



Foreign direct investment in Indian retail sector: opportunities and challenges

Satbir Saroy and Mamta Sharma

Department of Commerce, Kurukshetra University, Kurukshetra, India.

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ABSTRACT

Widespread liberalization and deregulation of financial markets, cross border mergers and acquisition, increased role of investors willing to invest abroad, rapid advances in modern technology and internet – have all resulted in remarkable increase of international capital flows in India. Foreign direct investment acts as a major medium in the development of a country through up-gradation of technical know how, managerial skills and financial resources. Rise in purchasing power, growing consumption and brand flare-up has led to transformation in retail sector. FDI in retail can enlarge market by reducing operation and transformation cost of business through implementation of advanced supply chain and benefit consumers and suppliers. As well as raised concerns about employment losses, increase in competition for domestic retailers resulting in closing of small domestic retailers from the market and distortion of urban culture development. The present paper focuses on the Indian retail sector in context of opportunities of expansion of FDI in Indian retail sector and the challenges come forward that retail sector faces.

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Introduction

Foreign direct investment is the process whereby residents of one country acquire the ownership of assets for the purpose of controlling the production, distribution and other activities of a firm in another country. According to IMF, foreign direct investment is the category of international investment that reflects the objective of obtaining a lasting interest by a resident entity in one economy in an enterprise resident in one economy. Foreign direct investment is growing rapidly in India. Foreign direct investment is an essential part of an international economic system and a major medium to development. FDI generate technological spillovers, support human capital formation, contributes to international trade integration, helps create a more competitive business environment and enhance enterprise development. All these factors contribute to higher economic growth and consequently aid in alleviating poverty. India has a relatively younger population in the age of 15-64 years with a median age of 26.2 years, lowest among the BRICS countries; moreover, 29.7% population is in between the age of group of 0-14 which is the highest among the BRICS. India is ninth largest in the world by nominal GDP and the fourth largest by purchasing power parity (PPP). (Source: International Monetary Fund). India's per capita income has tripled from 423 US\$ in 2003-03 to 1219 US\$ in 2010-11. Dependency on agriculture has reduced and the share of services and industry sector has increased.

Flows of FDI in India

Flows of FDI comprise capital provided by a foreign direct investor to an FDI enterprise, or vice versa by a foreign direct investor. FDI has three components, viz., equity capital, reinvested earnings, and intra company loans:-

- Equity capital is the foreign director investor's purchase of share of an enterprise in a country other than its own.
- Reinvested earning compromise the direct investor's share of earning not distributed as dividends by affiliates, or earning not

remitted to the direct investor. Such retained profits by affiliates are reinvested.

- Intra company loans or intra company debts transactions refer to short or long term borrowing and lending of funds between direct investor and affiliate enterprise.

Objectives of the study

The objectives of this study are:

- To have an overview of Indian Retail Sector.
- To explain the legal framework of FDI in Indian retail sector.
- To show the current scenario of FDI in Indian retail sector.
- To discuss the challenges and opportunities of FDI in both single and multi brand retailing.

Research Methodology

The present study is descriptive in nature. The data used for the study is secondary in nature and has been collected from various websites of Government, reputed journals, books and magazines related to FDI flows, reports and publications of various associations connected with business and industry, agencies and Government. The main focus of the study is on the controversial views of the various stakeholders and evaluated the challenges and opportunities faces by the Indian retail sector after liberalization of foreign direct investment.

Overview of Indian retail sector:-

Till the 1990's Indian retail market was primarily dominated by traditional neighborhood retailers or "kirana" stores. The retail is one of the fastest growing sectors in the nation that caters to the world's second largest consumer market. India has one of the largest numbers of retail outlets in the world. The country has about 14 million outlets.

The retail sector in India can be broadly classified into organized and unorganized retail sectors. Organized retailing refers to trading activities undertaken by licensed retailers i.e. 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 refers to the traditional formats of low cost retailing

such as the local kirana shops, paan/beedi shops, convenience stores, handcart and pavement vendors, owner managed general stores etc.

Total retail employment in both organized and unorganized retail, calculated about 7% of Indian work force currently most of which is unorganized. Retail sector generates around 15% of India's GDP. In an estimate the unorganized retail sector has 97% presence on the other hand organized retail sector calculated merely 3%. India's retail and logistics industry, organized and unorganized in combination, employs about 40 million Indians.

Growth Drivers for Indian retail sector:

Currently, India is the 5th largest retail market in the world. The overall Indian retail sector is expected to rise to US\$ 833 million by 2013 and to US\$ 1.3 trillion by 2018. The retail industry in India is currently growing at a great pace. As the country has got a high growth rate, the consumer spending has also gone up and is also expected to go up further in the future. The key factors that drive growth in retail industry are young demographic profile, increasing consumer aspirations, growing middle class incomes and improving demand from rural market. Also rising income and improvement infrastructure are enlarging consumer market and accelerating the convergence of consumer tastes. Liberalization of the Indian economy, increase in spending per capita income and the advent of dual income families also help in the growth of retail sector.

Operating Environment retailing formats in India:-

Retail formats prevailing in India are in various forms like hypermarkets or supermarkets i.e. large self servicing outlets offering products form a variety of categories. Some of them are followings:-

1. **MOM and POP Stores:** Mom and pop shops usually have a single location that often occupies a physically small space. The "shop" could be any type of business, such as an auto repair garage, bookstore or restaurant. "Mom and pop" can also refer to inexperienced investors who play the market casually and do not rely on trading to significantly supplement their income.

2. **Departmental Stores:** A department store is a retail establishment which satisfies a wide range of durable goods and products to the consumer's personal and residential needs; and at the same time offering the consumer a choice of multiple merchandise lines, at variable price points, in different product categories.

3. **Convenience Stores:** Convenience store is a small store that stocks a range of everyday items such as groceries, toiletries, alcoholic and soft drinks, tobacco products, and newspapers.

4. **Shopping Malls:** Shopping mall is one or more buildings forming a complex of shops representing merchandisers, with interconnecting walkways enabling visitors to easily walk from unit to unit, along with a parking area – a modern, indoor version of the traditional marketplace.

5. **E- Retailer:** The sale of goods and services through the Internet. Electronic retailing, or e-tailing, can include business-to-business and business-to-consumer sales. E-tailing revenue can come from the sale of products and services, through subscriptions to website content, or through advertising.

6. **Discount Stores:** A **discount store** is a type of department store, which sells products at prices lower than those asked by traditional retail outlets. Most discount department stores offer a wide assortment of goods; others specialize in such merchandise as jewelry, electronic equipment, or electrical appliances. These

are factory outlets that give discount on the MRP to the customers.

7. **Vending:** Vending is a relatively new entry, in the retail sector. Here beverages, snacks and other small items can be brought via vending machine.

8. **Category Killers:** These are small specialty stores that offer a variety of categories. They are known as category killers as they focus on specific categories, such as electronics and sporting goods.

9. **Specialty Stores:** Specialty stores are small stores which specialize in a specific range of merchandise and related items. Most stores have an extensive depth of stock in the item that they specialize in and provide high levels of service and expertise.

Policy framework regarding FDI in Indian context:-

Foreign direct investment is freely allowed in all sectors including service sector, except a few sectors where the existing and notify sectoral policy does not permit FDI beyond a ceiling. FDI for virtually all items or activities can be brought in through the **Automatic Route** under which no prior approval and filing investment details to the Reserve Bank of India. The automatic route is appropriate for a few sectors where there is no sector cap i.e. sectors where 100% foreign ownership is allowed. And another route is **FIPB Approval Route** is for proposals where the shareholding is intended to be above a prescribed sector cap of where FDI is currently not allowed, or where it is mandatory for the application to be approved by the **Foreign Investment Promotion Board (FIPB)**

Today in the retail sector, foreign direct investment is currently limited to 51% in multi brand retailing and allows for 100% FDI in single brand and Wholesale Cash and Carry formats. Subject to these equity conditions, a foreign investor can set up a registered company and operate under same rules and regulations as an Indian company. Foreign investments are freely repatriable and are regulated under the **Foreign Exchange Management Act, 1999 (FEMA)**, administered by the Reserve Bank of India's exchange control department. The ministry of commerce and industry, Government of India is the nodal agency for monitoring and reviewing the FDI policy on continued basis and changes in sectoral policy or sectoral equity caps. The FDI policy is notified through Press Notes by the **Secretariat for Industrial Assistance (SIA)**, Department of **Industrial Policy and Promotion (DIPP)**.

Current status of FDI in India Retail sector:-

As of September 2012, the Government of India allowed FDI in single and multi brand retailing along with the following conditions:-

1. Up to 100% FDI in single brand retail trading.
 - By only one non-resident entity whether owner or the brand or otherwise.
 - 30% domestic sourcing requirement eased to preferable sourcing rather than compulsory.
 - Further clarification on FDI companies that cannot engage in B2C e-commerce.
 - Products to be sold should be of a 'single brand'.
 - Product should be sold under the same brand internationally.
 - 'Single brand' product retailing would cover only products, which are branded during manufacturing.
2. Up to 51% FDI in multi brand retail trading.
 - At least 100 million US\$ must be invested into Indian company.

- At least 50% of the total FDI is to be invested in back end infrastructure within 3 years.
- At least 30% of the value of procurement of processed product shall be sourced from Indian small industry.
- Fresh agriculture produce is permitted to be sold unbranded.
- Indian states have been given the discretion to accept or refuse the implementation of FDI.
- Retail outlets can be set up in cities having population of at least 1 million.
- Application needs to be approved by two levels at Department of Industrial Policy and Promotion and Foreign Investment Promotion Board.

Opportunities and challenges of FDI in Indian retail sector:

Opportunities always lie in challenges. It can be simply defined that opportunities and challenges are related with each others. Every act has two dimensions on the one side brings challenges for a country on the other side it brings opportunities. Each country has to make balance in both the situations. Every challenge led the country to the development because when a country face challenges then the country go to implement the new amendments to change. The major opportunities and challenges perceived to face by Indian retail industry because of FDI are shown below:

Opportunities:

Foreign Direct Investment Has the following potential benefits for less developed countries like India:

- 1. Improvement in quality standard:** The flow of FDI in retail sector is bound to pull up the quality standards and cost competitiveness of Indian producers in all the segments and hence India will significantly do well in terms of consumer expectations.
- 2. Capital Infusion:** FDI would provide an opportunity for cash lacking retailers to bridge the gap between capital required and raised. In fact FDI is the major source of investment for a developing country like India wherein it expects investment from multinational companies to improve the countries growth rate, create jobs, share their expertise, back end infrastructure and research and development in the host country.
- 3. Boost Healthy Competition and check inflation:** Supporters of FDI argue that entry of the many multi-national corporations will obviously promise intensive competition between the different companies offering their brands in a particular product market and this will result in availability of many varieties, reduced prices, and convenient distribution of the marketing offers.
- 4. Improvement in Supply Chain:** Improvement of supply chain/ distribution efficiencies, coupled with capacity building and introduction of modern technology will help arrest wastages (in the present situation improper storage facilities and lack of investment in logistics have been creating inefficiencies in food supply chain, leading to significant wastages).
- 5. Improvement in Customer Satisfaction:** Consumers in the organized retail will have the opportunity to choose between a numbers of internationally famous brands with pleasant shopping environment, huge space for product display, maintenance of hygiene and better customer care. There is a large segment of the population which feels that there is a difference in the quality of the products sold to foreign retailers and the same products sold in the Indian market. There is an increasing tendency to pay for quality and ease and access to a "one-stop shop" which will have a wide range of different products. If the market is opened, then the pricing could also

change and the monopoly of certain domestic Indian companies will be challenged.

6. Improved technology and logistics: Improved technology in the sphere of processing, grading, handling and packaging of goods and further technical developments in areas like electronic weighing, billing, barcode scanning etc. could be a direct consequence of foreign companies opening retail shops in India,. Further, transportation facilities can get a boost, in the form of increased number of refrigerated vans and pre-cooling chambers which can help bring down wastage of goods.

7. Benefits for the Farmers: Presumably, with the onset of multi-brand retail, the food and packaging industry will also get an impetus. Though India is the second largest producer of fruits and vegetables, it has a very limited integrated cold-chain infrastructure. Lack of adequate storage facilities causes heavy losses to farmers, in terms of wastage in quality and quantity of produce in general, and of fruits and vegetables in particular. With liberalization, there could be a complete overhaul of the currently fragmented supply chain infrastructure. Extensive backward integration by multinational retailers, coupled with their technical and operational expertise, can hopefully remedy such structural flaws. Also, farmers can benefit with the "farm-to fork" ventures with retailers which helps (i) to cut down intermediaries ; (ii) give better prices to farmers, and (iii) provide stability and economics of scale which will benefit, in the ultimate analysis, both the farmers and consumers.

8. Creation of More and Better Employment Opportunities: The entry of foreign companies into Indian Retailing will not only create many employment opportunities but, will also ensure quality in them. This helps the Indian human resource to find better quality jobs and to improve their standard of living and life styles on par with that of the citizens of developed nations.

9. Boost up competition: Welcoming the FDI in retail industry can prove advantageous for India as it increase the competition in retail chain at domestic level. The competition always demands the innovation and differentiation and the out result of these two is the quality goods. As the competition increases, the competitor is compelled to serve quality of goods at competitive at reasonable price.

10. Efficient Banking Services: Efficient and customized services of bank's today, is a result of effective competition which increases only after the foreign players were welcomed in ground.

11. Increased Purchasing power: Large domestic market with an increasing middle class and potential customers with purchasing power.

12. Improving Distribution and Warehousing Technologies: The technical know-how from global firms, such as warehousing technologies and distribution systems, will lend itself to improving the supply chain in India, especially for agricultural produce.

13. Attractive Market: Global retail giants take India as key market .It is rated fifth most attractive retail market. Indian retail industry has come forth as one of the most dynamic and fast paced industry with several players entering the market. The organized retail sector is expected to grow stronger than GDP growth in the next five years driven by changing lifestyles, increase in income, purchasing power and favourable demographic outline. Food and apparel retailing are key drivers of growth.

14. Sustainable development and regulated system: There will be sustainable development and many other vital economic issues will be focused upon like child labour overtime, not taking of their welfare. These issues will not have any room in this transparent open system as contract between the employer and worker will evict corruption from grass root level and will control black money.

15. Improvement in export competitiveness: FDI can help the host country improve its export performance. By raising the level of efficiency and the standard of product quality, FDI makes a positive impact on the host country's export competitiveness.

Challenges:

FDI is not an unmixed blessing. Governments in developing countries have to be very careful while deciding the magnitude, pattern and conditions of private investment. Possible adverse implications of FDI are the following:

1. Inequitable Competition: It would lead to very inequitable competition and eventually 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.

2. Massive Job Losses: Indian economy is a developing economy and the level of development is not as desired. Due to paucity of infrastructure resources in Indian economy, there is a direct threat from big giants like Wal-Mart, which will compel current independent stores to close which will directly lead to massive job losses, as their level is very high, fully automated which need very few people to operate. This will lead to massive job losses; also since the Sector is unable to employ retail staff on contract basis, this becomes a biggest threat for the Indian economy.

3. Repatriation of profits outside India: India doesn't need foreign retailers, since home grown companies and traditional markets may be able to do the job. Just like in BPO industry, work will be done by Indians, profits will go to foreigners hence is not viable solution for Indians. We cannot ever forget the example of East India Company. It entered India as a trader and then took over politically.

4. Persistence of Political inconclusiveness of issues: There is still no consensus made by government in a politically and culturally diverse country like India, within no time every economic issues turns out to become a political issue and there is a persistence of inconclusiveness on the issue.

5. Monopolistic tendencies and unnatural price trends: Another concern is 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.

6. Asymmetric growth of cities: 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.

Key Findings and Implications

1. As policy framework, foreign investment can be approved via one of the following two different routes:

- Automatic approval route require no prior approval, and filling of the investment details to the Reserve Bank of India.

- Foreign investment promotion board (FIPB) approval route is for proposal where the shareholding is intended to be above a prescribed a sector cap i.e. the sectors where FDI is currently not allowed.

2. Today in retail sector, FDI is currently limited to 51% in multi brand retail stores and allows for 100% FDI in single brand retail and wholesale cash and carry formats. Strategic license agreements, cash and carry wholesale trading, joint ventures; franchising, distribution and manufacturing are some methods available for retailers under current FDI policy.

3. The cabinet has approved 100% FDI in single brand retail and 51% in multi brand retail. Government stipulates that the minimum capital for investment required shall be US\$ 100 million and 50% of the investment should be in back end infrastructure. Investment should be restricted to cities with population over 1 million. For investing in single brand retail, the government has made it mandatory for the retailer to secure 30% of the product sold from small industries/village and cottage industry, artisans and craftsman.

4. It is expecting that FDI in Indian retail sector will improve the back end infrastructure, supply chain management which would help in bigger scale of operations. Better back end infrastructure and supply chain efficiency will resulting in reducing the intermediaries which will ultimately benefit the farmers and the end users. The government also expects 10 million jobs to be created through the retail FDI.

5. FDI in retail created a lot of challenges for India, like domination of organized retailers, problem of unemployment, monopolistic tendencies and unnatural price trends etc.

6. Indian work force is 422 million and the organized retail sector employ only 27 million.

Conclusion

The opening up of the retail sector to FDI could therefore provide a boost to small and medium enterprises. Expansion in retail sector could also generate significant employment potential especially among rural and semi urban peoples. So it is very difficult to predict the future of Indian retail sector. But Indian government must be caution about the apprehension raised by the critics and adequate safeguards must be taken so that the positive effects may balance the negative ones and the traditional retailers coexist even after big foreign retailers enter the market.

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