

Foreign Direct Investment (FDI) in Indian Retail Sector

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Abstract: *Indian retail industry is one of the sunrise sectors with huge growth potential which is expanding and modernizing rapidly. Indian retail is one of the most sought after sectors that carry great potential for attracting Foreign Direct Investment (FDI) as foreign investors are extremely eager on charisma in Indian retail sector. In spite of the recent developments in retailing and its immense contribution to the economy, retailing continues to be the least evolved industries and the growth of organized retailing in India has been much slower as compared to rest of the world. Undoubtedly, this gloomy situation of the retail sector, despite the ongoing wave of incessant liberalization and globalization, stems from the absence of an FDI encouraging policy in the Indian retail sector. The issue of opening of retail sector for FDI is most controversial concern in recent time. As the Indian retail sector in vast thus FDI in such forum is a big challenge which is the purpose of present paper.*

Keywords: *Foreign Direct Investment (FDI), Retail, Indian Retail Sector, FDI in Indian Retail Sector*

I. Introduction

1.1. Foreign Direct Investment (Fdi)

According to the Financial Times, "Standard definitions of control use the internationally agreed 10 percent threshold of voting shares, but this is a grey area as often a smaller block of shares will give control in widely held companies. Moreover, control of technology, management, even crucial inputs can confer de facto control [4]. FDI is a controlling ownership in a business enterprise in one country by an entity based in another country [4]. FDI is direct investment into production or business in a country by a company in another country, either by buying a company in the target country or by expanding operations of an existing business in that country. foreign direct investment is done for many reasons including to take advantage of cheaper wages or for special investment privileges such as tax exemptions offered by the country as an incentive to gain tariff-free access to the markets of the country or the region [15]. FDI refers to capital inflows from abroad that is invested in or to enhance the production capacity of the economy. It can be a subsidiary, joint venture or merger or acquisition and includes Greenfield and Brownfield projects [18]. FDI is distinguished from portfolio foreign investment, a passive investment in the securities of another country such as public stocks and bonds, by the element of "control".[4]

1.2. Foreign Direct Investment (Fdi) In Indian Scenario

FDI is an important tool in the economic development of the nation. Contribution of FDI through financial resources, technology and innovative techniques raises overall productivity of diverse sectors of economy. If properly navigated, it also acts as a catalyst for development of sectors such as agriculture, manufacturing, service, SME and many more. Indian retail sector is one of the most sought after sectors that carry great potential for attracting FDI. The sector is rightly projected as sunrise sector of India. The growth of retail, especially in 21st century is mind boggling and attracting the attention of retailers world over. With steady entry of top global retailers such as Wal Mart, Tesco, Carrefour and many more in last couple of years despite conservative approach of the Government, the sector has become more fascinating for research study. The recent decision of Indian Government of opening up the sector for FDI in single and multi brand retail has stirred up the heat with intense agitational activities witnessed all over India. The whole issue needs dispassionate review from all - intelligentsia, corporate world as well as from Government so that Indian retail sector benefits in its onward march of progress [3]. 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 [8].

1.3. Retail

Retail is a French word which means to "cut it again" and essentially mean a sale to the consumer for direct consumption [18]. Retail is the process of selling consumer goods and/or services to customers through multiple channels of distribution to earn a profit [2]. The Retail 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[1].

1.4. Retail In Indian Scenario

The retail sector is the backbone of any economy, determining its growth trajectory in a big way. India is Asia's largest retail market after China and Japan and retail is one of the largest employers in India. The sector has evolved dramatically from traditional village fairs, street hawkers to resplendent malls and plush outlets, growing from strength to strength. The retail sector in India includes a variety of product lines like food retailers, health, beauty products, clothing, footwear, home furniture, household goods, durable goods, leisure and personal goods. The food, beverage and clothing segment occupy the largest share and are growing exponentially [6]. In 2004, The High Court of Delhi referred to Black's Law Dictionary to define the term 'retail'. The term 'retail' is defined as a sale for final consumption in contrast to a sale for further sale or processing (i.e. wholesale). Thus, retailing can be said to be the interface between the producer and the individual consumer buying for personal consumption. This excludes direct interface between the manufacturer and institutional buyers such as the Government and other bulk customers. Retailing is the last link that connects the individual consumer with the manufacturing and distribution chain. A retailer is involved in the act of selling goods to the individual consumer at a margin of profit [8]. Retailing is the largest private industry in India and second largest employer in the Indian economy [12]. The Indian retail industry is the fifth largest in the world [9]. Retailing is one of the most important sectors of India economy. It provides 9 percent employment to the total workforce and contributes around 15 percent to the Indian GDP [8]. In 2010, the Indian retail market was valued at \$435 billion of which the share of modern retail was 7 per cent. The sector is expected to grow to \$535 billion by 2013 with the share of modern retail at 10 per cent [6]. The Indian retail sector is fragmented, consisting of small independent owner managed shops, accounting for 92 percent of the retail sector and the remaining 8 percent constitutes the organized sector [17]. 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 [15]. 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 [16]. The main reason for allowing FDI in retail sector is that, it complements and supplements domestic investment. Domestic companies are benefited through FDI, by way of enhanced access to supplementary capital and state of the art technologies; exposure to global managerial practices and opportunities of integration into global markets [15]. The change in life style, education, travel and disposable income has changed the consumption pattern of Indian consumer. Understanding the pulse of the market, large corporate groups such as ITC, Reliance, TATA, and Birla are investing huge amounts in organized retail trade. Aditya Birla plans to open 10 hyper markets and 100 super markets. Spencer will add 25 markets. Reliance plans to open 150 stores in the coming year [14]. The Indian retail sector 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: first via independent retailers (vertical separation) and second directly from the producer (vertical integration). In the latter case, the producers found their own chains of retail outlets, or develop franchises. Indian retail industry is divided into organized and unorganized sectors. The Organized retailing market is referring to the trading activities carry out by the licensed retailers; and that is also, those who are registered for sales tax, income tax, etc. The organized retailers include the corporate funded supermarkets and retail chains, and also the privately owned gigantic retail businesses. The unorganized retailing refers to the traditional players 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 unorganized retailing is the prevalent form of trade in India, even in present scenario constituting almost 98 percent of total trade in retail market, while organized trade accounts only for the remaining 2 percent [11]. The Indian retailer sector is divided in three segments, 'Single Brand Retail', 'Multi Brand Retail' and 'Cash And Carry' which refer to wholesale retail. 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. Wal-Mart has already entered this market with a joint venture with Bharti. 100 percent foreign investment in single brand retailing and 51 percent FDI in multi brand retailing are permitted in 2012. The organized retail sector in India is at its nascent stage. There are department stores like Shopper's Stop, Ebony, Piramyd and Globus, Supermarkets like Subhiksha, Vitan, Food World and the own brand store like Pantaloon. But unfortunately, the Indian Supermarket experience has not been so pleasant. The retail chains buy only 'A' grade produce and that to only a part of it. Farmers have to approach Mandis for the sale of rest of the produce. Recent studies reveal that these chains led to no improvement in the supply chain efficiency and buy from a few resourceful contract farmers without any promise or contract to buy regularly. These stores have miserable performance e.g. Subhiksha, More, Spencer's. For example; Bangalore has highest supermarket penetration and the Kirana stores have suffered badly. In the present scenario the supermarkets have only informal arrangements with growers instead of contract farming. The supermarkets are unwilling to share the risk of the growers. They give the market price based prices to the farmers who have to bear the risk of price fall in the market [5].

II. Necessity Of Fdi In Indian Retail

It is universally acknowledged that, FDI inflow offers many benefits to an economy. UNCTAD (1999) reported that, Transactional Corporations (TNCs) can complement local development efforts by:

- i. Increasing financial resources for development
- ii. Boost export competitiveness
- iii. Generate employment and strengthening the skill base
- iv. Protecting the environment to fulfill commitment towards social responsibility
- v. Enhancing technological capabilities through transfer, diffusion and generation.

Table No.1 Future Turnover and Share of Retailing in India (Crore Rupees)

Year	Total Retailing Turnovers	*Growth Over Last Year, in %	Organised Sector Turnover	Growth Over Last Year, in %	Market Share in %
2011	23,55,000	10.82 %	1,75,000	25.00	8
2012	26,40,000	12.10 %	2,20,000	25.71	9
2013	29,50,000	11.74 %	2,75,000	25.00	11
2014	32,65,000	10.67 %	3,45,000	25.45	12
2015	36,25,000	11.02 %	4,25,000	23.18	13
2016	39,95,000	10.20 %	5,30,000	24.70	14
2017	44,95,000	12.51 %	6,70,000	26.41	15
2018	50,35,000	12.01 %	8,40,000	25.37	17
2019	56,15,000	11.51 %	10,50,000	25.00	19
2020	62,40,000	11.13 %	13,10,000	24.76	21

Source: Veerendra Talegaonkar, Loksatta, Mumbai, 5/12/2011, P.p. 11

At present growth of turnover of retailing is 11 percent and in the next 10 years it is estimated to increase 11 percent every year. In case of organized retailing, growth would be more than 25 percent every year up to 2020. The above table specifies the necessities of FDI in India. India needs large amount of foreign exchange through FDI in retailing to sustain and enhance its economic growth. Analysts estimate that, the retail market in India, currently worth \$500 billion, will grow to \$1.3 trillion by 2020. Organized retail is expected to reach 20-25 percent of total retail by 2020 [10]. For achieving such high growth of retail sector there will be need for capital, proper infrastructure, latest technology, skilled worker etc. FDI can play an important role in fulfilling these need that's why India has liberalized its norms regarding FDI in retail sector. FDI in retail sector will lead to competition and efficiency. Through FDI in retail, Major global Players are expected to be beneficial for consumers, Farmers as well as well as economy as a whole [11].

III. Impact Of Fdi In Indian Retail Sector

FDI in the retail market will impact the industry in a number ways. Some of them are as follows:

- i. With the entrance of foreign retailers such as Wal-Mart, IKEA, Tesco, Abercrombie and Fitch, Amazon, and others into the Indian market, a streamlining of the existing retail partnerships is expected
- ii. The share of foreign players in the industry is estimated to increase to 10 - 12 percent this year (2015).
- iii. The value of the Indian retail market stood at USD 435 billion in 2010, with the 7 percent share of modern retail. The retail market is expected to grow.
- iv. Due to the terms and conditions of FDI investments, like the minimum limit of USD 100 million and 50 percent to be ploughed into backend infrastructure, the Indian supply chain is likely to benefit. Sophisticated foreign technology will considerably boost the domestic supply chain through efficient storage and transportation facilities, resulting in minimizing wastage
- v. With the entry of new players into the retail industry, the demand for agricultural products is set to rise. This is anticipated to increase the productivity output of Indian agriculture and bring better farming practices into the agriculture sector
- vi. The entry of fresh foreign retailers into the Indian retail industry is expected to increase
- vii. The unorganized retail sector also projected to grow, but at a slower pace. The quality and diversity of products in the retail sector is also expected to improve.
- viii. Indian consumers will have better accessibility to a wide range of foreign brands
- ix. The rise in competition will force Indian retailers to work on enhancing the quality of their products

IV. Policy Of Indian Government For Fdi In Retail

The Indian Government has opened up the retail sector for foreign players given that it is bursting with opportunities to explore. Though there is 100 percent FDI permitted in the cold chain sector but FDI opening in single and multi brand retailing is expected to yield much better results. Moreover, there is less consolidation in retail sector, weaker competition and an ever growing middle class with a large appetite for consumer goods and services. The current FDI in retail policy of Indian Government is being discussed below:

- i. 51 percent FDI permitted in the multi brand retailing. The unbranded products are allowed for agricultural produce like fruits, vegetables, flowers, grain, pulses, fish and meat.
- ii. Minimum investment to be brought in, as FDI, by the foreign investor would be US \$100 million.
- iii. FDI is not likely under the automatic route implying that FIPB approval is needed on case by case basis.
- iv. 50 percent investment should be done at improving the back-end infrastructure. Back-end infrastructure will include investment made towards processing, manufacturing, distribution, design improvement, quality control, packaging, logistics, storage, warehouse, agriculture market produce infrastructure etc.
- v. 30 percent of the raw materials should be procured from small and medium enterprises (SMEs).
- vi. Permission to set up stores only in cities with a minimum population of 1 million which is 53 cities in India according to 2011 census
- vii. Government has the first right to procure materials from the farmers.
- viii. While the proposals for FDI will be sanctioned by the Centre, approvals from each State Government will be required.
- ix. Retail trading, in any form, by means of e-commerce, would not be permitted, for companies with FDI, engaged in the activity of multi brand retailing [7].

V. Entry Options For Foreign Players Prior To Fdi Policy

Although prior to Jan 24, 2006, FDI was not authorized in retailing, most general players had been operating in the country. Some of entrance routes used by them have been discussed in sum as below:

1. Franchise Agreements: It is an easiest track to come in the Indian market. In franchising and commission agents services, FDI (unless otherwise prohibited) is allowed with the approval of the Reserve Bank of India (RBI) under the Foreign Exchange Management Act. This is a most usual mode for entrance of quick food bondage opposite a world. Apart from quick food bondage identical to Pizza Hut, players such as Lacoste, Mango, Nike as good as Marks as good as Spencer, have entered Indian marketplace by this route.
2. Cash and Carry Wholesale Trading: 100 percent FDI is allowed in wholesale trading which involves building of a large distribution infrastructure to assist local manufacturers. The wholesaler deals only with smaller retailers and not Consumers. Metro AG of Germany was the first significant global player to enter India through this route.
3. Strategic Licensing Agreements: Some foreign brands give exclusive licenses and distribution rights to Indian companies. Through these rights, Indian companies can either sell it through their own stores, or enter into shop-in-shop arrangements or distribute the brands to franchisees. Mango, the Spanish apparel brand has entered India through this route with an agreement with Piramyd, Mumbai, SPAR entered into a similar agreement with Radhakrishna Foodlands Pvt. Ltd
4. Manufacturing and Wholly Owned Subsidiaries: 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 [13].

VI. Challenges Of FDI In India Retailing

According to A. Arabunisa (2014) skilled manpower, the inefficiencies in the current supply chain, undesirable quality of products and Lack of basic infrastructure like roads, power, and water are the most remarkable challenges in Indian retail sector [1]. Santosh Kr. Pandey and Pratyush Chandra (2012) state that, Competition from unorganized sector, tax structure (as retail sector has to pay huge taxes), supply chain, adequate infrastructure facilities, lack of trained work force and low skill level for retailing management, the intrinsic complexity of retailing- rapid price changes, threat of product obsolescence, low margins, high cost of real estate and dissimilarity in consumer groups are the other challenges that the retail sector in India is facing. They explain that, there are some external factors which affect the Indian retail sector such as regulations and policies, real estate prices, demands of the customers and economy across the globe [9]. Sheetal Mundra et.al (2013) explains that, the challenges in Indian retail market are: geographically dispersed population, small ticket sizes, complex distribution network, little use of it systems, limitations of mass media and existence of

counterfeit good [12]. M.Roy and S.Kumar (2012) believe that, there are three major limitations for setting up the foreign direct investment in Indian retailing which are:

- 1) Infrastructure as there is lack of investment in the logistics of the retail chain
- 2) Dominance of Intermediaries In the value chain Intermediaries often flout market norms and their pricing lacks transparency
- 3) Improper Public Distribution System (PDS) [19]

Sulochana Chhajed (2012) mention that, competition from the unorganized is the most challenging for foreign firms in organized retail as Traditional retailing with very low-margin are owner-operated and have mostly negligible real estate and labour costs. , they pay little by way of taxes; they develop strong networks with local neighborhoods. The informal system of credit adds to their attractiveness, with many houses ‘running up a tab’ with their neighborhood, paying it off every fortnight or month. . In contrast, players in the organized sector have to cover big fixed costs and yet have to keep prices low enough to be able to compete with the traditional sector [20]. S. Pattu Meenakshi et.al (2013) explain that, the problems of FDI in Indian retail sector are: adverse impact on the employment, threat on organized retail players, huge spread of retail chain stores financially, predatory practices of the multinational retail chains FDI, monopoly in the customer market and creation of cartels by the global players, setback to the trade balance, towering effect on real estate prices, distortion of urban development and culture [21]. According to B.Vijayalakshmi Murthy (2012), opening of retail sector to FDI causes divide and opposition from small traders, it harms small retail outlets and emerging domestic retail chains ,it fierce competition rather than enhancing business potential, it marginalizes the domestic entrepreneur, FDI in multi brand retail as proposed by the recent government bill will hit 14.6 million unorganized retailers and intermediaries resulting in job losses and finally Monopoly procurement and farm practices of MNC retailers may impact the livelihood of millions of small and marginal farmers [14]. A. Vijayakumar (2014) suggests that, to become a truly flourishing industry, retailing in India needs to cross the following challenges: Automatic approval is not allowed for foreign investment in retail, Regulations restricting real estate purchases, and cumbersome local laws. ,Taxation, which favors small retail businesses , Absence of developed supply chain and integrated IT Management , Lack of Trained work force , Low skill level for retailing Management , Lack of retailing courses and study options , Intrinsic complexity of retailing rapid price changes, constant threat of product obsolescence and low margins , Competition from unorganized sector [16]. Kamaladevi Baskaran (2012) argues that, the Supply chain, Channel conflicts, Location and rental, Unique Indian customer, Regulatory, Private Labels are Challenges faced by the Retail Sector [22].

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