Table 1: Share of organized retail in selected countries

Country	Total Retail Sales (US\$ bn)	Share of Organized Retail (%)
USA	2,983	85
Japan	1,182	66
China	785	20
United Kingdom	475	80
France	436	80
Germany	421	80
India	322	4
Brazil	284	36
Russia	276	33
Korea, South	201	15
Indonesia	150	30
Poland	120	20
Thailand	68	40
Pakistan	67	1
Argentina	53	40
Philippines	51	35
Malaysia	34	55
Czech Republic	34	30
Vietnam	26	22
Hungary	24	30

In the developed economies, organized retail is in the range of 75-80 per cent of total retail, whereas in developing economies, the unorganized sector dominates the retail business. The share of organized retail varies widely from just one per cent in Pakistan and 4 per cent in India to 36 per cent in Brazil and 55 per cent in Malaysia (Table-1). Modern retail formats, such as supermarkets, superstores, supermarkets, discount and convenience stores are widely present in the developed world, whereas such forms of retail outlets have only just begun to spread to developing countries in recent years. In developing countries, the retailing business continues to be dominated by family-run neighbourhood shops and open markets. As a consequence, wholesalers and distributors who carry products from industrial suppliers and agricultural producers to the independent family-owned shops and open markets remain a critical part of the supply chain in these countries.

Recent statistics states that though organized retail in India constituted a meager 4 percent of total retail in 2006, but it is expanding at a much faster pace of 45-50 percent per annum and has quadrupled its share to 16 percent by 2011-12. The unorganized retail sector is also growing at about 10 percent per annum with sales rising from US \$ 309 billion in 2006-07 to US \$ 496 billion in 2011-12.

2.5 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, 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.

While the minimum capital requirement of US\$ 100 million is unlikely to be an issue for the large foreign players varying 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.

Table 2: 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\$ 100 million 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 infrastructure	No Condition
Location of Stores	Stores to be restricted to cities with a population of 1 million or more 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	In respect of Proposals involving FDI beyond 51%,30% sourcing would mandatory have to be done from domestic SMEs
Sales	No Condition	Products to be sold should be of a single brand which are branded during manufacturing only.
Approval of State Governments Requirement	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

Present FDI Policy for Retail Sector in India

The Ministry of Commerce and Industry, Government of India is the nodal agency for motoring 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.

1. India will allow FDI of up to 51% in. multi-brand. Sector.
2. Single brand retailers such as Apple and Ikea, can own 100% of their Indian stores, up from previous cap of 51%.
3. FDI up to 100% for cash and carry wholesale trading and

export trading allowed under the automatic route.

4. The retailers (both single and multi-brand) will have to source at least 30% of their goods from small and medium sized Indian suppliers.
5. All retail stores can open up their operations in population having over 1million.Out of approximately 7935 towns and cities in India, 55 suffice such criteria.
6. Multi-brand retailers must bring minimum investment of US\$ 100 million. Half of this must be invested in back-end infrastructure facilities such as cold chains, refrigeration, transportation, packaging etc. to reduce post-harvest losses and provide remunerative prices to farmers.
7. The opening of retail competition (policy) will be within parameters of state laws and regulations.

Challenges Faced by the Retail Sector

- 1. Supply chain:** Finance Minister Pranab Mukherjee in his 2010-11 budget speech had emphasized on the reduction of wastages estimated at 40 percent of National Produce in storage as well as in the operations of the existing food supply chains in the country. Catering to people in 35 states and union territories is equivalent to catering to people in 35 countries, leading to complexities in merchandise/ inventory management. Infrastructure has been developing at a rapid pace over the past decade but has still a significant ground to cover; the planned expenditure of US\$ 1 trillion in the 12th five year plan will help bridging this gap.
- 2. Location and rental:** Finding the right location with the right rental for stores has been a challenge for all retailers. Rent forms a large portion of the total expenditure (6 to 11 percent of the revenue) in retailer's income statement and can more often than not convert a profitable store into loss making. The challenge for a retailer would be to find the right location for their stores either in malls or as a standalone store to be able to generate enough footfalls.
- 3. Channel conflicts:** The retailers need to maintain a direct relationship with their suppliers. Due to the complex taxation structure and geographic spread of the country, most FMCG companies have developed regional distribution and re-distribution network. Cutting out the distribution network will hurt operating structures of distributors, who as an industry body in the past have opposed FMCG companies selling directly to retailers.
- 4. Regulatory:** Currently, indirect taxation structure is complex in India with varying tax rates, multiplicity of taxes and multiple tax enforcement authorities. Goods and Service Tax likely to be implemented in 2011 will replace a host of levies like excise, sales tax, value-added tax, entertainment tax and luxury tax.. Opening a new store requires a lot of licenses, which have to be obtained from different government departments leading to considerable lead time in opening up of the stores. A push has been made by existing retailers to get the government to have a single window clearance for getting all the licenses at one place to speed up the process.
- 5. Unique Indian customer:** The Indian consumer experiencing modern retail has now warmed up to this idea. Buying habits have still not changed, where people prefer to buy most of the fruits and vegetables on a daily basis.
- 6. Private labels:** Private labels enable retailers to offer products at a better price point attracting footfalls to the store. This, in turn, not only translates to better margins by cutting out middle men.

3. Forecasts for Retail Sector Growth in India

The data from private consulting company reports suggest that growth in the retail market has been rapid despite major restrictions on FDI. In the third-quarter report of 2014, the BMI India Retail Report forecasts that the total retail sales will grow from US\$ 353 billion in 2010 to US\$ 543.2 billion by 2014.1 an important consideration, the report suggests, is the fast-growing middle and upper class consumer base. The analysis also suggests that in the next few years there will be major opportunities in India's smaller cities. AT Kearney, a global management consulting firm, rates India as the most attractive

nation for retail investment. The study, presented in the Global Retail Development Index of 2013, is carried out annually for 30 emerging markets, and has rated India highest four times in the last five years. This report expresses even more optimism, and estimates that suggests that India's retail market is expected to be about US\$735 billion by 2015, with around 13 per cent coming from organized retail. Other estimates are more conservative, though still impressive. According to McKinsey, a research and consulting firm, organized retail in India is expected to increase from 5 per cent of the total market in 2008 to 14-18 per cent of the total retail market and reach US\$ 450 billion by 2015. Even if growth is more conservative than estimated, the spill-over effects of this rapid expansion could be felt by many other sectors of the economy. A report published by Knight Frank India in May 2014 looks at the question of land and available retail space. It estimates that, during 2014-15, around 55 million square feet of retail space will be ready in the major cities like Mumbai, the national capital region (NCR), Bengaluru, Kolkata, Chennai, Hyderabad and Pune. Furthermore, between 2013 and 2015, the organized retail real estate stock is expected to grow from the existing 41 million square feet to 95 million square feet.4 Arguably, this could drive up real estate prices, with consequent knock-on effects.

4. Conclusion

Despite the current policy and regulatory environment not being perfect for foreign investors, there are clearly moves towards improving the current position and facilitating FDI inflows without having a detrimental impact on various sectors of the economy. The current policy is trying to encourage Joint Ventures in multi-brand retailing so as to boost the domestic retailer's growth in this area. In our view, the advantages outweigh the disadvantages of allowing unrestrained FDI in the retail sector, as successful experiments in countries like Thailand and China demonstrate. In both countries, the issue of allowing FDI in the retail sector was first met with incessant protests, but allowing such FDI led to GDP growth and a rise in the level of employment. The International Business Times (US edition) has already confirmed that Walmart is to launch its first Indian store within 12-18 months. Thus, being the first to enter the US\$500 billion retail market of India. The government has approved the Walt Disney Company South East Asia's foreign direct investment (FDI) proposal to transfer INR 10 billion into Walt Disney Company India to increase foreign equity. Besides Disney's proposal, the government has also approved nine other FDI proposals amounting to approximately INR 2.59 billion. With this, a plethora of business opportunities in India has been thrown open to the foreign investors. India has seen an eightfold increase in its FDI in March 2012, at a time when the aforesaid norms were not even approved – a sign that suggests India is set to be one of the favoured destinations for foreign investors in the retail sector.

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