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FDI and its impact on Indian retail market

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Abstract
This paper discusses the issues like impact of FDI on Indian retail market and to find out the entry options for foreign players prior to FDI policy. Liberalization of trade policies during the last one and half decade has led India to become an investment friendly country. Foreign direct investment (FDI) in this country assumed critical importance in the context of this liberalization. Though India is the tenth most industrialized country in the world, it is well known that it is mainly agro-based with around 70% population engaged in the farm sector. However, in the initial stage of liberalization, FDI was centred on the urban manufacturing sectors because of its civic infrastructure, labour availability, flexible taxation mechanism etc. The success story of FDI in these sectors is known to us.
For a long time, there were efforts for FDI in the retail sector so that the trader can reap the benefit of FDI. Retail trade contributes around 10-11% of India's GDP and currently employs over 4 crores of people. Recently, a great debate has cropped up against the government plans for FDI in the Indian retail sector. FDI in retail is fundamentally different from that in manufacturing. FDI in manufacturing basically enhances the productive employment in most cases; but FDI in retail trade may create job losses and displacement of traditional supply chain. One of the main features of rural India is disguised unemployment. Farmers, evicted from the agricultural sector, engage in small retail trades for livelihood. The main fear of FDI in retail trade is that it will certainly disrupt the livelihood of the poor people engaged in this trade. The opening of big markets or foreign-sponsored departmental outlets will not necessarily absorb them; rather they may try to establish the monopoly power in the country. However, so many positive factors are also there in favour of FDI in Indian retail service.

Keywords: FDI organized retail, unorganized retail

Introduction

The Centre's relaxations in FDI in single-brand retail will boost organised retail market share by 300 basis points in three years, according to research by credit ratings agency Crisil.
In a report, Crisil said it expects the market share of organised retail in India to rise to about 10 per cent by fiscal 2020, compared with 7 per cent last fiscal. This will be supported by the government's decision to permit 100 per cent FDI in single-brand retail under the automatic route from 49 per cent earlier, relaxation in sourcing norms, and healthy growth prospects for organised retail. Before the change in rules, the agency's forecast for the share of organised retail was 9 per cent by FY20, based on healthy revenue growth of about 18 per cent of organised brick and mortar (B&M) retailers.
Apparel, luxury goods, home decor, footwear and the electronics segments are those most likely to benefit from the new rules, and are expected to ratchet up about 45 per cent of India's organised retail revenues, said Crisil. "Global single-brand retailers facing growth headwinds in their key geographies will now be more than keen to peg tent in India," said Anuj Sethi, Senior Director, Crisil Ratings. "And those already present could step up investments. The previous sourcing norms were a bottleneck to scaling-up of operations."
While FDI approval under the automatic route will lower the time to commence business, the relaxation of 30 per cent local sourcing norms for the first five years by allowing inclusion of incremental sourcing for global operations will provide sufficient time for new entrants to set up and stabilise their sourcing base. This will also make the operating environment that much more competitive for domestic B&M retailers.
The credit quality of retailers has been on the rise. Crisil, which rates 93 organised retailers, said their credit quality has been improving as reflected in the credit ratio (upgrades to downgrades) of over 1 time for the past five years.

Definition of Retail

In 2004, The High Court of Delhi [1] defined the term 'retail' as a sale for final consumption in contrast to a sale for further sale or processing (i.e. wholesale). *A sale to the ultimate consumer.*
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.

Division of Retail Industry – *Organised and Unorganised Retailing*

The retail industry is mainly divided into:- 1) Organized and 2) Unorganized Retailing
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.

Unorganized retailing, on the other hand, 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.

The Indian retail sector is highly fragmented with 97 per cent of its business being run by the unorganized retailers. The organized retail however is at a very nascent stage. The sector is the largest source of employment after agriculture, and has deep penetration into rural India generating more than 10 per cent of India's GDP.

Objectives

1. To understand the Indian retail market concept in general.
2. To analyse the impact of FDI on Indian retail market.
3. To find out the entry options for foreign players prior to FDI Policy

FDI Policy in India

FDI as defined in Dictionary of Economics (Graham Bannock et.al) 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 [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 [4]. 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.

Advantages (Govt. Arguments) and Disadvantages (oppositions Arguments)

Government argument

- Huge investments in the retail sector will see gainful employment opportunities in agro-processing, sorting, marketing, logistics management and front-end retail.
- At least 10 million jobs will be created in the next three years in the retail sector.
- FDI in retail will help farmers secure remunerative prices by eliminating exploitative middlemen.
- Foreign retail majors will ensure supply chain efficiencies.
- Policy mandates a minimum investment of $100 million with at least half the amount to be invested in back-end infrastructure, including cold chains, refrigeration, transportation, packing, sorting and processing. This is expected to considerably reduce post-harvest losses.
- This will have a salutary impact on food inflation from efficiencies in supply chain. This is also because food, which perishes due to inadequate infrastructure, will not be wasted.
- Sourcing of a minimum of 30% from Indian micro and small industry is mandatory. This will provide the scales to encourage domestic value addition and manufacturing, thereby creating a multiplier effect for employment, technology upgradation and income generation.
- A strong legal framework in the form of the Competition Commission is available to deal with any anti-competitive practices, including predatory pricing.
- There has been impressive growth in retail and wholesale trade after China approved 100% FDI in retail. Thailand has experienced tremendous growth in the agro-processing industry.
- In Indonesia, even after several years of emergence of supermarkets, 90% of fresh food and 70% of all food is still controlled by traditional retailers.
- In any case, organized retail through Indian corporates is permissible. Experience of the last decade shows small retailers have flourished in harmony with large outlets.

Opposition's argument

- Move will lead to large-scale job losses. International experience shows supermarkets invariably displace small retailers. Small retail has virtually been wiped out in developed countries like the US and in Europe. South East Asian countries had to impose stringent zoning and licensing regulations to restrict growth of supermarkets after small retailers were getting displaced. India has the highest shopping density in the world with 11 shops per 1,000 people. It has 1.2 crore shops employing over 4 crore people; 95% of these are small shops run by self-employed people
- Global retail giants will resort to predatory pricing to create monopoly/oligopoly. This can result in essentials, including food supplies, being controlled by foreign organizations.
- Fragmented markets give larger options to consumers. Consolidated markets make the consumer captive. Allowing foreign players with deep pockets leads to consolidation. International retail does not create additional markets, it merely displaces existing markets.
- Jobs in the manufacturing sector will be lost because structured international retail makes purchases internationally and not from domestic sources. This has been the experience of most countries which have allowed FDI in retail.
- Argument that only foreign players can create the supply chain for farm produce is bogus. International retail players have no role in building roads or generating power. They are only required to create storage facilities and cold chains. This could be done by governments in India.
- Comparison between India and China is misplaced. China is predominantly a manufacturing economy. It's the largest supplier to Wal-Mart and other international majors. It obviously cannot say no to these chains opening stores in China when it is a global supplier to them. India in contrast will lose both manufacturing and services jobs.

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 [5] 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) [6].
c. FDI is not permitted in Multi Brand Retailing in India.

Entry options for foreign players prior to FDI Policy

Although prior to Jan 24, 2006, FDI was not authorized in retailing, most general players ha\d 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% FDI is allowed in wholesale trading which involves building of a large distribution infrastructure to assist local manufacturers [7]. 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 Pyramid, 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.

Conclusion

From the above point it is clear that the percentage of organize retails in India is about 5% and growth of organized retail markets at the expenses of un organized retails markets. That's why the Impact of FDI on Indian retails is only little percentage (20%).

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