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Role of Foreign Direct Investment in Retail Sector in Indian Perspective

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Abstract

The Concept of Foreign Direct Investment is now a part of India's economic future but the term remains vague to many, despite the profound effects on the economy. FDI is allowed up to 51% investment in single brand retail but government is going to open the doors for Multi Brand investment. India is the second most attractive retail destination, globally from among thirty emergent markets so foreign investors are curious to invest in India in so many sectors. It has made India the cynosure of many foreign eyes. FDI in multi brand can effect our economy by so many ways. This paper shows the different dimensions of FDI in multi brand retailing. The Indian media regularly discusses the issues of FDI in Retailing.

Keywords: *Multi brands, organised sector, retail destination*

1. INTRODUCTION

Retailing defines the direct interface between the manufacturers and the end users who are basically individual consumers. The retail business owners stock up all goods after purchasing it directly from the manufacturers and then sell it to individual customers keeping a profit margin for themselves. India's retail industry is divided into organized and unorganized sectors. Post liberalization, organized retail has grown exponentially and is a testament of the Indian middle class's burgeoning purchasing power. As a consequence, the opening up of the wholesale and single brand retail sector to foreign direct investment ("FDI") was inevitable. India is ranked as the third most attractive nation for retail investment among 30 emerging markets with domestic companies like the Future Group, Tata's Westside, Reliance Fresh, Raheja Group and Bharti Retail competing for market share. Multi-brand retail comes in different formats like supermarket, hypermarket, compact hyper and the ubiquitous mall. The success of this sector is best reflected in the fact that the shares of retail companies are well represented in all top mutual funds. However, the sector is constrained by several factors, primarily by a highly restrictive licensing regime and overall poor infrastructure. These factors have contributed to restrict organized retail to only about 3% of the total retail industry. This newsletter examines the prospects of FDI in multi-brand retail in India, and builds a case as to why the sector needs to be opened. India being a signatory to World Trade Organisation's General Agreement on Trade in Services, which include wholesale and retailing services, had to open up the retail trade sector to foreign investment. There were initial reservations towards opening up of retail sector arising from fear of job losses, procurement from international market, competition and loss of entrepreneurial opportunities. However, the government in a series of moves has opened up the retail sector slowly to Foreign Direct Investment ("FDI"). In 1997, FDI in cash and carry (wholesale) with 100 percent ownership was allowed under the Government approval route. It was brought under the automatic route in 2006. 51 percent investment in a single brand retail outlet was also permitted in 2006. The Organised Retail market stood at Rs.96, 500 crore in 2008. The industry has grown at a CAGR of 36% between 2004 and 2008. This growth was mainly driven by changing lifestyles, rising disposable incomes, favourable demographics, and easy credit availability, etc. the retail business in India is estimated to grow at 13 per cent annually from US$ 322 billion in 2006-07 to US$ 590 billion in 2011-12. The study shows:

2. FDI IN INDIA

Foreign direct investment (FDI) in the retail sector in India is restricted. In 2006, the government eased retail policy for the first time, allowing up to 51 per cent FDI through the single brand retail route (see Section 2 for a classification of organized retail in India). Since then, there has been a steady increase in FDI in the retail sector, and the cumulative FDI in single-brand retail stood at $195 million by the middle of 2010 (DIPP, 2010). Foreign investment in the single-brand retail sector in India has been resilient to the global economic crisis of 2007-08. Given India's large population and rapidly expanding middle-class, there is robust and growing demand and a rapidly expanding market. Table 1 shows the growth in private consumption expenditures across categories to highlight this trend.

Table 1:
Growth Rates in Private Final Consumption Expenditure: 2006-2010 (%) in Constant Prices

Category	2006-07	2007-08	2008-09	2009-10
Food and Beverages	11.70%	11.10%	13.00%	10.40%
Clothing & Footwear	18.00%	25.00%	7.70%	5.20%
Rent, Fuel and Power	10.50%	12.50%	14.20%	16.60%
Furniture and Appliances	17.70%	22.20%	19.40%	9.40%
Medical Care	10.10%	10.10%	10.10%	10.10%
Transport and Communication	10.60%	14.10%	9.30%	16.50%
Recreation, Education and Culture	12.30%	12.90%	18.30%	13.30%
Miscellaneous Goods and Services	12.90%	27.10%	29.70%	29.00%
Total Private Consumption Expenditure	12.00%	14.80%	14.10%	14.20%
Estimated Retail Trade Sales	12.40%	14.90%	15.10%	12.50%

Source: DIPP Discussion Paper, authors' Calculations.

Retail trade sales exclude expenditures on rent, fuel and power; transport and communication; recreation, education and cultural activities; and expenditures on food in hotels and restaurants. FDI in India are permitted through financial collaborations, private equity or preferential allotments, by way of capital markets through Euro issues, and in joint ventures. With strong governmental support, foreign direct investment has helped the Indian economy grow tremendously. India has continually sought to attract FDI from the world's major investors. Different countries are investing in different sectors. FDI into India went up by an impressive 56 per cent to $2.53 billion in November 2011, signalling improvement in investor sentiment. The cumulative flows of $22.83 billion for the April-November (2011) period have crossed $19.43 billion which came in the full fiscal of 2010-11, according to officials.

3. 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

Table 2:
Foreign Direct Investment Flows to India: Country wise and Industry wise(US $ Million)

Source/Industry	2006-07	2007-08	2008-09	2009-10 P	2010-11 P
Total FDI	9,307	19,425	22,697	22,461	14,939
Country-wise Inflows					
Mauritius	3,780	9,518	10,165	9,801	5,616
Singapore	582	2,827	3,360	2,218	1,540
U.S.A	706	950	1,236	2,212	1,071
Cyprus	58	570	1,211	1,623	571
Japan	80	457	266	971	1,256
Netherlands	559	601	682	804	1,417
United Kingdom	1,809	508	690	643	538
Germany	116	486	611	602	163
UAE	215	226	234	373	188
France	100	136	437	283	486
Switzerland	57	192	135	96	133
Hong Kong	60	106	155	137	209
Spain	62	48	363	125	183
South Korea	68	86	95	159	136
Luxembourg	–	15	23	40	248
Others	1,055	2,699	3,035	2,376	1,184
Sector-wise Inflows					
Manufacture	1,641	3,726	4,777	5,143	4,793
Construction	967	2,551	2,237	3,516	1,599
Financial Services	1,330	3,850	4,430	2,206	1,353
Real Estate Activities	431	1,336	1,886	2,191	444
Electricity and other Energy Generation, Distribution & Transmission	174	829	669	1,877	1,338
Communication Services	423	66	2,067	1,852	1,228
Business Services	2,425	1,158	643	1,554	569
Miscellaneous Services	298	1,901	1,458	888	509
Computer Services	824	1,035	1,647	866	843
Restaurants & Hotels	153	280	343	671	218
Retail & Wholesale Trade	47	200	294	536	391
Mining	42	461	105	268	592
Transport	165	816	401	220	344
Trading	82	176	400	198	156
Education, Research & Development	43	156	243	91	56
Others	262	884	1,097	384	506

Source; RBI annual report 2010-11

sector specific guidelines for FDI with regard to the conduct of trading activities.

· FDI up to 100% for cash and carry wholesale trading and export trading allowed under the automatic route. 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). FDI is not permitted in Multi Brand Retailing in India.

4. WHY GLOBAL RETAILERS ARE INTERESTED IN INDIA?

More specifically the global players are interested in India due to following reasons:

Strategic Location & Geography: India enjoys unique geographical advantage. It is strategically located in Asia with access to all leading markets of the World. With total area of 32, 87,590 Sq. Km, Coastline of 7000 Km and borders with six countries India becomes most promising destination for the foreign direct investment.

Versatile Demographics: Demographically with a population of more than 1.1 billion and diverse culture, India is a land of all seasons. India presents a real cosmopolitan population with diverse religions and culture. Hinduism, Buddhism, Jainism, Sikhism, Christianity and Islam are the main religions of India. This variety of religions provides India with a diverse culture. Besides, India has versatile population of urban and rural nature. This versatility of population makes India a readymade market for foreign retailers.

Vast growing Economy: On economic front, India the largest democracy of the world, have a stable Govt. with robust programme of economic reforms. India with a foreign exchange reserve of more than US $120 billion, FDI of more than US $9.9 billion ,average GDP growth of more than 7% per annum, rupee appreciation Vs U.S dollar of more than 2% in last two years and with a rapidly growing investment in infrastructure has all the ingredients of a emerging economic super power. India is tipped to be third largest economy in terms of GDP by the year 2050 (Table 3).

Table 3: Forecast of GDP ($ Trillion)

Country	China	U.S.A.	India	Japan	Brazil	Russia	U.K.	Germany	Italy
2010	3	13.3	0.9	4.6	0.7	0.8	1.9	2.2	1.3
2050 (P)	44.5	35.2	27.8	6.7	6.1	5.9	3.8	3.6	2.1

Source; Mc Kinsey Quarterly Nov. 09

In such a scenario every multinational aims to set up a base in India, not to participate in Indian growth story, rather to build their own future.

5. RETAILING: THE EMERGING REVOLUTION

Retailing is the largest private industry in India and second largest employer after agriculture. The sector contributes to around 10 percent of GDP. With over 12 million retail outlets, India has the highest retail outlets density in the world. This sector witnessed significant development in the past 10 years from small unorganized family owned retail formats to organized retailing. Liberalization of the economy, rise in per capita income and growing consumerism has encouraged large business and venture capitalist in investing in retail infrastructure. The importance of retail sector in India can be judged from following facts (a) Retail sector is the largest contributor to the Indian GDP (b) The retail Sector provides 15% employment (c) India has world largest retail network with 12 million outlets (d) Total market size of retailing in India Is U.S $ 180 billion (e) Current Share of Organized Retailing is just 2% which comes around to $3.6 trillion (f) Organized retail sector is growing @ 28% per annum.

6. RETAIL AS A 'FORCED EMPLOYMENT' SECTOR

It is important to understand how retailing works in our economy, and what role it plays in the lives of its citizens, from a social as well as an economic perspective. India still predominantly houses the traditional formats of retailing, that is, the local kirana shop, *paan/beedi* shop, hardware stores, weekly haats, convenience stores, and bazaars, which together form the bulk. Most importantly, Indian retail is highly fragmented, with about 11 million outlets operating in the country and only 4% of them being larger than 500 square feet in size. Compare this with the figure of just 0.9 million in the US, yet catering to more than 13 times of the Indian retail market size.

The Indian retail industry was, and continues to be, highly fragmented. According to the global consultancy firms AC Neilsen and KSA Technopak, India has the highest shop density in the world. In 2001 they estimated there were 11 outlets for every 1,000 people. Further, a report prepared by McKinsey & Company and the Confederation of Indian Industry (CII) predicted that global retail giants such as Tesco, Kingfisher, Carrefour and A hold were waiting in the wings to enter the retail arena. This report also states that the Indian retail market holds the potential of becoming a $300 billion per year market by 2010, provided the sector is opened up significantly. It does not talk about creating additional jobs however, which should be the prime concern of the policy maker.

7. BENEFITS BY FDI IN RETAIL

- Introduce modern logistics such as efficient supply chain & cold storage that will cut down the estimated 40% wastage in farm produce helping to tame inflation & putting more money in farmers' pocket. This will raise GDP growth with additional purchasing power of the farmers & consumers.
- Reduce middlemen who pocket most of the profit today thereby letting farmers get better price & reduce price for the consumers,
- Create jobs in retail without requiring high education level such as in IT,
- Help make medium-small suppliers more efficient since foreign retailers work with their vendors to help them improve quality (look at China example),
- With the improvement in competitiveness of Indian suppliers the foreign retailers may export more items from India,
- Better quality since organized foreign retailers have to observe quality control for fear of bad publicity,
- Tax revenue for the govt as organized retail will collect sales tax.

8. DRAWBACKS OF FDI IN RETAIL

Drawbacks to allowing FDI in retail were pointed out by the Standing Committee of Parliament in June 2009. In the absence of a level playing field between Indian retail and the MNCs, it suggested comprehensive steps to strengthen the former before opening the gates to FDI. Otherwise, it is said, the economy would suffer and widespread unemployment would lead to social unrest. According to the non-government cult, FDI will drain out the country's share of revenue to foreign countries which may cause negative impact on India's overall economy. Many of the small business owners and workers from other functional areas may lose their jobs, as lot of people are into unorganized retail business such as small shops .Global retail giants are highly capital intensive and create fewer jobs. A single Wal-Mart store could put tens of thousands of mom and pop stores out of business — as it did in the US — while generating perhaps 3,000 jobs. Traditional retail will struggle with the likes of Wal-Mart and lose, because Big Retail with its deep pockets would resort to predatory pricing. Nor should we expect ethical practices from multinational players. However the government is quite stringent on this issue and determined to allow FDI in India. The actual impacts would be observed over time and till then the laymen have nothing but to hope for the best!

9. 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.

10. CONCLUSION

Due to FDI in retail Farmers will get a better price, easy credit availability and lower price psychologically attract the customers to spend more than they otherwise would. FDI should be aggressively promoted in R&D, Manufacturing, and entertainment to accommodate the people who have lost their jobs. FDI could have a favourable short term effect on growth as it expands the economic activity however, in long run it will reduce the growth rate due to dependency, particularly due to recapitalisation. Export oriented sector should be opened for the FDI so that higher growth of economy could be achieved through the growth of these sectors. In principle, governments should not prevent anybody, Indian or foreign, from setting up any business unless there are very good reasons to do so.

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