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Impact of FDI on Indian Retailing

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Abstract

Till recently, Government of India allowed 51% FDI in single brand retail and 100% in cash & carry only. But FDI in multi brand retail has not yet been allowed. One of the major steps taken by the Government recently to encourage the organized retailing in the country was the recent decision of the cabinet to allow 51% FDI in multi brand retail and 100% in single brand retail in Nov 2011. The government has ultimately taken the bold decision and notified the much-awaited policy allowing 100 % FDI in single brand retail from the existing 51%. In view of the above background, it was proposed to undertake a study to assess the impact of the government's decision to allow 51% foreign direct investment (FDI) in multi-brand retail and 100% in single brand retail on the Indian retail sector. This study is completely a review based study which throws light on reviewing FDI Policy in India, FDI Policy with regard to Retailing in India, Factors attracting FDI towards Indian Retail Sector and Impact of FDI on Retail Sector.

1. Introduction:

Any process of change is a dialectic process. Change is the only truth which prevails at the end if it brings well being to the masses. It is believed sooner or later opposition to the FDI in retail will end and new era will begin. India's retailing industry is essentially owner manned small shops. In 2010, larger format convenience stores and supermarkets accounted for about 4% of the industry, and these were present only in large urban centers. India's retail and logistics industry employs about 40 million Indians (3.3% of Indian population). Until 2011, Indian central government denied foreign direct investment (FDI) in multibrand retail, forbidding foreign groups from any ownership in supermarkets, convenience stores or any retail outlets. Even single-brand retail was limited to 51% ownership and a bureaucratic process. In November 2011, India's central government announced retail reforms for both multi-brand stores and single-brand stores. These market reforms paved the way for retail innovation and competition with multi-brand retailers such as Walmart, Carrefour and Tesco, as well single brand majors such as IKEA, Nike, and Apple (The Economist. 29 May 2008.) The announcement sparked intense activism, both in opposition and in support of the reforms. In December 2011, under pressure from the opposition, Indian government placed the retail reforms on hold till it reaches a consensus: (Agarwal, Vibhuti; Bahree, Megha, 2011).

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In January 2012, India approved reforms for single-brand stores welcoming anyone in the world to innovate in Indian retail market with 100% ownership, but imposed the requirement that the single brand retailer source 30% of its goods from India. Indian government continues the hold on retail reforms for multi-brand stores, as opined by Sharma, Amol; Sahu, Prasanta (2012). IKEA announced in January that it is putting on hold its plan to open stores in India because of the 30% requirement: (Financial Times, 2012).

2. Purpose of the Study:

This sole purpose of this completely review based study is to review FDI Policy in India, FDI Policy with regard to Retail sector, Factors attracting FDI towards Indian Retail Sector, Impact of FDI on Retail Sector with to and fro arguments and some policy measures as concluding remarks.

3. FDI Policy in India:

FDI as defined in Dictionary of Economics 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 (Hemanth Batra (2010)).

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, (Notification No. FEMA 20/2000-RB dated May 3, 2000) 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 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.

4. 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 (FDI Circular 02/2010, DIPP) 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.

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5. Prospected Changes in FDI Policy for Retail Sector in India:

The government (led by Dr.Manmohan Singh) announced following prospective reforms in Indian Retail Sector

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. The retailers (both single and multi-brand) will have to source at least 30% of their goods from small and medium sized Indian suppliers.
4. 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.
5. 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.
6. The opening of retail competition (policy) will be within parameters of state laws and regulations.

6. 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 3[13] that

1. 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),
2. Products should be sold under the same brand internationally,
3. Single-brand product retail would only cover products which are branded during manufacturing and
4. Any addition to product categories to be sold under —single-brand would require fresh approval from the government.

While the phrase single brand has not been defined, it implies that foreign companies would be allowed to sell goods sold internationally under a single brand, viz., Reebok, Nokia, and Adidas. Retailing of goods of multiple brands, even if such products were produced by the same manufacturer, would not be allowed.

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

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required. If granted permission, Adidas could sell products under the Reebok brand in separate outlets.

7. 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 14 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.

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 FDI. In 1997, FDI in cash and carry (wholesale) with 100% ownership was allowed under the Government approval route. It was brought under the automatic route in 2006. 51% investment in a single brand retail outlet was also permitted in 2006. FDI in Multi-Brand retailing is prohibited in India.

The Union Cabinet has approved 51% FDI in multi-brand retail and raised the cap on FDI in single-brand retail from 51% to 100%. In this context, Pinakiranjan Mishra, Partner & National Leader - Retail and Consumer Products, Ernest and Young India, opined that the FDI in retail will lead to Growth of the Retail sector in India, Improvement in Retail capability building in India, Push to Infrastructure, Improvement in management of supply chain and Push to productivity of the Farming Community in India. That shows positive signs of FDI in retail in India.

According to Anand Dikshit (2011), Retailing in India is one of the pillars of its economy and accounts for 14 to 15% of its GDP. The Indian retail market is estimated to be US$ 450 billion and one of the top five retail markets in the world by economic value. India is one of the fastest growing retail markets in the world, with 1.2 billion people - McKinsey & Company (2005).

8. Global Retailing Scenario:
Retail has played a major role in improving the productivity of the whole economy at large. The positive impact of organized retailing could be seen in USA, UK, and Mexico and also in China. Retail is the second largest industry in US. It is also one of the largest employment generators. It is also important to understand that Argentina, China, Brazil, Chile, Indonesia, Malaysia, Russia, Singapore and Thailand have allowed 100% FDI in multi brand retail. These countries benefited immensely from it. Also small retailers co-exist. The quality of the services has increased. China permitted FDI in retail in

1992 and has seen huge investment flowing into the sector. It has not affected the small or domestic retail chains on the contrary small retailers have increased since 2004 from 1.9 million to over 2.5 million.

9. Factors attracting FDI towards Indian Retail Sector:

According to India Retail Report (2007), Indian retailing industry has been present in India through history and is considered as one of the largest sectors in the Indian economy, contributing to around 14% to the GDP and employing around 7% of the total population. The Indian Retail sector is estimated to have a market size of about $180 billion, but the organized sector represents only 4% share of this market and is likely to increase its share to over 30% by 2013. India has over 5 million retail outlets and today retailing is largest contributing sector to country's GDP i.e. 10% as compared to 8% in China, 6% in Brazil.

Indian retail market is estimated to grow from $427 billion in 2010 and expected to reach $637 billion by 2015 (Srivastava 2008). The Indian retail market consists of 14 million outlets and has the largest retail outlet destiny in the world (Sinha and Uniyal, 2005).

Organized retailing in India accounts for 4.6% ($ 12.4 Billion) of $ 270 Billion retail market with an expected 40% plus annual growth rate, and is expected to grow (India Retail Report, 2007). Arshad and Hisam (2007) and Ghosh et al (2010) presented that 47% of India’s population is under the age of 20 and this will increase to 55% by 2015 and this young population will immensely contribute to the growth of the retail sector in the country.

Mulky and Nargundkar (2003) opined that the Indian retail sector is largely traditional, but stores in modern format are emerging. As compared to traditional stores, new format stores are pre-engineered retail outlets, characterized by well designed layout, ambience, display, self service, value added services, technology based operations and many more dimensions with modern outlook and practices. Traditional retailing is typically small family business (Bianchi, 2004) linked with local culture (Goldman et al, 1999) and non-organised distribution.

Organized retail sector has also grabbed the attention of foreign companies, showing their interest to enter India, (Dalwadi 2010). Aggarwal (2008) and Bhardwaj and Makkar (2007) stated that organized retail industry will mean thousand of new jobs, increasing income level, standard of living, better products, better shopping experience etc.

Several demographic indicators show favorable trends for the growth of organized trade in India and these become the important drivers for retail industry in India like Rapid income growth, increasing urbanization, growing young population: Swar (2007). Satish and Raju (2010) identifies major Indian retailers that highly contribute to the retail sector in India are Pantaloon, Tata Group, RPG Group, Reliance Group and A V Birla group etc.

India is expanding internationally due to saturation of markets and challenges faced by international retailers. Partnership between Bharti and Wal-Mart is one of the successful expansions of international retail in India: Halepete et al (2008). Food and Grocery, Health and Beauty, Apparel, Jewellery and Consumer durables are the fastest growing categories of organized retail and fashion sector in India commands lion's share in the organized retail pie (Shukla and Jain, 2007).

Growing middle class, large number of earning youth customers, increase in spending, and improvement in infrastructure, Liberalization of Indian economy and India's booming economy are the various opportunities for organized retailing in India. On the other hand, complexity of taxes, lack of proper infrastructure and high cost of real estate are the hurdles which need to remove for retail success in India: Dash and Chandy (2009). In India, a consuming class is emerging as a result of increasing income levels and dual career families with high disposable incomes: Goyal and Aggarwal (2009).

Mishra (2008) opined that mall space, demography, rising young population, availability of brands, rising retail finance, changing lifestyle, modern retail formats and foreign direct investment are the strengths and opportunities for modern retail model. On the other hand, real estate cost, improperly developed mall, lack of skilled personnel, underdeveloped supply chain and taxation hurdles are the weaknesses and threats for modern retail formats. Hino (2010) observed that the emergence and expansion of supermarkets that gradually decreased the market share of the traditional formats by displacing them and the factors that helped supermarkets in gaining consumers favors over the traditional stores are the 'consumers economic ability' and the 'format output'. Goyal and Aggarwal (2009) study indicated that the most appropriate retail formats for various items in India are: Food and grocery-Supermarket; Health and beauty care services-Supermarket; Clothing and Apparels'- Mall; Entertainment-Mall; Watches-Hypermarket; Pharmaceuticals-Hypermarket; Mobile, accessories & services-Hypermarket; Foot wares-Departmental store.

10. Arguments that for and against of FDI in Indian Retail Sector:

Arguments against FDI in Retail	***Arguments supporting FDI in Retail***
• Government does not have any clear stands on the FDI in Retail. • They have not done any survey and cost benefit analysis of this issue. As claimed by the Government that it will create Jobs, opposition does not buy it. • They claim million of retailers have to shut their shops. As claimed by Government that it will bring down price, opposition thinks otherwise.	• FDI in retail will create 80 lakhs jobs. • FDI in retail will bring growth and prosperity. Prices of products will come down. • FDI in retail will tame inflationary pressure in the economy.
Source: Report, sharetipsinfo.com	

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11. Negative Effects of FDI in Indian Retail Sector:

Till now there are positive arguments and non-positive arguments are discussed about the FDI in Indian Retail Sector. But once to have a glance boxes the side-effects of FDI in Indian Retail Sector, it will have the following.

1. Competitive pricing can make the domestic and traditional retailers out of the business.

2. Economies of scale and scope of MNC retailers can create problems to Indian Retailers.

3. In order to bring goods at lowest possible price for customers they squeeze the margins of their suppliers. So as claimed by thousand that suppliers will benefit, it still doubted.

12.Conclusion:

In order to correct these anomalies, India need to have strong regulator for the sector. And at the same time strengthen the Competition Commission of India before these Big Retailers prowls into the Indian Territory. In order to correct these non-positive effects of FDI in Indian Retail Sector, Indian Government need to have a strong regulatory framework that protects the interests of the domestic and traditional retailers of India. Indian Government needs to strengthen the Competition Commission of India before these Big Retailers lurks into the Indian Territory. Wishing FDI in Indian retail sector gets over soon and new era of retailing commences in India.

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