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FOREIGN DIRECT INVESTMENT IN INDIAN RETAIL SECTOR

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Foreign Direct Investment in Indian Retail Sector

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Abstract – India is without doubt a growth economy and many consider it an attractive country to invest in, particularly its rapidly growing and changing retail market. However, Foreign Direct Investment (FDI) is restricted in the retail sector, and despite many years of debate, the regulations are still only changing very slowly and there are still lots of uncertainties. Foreign investors are watching India, ready for a piece of the action in the retail market, but there are still plenty of uncertainties, restrictions and potential socio-economic risks.

India should be well on the radar for foreign retailers was recently supported by A.T. Kearney, whose 2011 global retail development index ranks the nation as fourth globally. India's retail industry is estimated to be worth approximately US$ 411.28 billion and is still growing, expected to reach US$ 804.06 billion in 2015. As part of the economic liberalization process set in place by the industrial policy of 1991, the Indian government has open the retail sector to FDI slowly through a series of step.

Objectives of this paper are to investigate the Indian market place and review current policy and regulations with a view point of foreign investors so as to gain an understanding of the current position on FDI, as well as an overview of the Indian policy and regulatory environment.

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INTRODUCTION

Foreign direct investment (FDI) refers to the net inflows of investment to acquire a lasting management interest (10% or more) in an enterprise operating in an economy other than that of investor. FDI is the sum of equity capital, re-investment of earnings and other long or short term capital as shown in the balance of payments. It usually involves participation in management, joint venture, transfer of technology and expertise. There are two types of FDI: (a) Inward FDI and (b) outward FDI. Foreign direct investment excludes investment through purchase of shares.

FDI IN SINGLE BRAND

Single brand implies that foreign companies would be allowed to sell goods sold internationally under a 'single brand' viz., Reebok, Nokia, and Adidas. FDI in single brand retail implies that a retail store with foreign investment can only sell only 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 required. If granted permission, Adidas could sell products under the Reebok brand in separate outlets.

FDI IN MULTIPLE BRANDS

FDI in multiple brands implies that a retail store with a foreign investment can sell multiple brands under one roof. 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 some way as the ubiquitous 'kirana' store.

BACKGROUND OF FDI IN RETAIL SECTOR IN INDIA

During nineties Mr. P. V. Narsimha Rao lead Govt. allowed limited FDI in retail and as a result 'Dairy Farm' a MNC made entry in India.

In 1997, FDI in cash and carry (wholesale) with 100% ownership was allowed under the Govt. approval route. It was brought under the automatic route in 2006.

NDA Govt. was willing to introduce FDI in retail sector in MAY, 2002 but it could not materialize due to unknown reasons.

51% FDI in single brand retail was also permitted in 2006.

In 2011 100% FDI was allowed in Single Brand retail withholding the FDI in Multi Brand Retail due to various political reason.

100% FDI in Single Brand (with revised guidelines) and 51% in Multi Brand retailing with some conditions have mow been allowed in India w.e.f. 20th September 2012 with an option to the state

Governments to allow or not to allow the FDI in retail sector in their states.

Some Parties have opposed the FDI in Retail Sector particularly in the Multi Brand Retail. Agitations and Bandhs have been called. Govt. of India is firm on implementing the FDI policy in retail sector as it feels that FDI is beneficial for the economic growth of the country and how the rights of the local retailers have been protected in the FDI policy

PROCEDURE FOR FDI IN RETAIL SECTOR

Applications would be processed in the Department of Industrial Policy & Promotion (DIPP), to determine whether the proposed investment satisfies the notified guidelines, before being considered by the Foreign Investment Board (FIPB) for Government approval. Final approval will be given by Foreign Investment Promotion Board.

FOREIGN INVESTOR'S CONCERN REGARDING FDI POLICY IN INDIA:

The current FDI Policy will not make any difference for those brands which adopt the franchising route. They would have preferred that the Government liberalize rules for maximizing their royalty and franchise fees. They must still rely on innovative structuring of franchise arrangements to maximize their returns. Consumer durable majors such as LG and Samsung, which have exclusive franchisee owned stores, are unlikely to shift from the preferred route right away. Companies which choose to adopt the Multi Brand retailing must tie up with a local partner. The key is finding a partner which is reliable and who can also teach a trick or two about the domestic market and the Indian consumer. Currently, the organized retail sector is dominated by the likes of large business groups which decided to diversify into retail to cash in on. The boom in the sector – corporate such as Tata through its brand Westside, RPG Group through Food world, Pantaloon of the Raheja Group and Shopper?s Stop. Do foreign investors look to tie up with an existing retailer or look to others not necessarily in the business but looking to diversify, as many business groups are doing?

An arrangement in the short to medium term may work wonders but when the Government has allowed 51% FDI in Multi Brand and 100% in Single Brand retail, will the foreign investor will terminate the agreement with Indian partner and trade in market without him? Either way, the foreign investor must negotiate its joint venture agreements carefully, with an option for a buy-out of the Indian partner? Share. They must also be aware of the regulation which states that once a foreign company enters into a technical or financial collaboration with an Indian partner, it cannot enter into another joint venture with another Indian company or set up its own subsidiary in the same field? without the first partner?s consent if the joint venture agreement does not provide for a „conflict of interest? clause. In effect, it means that foreign brand owners must be extremely careful whom they choose as partners and the brand they introduce in India. The first brand could also be their last if they do not negotiate the strategic arrangement diligently.

ENABLING POLICY:

The above policy is an enabling policy only and the State Governments Union Territories would be free to take their own decisions in regard to implementation of the policy. Therefore, retail sales outlets may be set up in those States Union Territories which have agreed, or agree in future, to allow FDI in MBRT under this policy. The list of States / Union Territories which have conveyed their agreement is annexed. Such agreement, in future, to permit establishment of retail outlets under this policy, would be conveyed to the Government of India through the Dept. of Industrial Policy & Promotion and additions would be made to the annexed list accordingly. The establishment of the retail sales outlets will be incompliance of applicable State/Union Territory laws/ regulations, such as the Shops and Establishments Act etc. Retail trading, in any form, by means of e-commerce, would not be permissible, for companies with FDI, engaged in the activity of multiband retail trading.

STATES IN FAVOUR OF FDI IN MULTIBRAND RETAIL:

Maharashtra, Haryana, Andhra Prades,Rajasthan, Jammu And Kashmir, Utrakhand, Manipur, Assam And Delhi. Uttrakhand, Manipur And Assam have no cities with population of one million but capital cities of these states can be considered for opening multibrand retail stores. These states covers 19 cities like Delhi, Mumbai, Pune, Nagpur, Jaipur, Hyderabad, Vijaywada and Srinagar.

STATES OPPOSING FDI IN MULTI BRAND RETAIL:

Gujarat, Uttarpradesh, West Bengal, Bihar, Tamilnadu, Kerla, Chatishgarh Odisha.

FDI Policy in Multi Brand Retail though approved by the Cabinet yet the final authority for granting the trade licence rests with the states under the irrespective Shops and Establishment Acts. Also, foreign retailers will only be allowed to set up shop in cities with a population of more than one million.

MAJOR PLAYERS EXPECTED TO ENTER INDIAN RETAIL SECTOR

- WAL-MART STORES INC
- CARREFOUR SA
- TESCO PLC

• METRO AG

• IKEA

SWOT ANALYSIS OF INDIAN RETAIL SECTOR:

STRENGTH

• Will boost economic development

• Young and dynamic manpower to take the challenge.

• Highest shop density in the world so no fear for small outlet

• High growth rate in retail and wholesale trade in India

• Presence of big business/industry house which can absorb losses.

WEAKNESS

• Low capital investment in retail sector

• Lack of trained and educated force

• Lack of competition

• More prices as compared to specialized shops

• Poor infrastructure

• Heavy wastage due to non-availability of sufficient warehouses and cold storage facilities

OPPORTUNITIES

• Hope of Major employment generation in future

• Will improve the financial conditions of farmers

• Will add to retailer?s efficiency

• Foreign capital inflows

• Big markets with better technology and branding

• Quality improvement with cost reduction

• Increasing the export capacity.

• Increase in lifestyle changes and status consciousness

THREATS

Kirana and retailers will may lose business in long run.

Fear of controlling the retail sector by foreign investors/ Big stores.

FDI in multiband retail may result in job losses in manufacturing sector.

Roadside bargains may start which may harm the farmers

Work will be done by Indian and the profit will go to foreigners.

Farmers will be exploited and will lose their fields and crops to foreign investors.

GOVERNMENT'S VIEW POINT ON FDI IN RETAIL SECTOR

BENEFITING THE FARMERS:

At least 50% of total investment will be in villages.

Transformation of rural India through improved agro processing and cold chain.

Farm produce reach store directly thereby reducing wastage

Farmers will get their dues in the form of higher prices

DISTINCT INDIAIN IMPRINT:

Only 51% Ownership is allowed to foreign investors and 49% will remain with Indian companies.

Retail stores can be established in cities having population of 1 million or more.

States have the right to make their decision to allow or not to allow the FDI in Multi Brand Retail

50% investment in villages for infrastructure creation

CREATION OF NEW JOBS:

Over one crores new jobs expected to be created.

FDI backed retailers will source 30% of all their products from small scale sector units.

New manufacturing opportunities will open for the nation?s micro small and medium enterprises

The nation?s youth will benefit from numerous employment opportunities in this sector

BENEFITING THE CONSUMERS:

• It is presumed that farm produce will reach in hygienic conditions to stores directly resulting in good quality, quantity and at lower prices as role of mediators will be negated.

• Product Choice to consumers to choose from variety of goods.

FAVOURABLE

Indian farmers: The biggest beneficiary of FDI in retail would be farmers who will be able to improve their productivity. The farmers will not only be able to increase their output but will also get better rewards in terms of supplying to organized retailers by tying up long terms contract with them. The foreign retailers will purchase raw materials from the farmers and various other goods from the original producer directly. The farmers across India's 6,00,000 villages stand to gain with higher profits and better market access. The farmers would be getting good prices for their harvest. The original producers will get a higher price since the profit will flow to them directly, leaving behind middle men. This can happen as the giant retailers have capital and high buying power. Direct purchase from farms will hugely benefit small farmers who are not getting good returns by selling in the local mandi. The payments will be directly credited into bank accounts and will be free from commission agents. The large retailers will also save 10-15% in commissions by purchasing fruits and vegetables directly.

Indian consumers:

India is now the home of the largest number of moneyed consumers. Indian consumers will get access to quality goods at a low cost, that too at home. The stage is now set when Indian consumers will have the luxury of world class opportunity of shopping to meet the requirements of daily life. They will find a new world of enjoyment of picking up consumer items to their greatest satisfaction. Big retailers will often allow discounts on selected items which will facilitate the consumers and they can end up with marginal bargains.

Proper tax system:

Tax revenue will increase like VAT and service tax. The organized sales with computerized billing system will also yield more revenue through commodity taxes like VAT and service tax to the government. Thus tax buoyancy of the economy would increase.

Partnership opportunity:

Indian retailers have reason to be happy with foreign direct investment in the retail sector because it is a partnership opportunity that involves a lot of learning that could take them to higher profitability. The central government is planning to have 51% foreign investment; this means the foreign retailers need partners for the rest investment to gain market.

High availability of jobs:

There will be huge opportunities in the country (in crores) as there will be opening of malls and store houses. The entry of modern retailers will expand the market creating large amount of additional jabs in retail. The job opportunities will vary from ordinary workers to specialized officers. The employment opportunities will be in retail sales, retail floor manager, cold chains, warehousing and logistics. The new jobs will created in front end and back end leading to a positive impact on economy. The jobs will be for urban as well as rural youth. The jobs will cover educated as well as semi educated males and females. The salaries will grow faster. The re will be huge scope of MBA's as they will cherish working with world class chain of retailers. They will give professional approach as they are only concerned with business and nothing else. They will allocate some amount of resource towards the training of the people they hire. This has already happened with Bharti Wal-Mart joint venture which has joined hands with some state governments in opening training centers in Amritsar, Delhi and Banaglore to train local youths for jobs in retail.

Distribution system:

The report shows that 30-35% of India’s total production of fruits and vegetables is waisted every year due to inadequate cold storage and transport facilities. Almost half of this wastage can be prevented if fruit and vegetable retailers have access to specialized cold storage facilities and refrigerated trucks. The organized retail will bring in efficient practices that will help farmers in the procurement process, reduce wastage with finally efficient storage and will finally cut the losses. The giant retailers will help India to have strong storage system with highly developed transportation. Giant retailers with decades of experience on how to manage mountains of inventories supply them to key distribution centers and do it all faster, better, cheaper. The arrival of foreign retailers will definitely bring in synergies in distribution management practices.

Indian middle class:

Middle class will be benefited as they are three fourth of Indian population. The middle class will be benefited because they are newly emerged and swelling. There is arising aspirations for a stylish abd luxurious life in this class. There has been shift from necessities to luxurious life. The emergence of large middle class in India and with rising disposable income, spends on branded products are likely to increase.

Knowledge enhancement:

FDI in retail will make way for inflow of knowledge from international experts. There will be drastic retail growth through the development of the retail capability.

MANAGEMENT EDUCATIONAL INSTITUTE BOOM:

The growth of the organized retail in India will be a 'sunrise' for the management educational institute as their requirement will be increasing. The management colleges or universities role will be increasing for giving retail education to the youth to stay competitive in the liberalized environment. Inflation control: Inflation will be curbed.

There are many who believe that FDI will act as guardian for the economic development of the farmers and job seekers. It will not happen that big fish will eat small fishes. This is because that in India 95% retail is in the un-organized sector. Local chains like Big Bazar and Spencers haven't dealt a deathblow to small retailers. So, the FDI in retail won't affect them either. The local kirana community is strategic and agile to get wiped off. Their offerings such as home delivery, credit facility and personalized customer relationship management can never be matched by foreign retail players.

FDI in retail is certainly a step forward to eliminate the evils of adulteration, shortage in naaptol (weights and measures), unreasonable profit due to large differences between the wholesale price and the printed maximum retail price (MRP) and corruption in saving taxes leading to generate black money.

The growth in the retail sector has so far been slower than what was projected, about 5 or 6 years back. The present FDI has once again arisen the hope of fast retail growth rate in India.

UNFAVORABLE

Now we will take up the arguments which will not support the decision. The argument against are that the new system will displace the traditional shops and petty retail stops in markets and mohallahs. India has two types of un-organized retailers: one the big un-organized retailers i.e. the shop of wealthy consumers and the other small un-organized retailers i.e. the shop of poor consumers. The latter will remain untouched while the former may be marginally affected. The real India shich is hardworking bread earners, comprising of 80 crore people will surely not benefited. In terns of employment in retail sector around 38% in rural areas and around 47% in urban areas depend on retail trade for their livelihood, which will be effected. Around 14 crore people are directly or indirectly earning from the retail sector and if we associate their family members then this number would reach 40 crore. This may in turn render the people engaged there jobless and non business oriented. The medium and small retailers will surely ne effected but not in a big way.

The world class retailers will import with huge quantities of consumer goods from their mother country and elsewhere that are available relatively cheaper to the detriment of the interest of the domestic producers. The proposal has drawbacks as it says that the big retailers have to purchase 30% from the small scale industries but they could be anywhere in the world. So the Indian industry will not be benefited. Some experts say that wherever these big retail stores have gone they have ruined the local retailers. Small retail is the thing of the past in developed countries especially in the US & Europe. The small retailers are of the view that the central government should help them to become big instead to invite big foreign retailers in India. If these things continue, the country's retail sector would be lost. If we take example of two soft drinks like Coca-cola and Pepsi, we will know that wherever they have gone they have killed the domestic products. They did the same in India. Today we don't hear about the brands like Campa Cola. It has vanished from the market.

Some experts say that there should be FDI in all large businesses like power, infra-structure, road and building leaving retail sector. There is a threat from China that has pumped goods into the state at less prices. It has forced closure of industries. China is the largest supplier to Wal-Mart. The foreign retailers will buy raw materials or other goods from China because Indian small scale goods would be costlier than the Chinese companies. In India power is costly and not available, bank interest rates are higher, infra-structure and roads are not there. This would break the backbone of small scale industries in India. Some experts say that it was un-organized economy that has helped India to survive during the times of recessions which the US faced due to organized sector. The big retail dies not create additional markets for themselves but they displace the existing ones.

CURRENT STATUS OF FDI

The government of India allowed FDI in the following sectors:

Up to 100% 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 compulsory 30% domestic sourcing computation further clarified Further clarification on FDI companies that can not engaged in B2C e-commerce Upto 51% in multi-brand retail trading At least US$100m as equity 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 industries”.

Fresh agricultural produce is permitted to be sold unbranded.

Indian states have been given the discretion to accept or refuse to implement FDI. More than 8 states have already given their consent.

Retail outlets can be set up in cities having a population of at least 1 million.

Application needs to be approved by two levels at Department of Industrial Policy (DIPP) and foreign Investment Promotion Board (FIPB)

CONCLUSION

The future of foreign retail players is also uncertain like that of Indian retail players. The government which acts better than the one which does not. Apprehensions were raised on many such occasions in the past on virtually every measures of liberalization of Indian economy but most of the apprehensions proved wrong while many others come true. It is better to act and watch than not to act at all.

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