

Foreign Direct Investment in Indian Retail Industry

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ABSTRACT

India is one of the largest budding markets, with a population of over one billion. India is one of the biggest economies in the world in terms of purchasing power. The market size of Indian retail industry is about US \$312 billion Foreign direct investment has boomed in post-reform India. Moreover, the composition and type of Foreign direct investment has changed considerably since India has opened up to world markets. This has fuelled high expectations that foreign direct investment may serve as a channel to the higher economic growth of India.

FACTUAL MEASURES OF FDI

Foreign direct investment (FDI) in trade has developed into the fresh theatre of war flank by the pro-reform and anti-reform lobbies.¹ Foreign investors are extremely eager on charisma in Indian retail sector.² Incontrovertibly, foreign direct investment in retail is budding as a sort of litmus trial to the government's pledge to liberalization.

Retailing is one of the most important sectors of India economy. It provides 9% employment to the total workforce and contributes around 15% to the Indian GDP. It could have been a welcome step in strengthening India's FDI regime with making it in tune with country's needs. The FDI policy has been moving away from the license mentality of protection against imagined foreign dictators towards a more open, healthy and competitive environment. This policy would have provided a window for the world class retailer Hermes, Tiffany and Co and Wal-Mart, *etc.* to set their foot in the booming Indian retail sector. The Indian Government believe that the opportunity of FDI in multi brand retail and further liberalization of single-brand retail trade will facilitate greater FDI inflows providing new opportunities and benefits besides quality improvement. At a time when declining investments have led to slower GDP growth, however, a healthy competition, between the large domestic retailers and those with FDI, should be maintained. Imposing socially-desirable constraints on FDI funded retailers would lead into unfair competition.³ 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. One main cause for this is that retailing is one of the few sectors where foreign direct investment is not allowed. Within the country, there have been protests by trading associations and other stakeholders against allowing FDI in retailing. 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.⁴ 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

Retailing is the largest private industry in India. It is mainly divided into two types:

1) Organized 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.

2) Unorganized Retailing:

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, convenience stores, hand cart and pavement vendors, *etc.* The Indian retail sector is highly fragmented with 96 per cent of its business being run by the unorganized retailers.⁵ 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. The performance of this sector has a strong influence on consumer welfare.

Retail trade in India After globalization our economies have moved from social sector to capital sector and there is a great need of foreign capital or investment in our country. As our economy is growing and targeting 10% development rate, there is a great need of concentration on underdeveloped and potentially viable sector i.e. retail sector agriculture *etc.* Retailing in India is the largest private sector and second to agriculture in employment. India has highest retail outlet density – Around 1.5 retail crore retail outlets. The retail sector contributes about 10-11% to Indian GDP and it is valued at an estimated Rs.93000 crore out of which organized retailing industry around Rs.35000 crore. All major players such as Wal-Mart, Tesco, Sainbury and others are keen to enter the retail market. "A. K. Kearney" ranked India 5th out of 30 most attractive retail markets in terms of investment.⁶ Recently government has taken certain action to liberalize the retail market in India.

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. 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. One important reason for this is that retailing is one of the few sectors where foreign direct investment is not allowed. Within the country, there have been protests by trading associations and other stakeholders against allowing FDI in retailing. 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. Role of FDI in Indian retail trade In January 2006, the Government relaxed FDI (foreign direct investment) controls on retailing to allow foreign retailers to participate directly in the Indian market for the first time by allowing equity ownership in 'single brand' retailing.⁷ Thus, foreign entities are now allowed to operate their stores, but only if they are single-brand stores and only up to 51 per cent ownership. The impact of the consequent increase in FDI, in Indian retail, is expected to not just develop strong backward linkages but also create a domestic supply chain of international standards. What is encouraging now for these global majors is the new policy thrust, which intends to further liberalize the FDI regime in Indian retail. Though FDI in retail trade is as yet

G. Urfi

restricted, the Government of India has a more liberal policy towards wholesale trade, franchising, and commission agents services, thus preparing the ground for FDI in retail as well. Foreign retailers have already started operations in India through various routes:

1. Joint ventures where the Indian firm is an export house.
2. Franchising (e.g. Kentucky Fried Chicken, Nike).
3. Sourcing of supplies from small scale sector.
4. Cash and carry operations (Giant in Hyderabad, Metro in Bangalore).
5. Non-store formats – direct marketing (Amway).

Large international retailers of home furnishing and apparels such as Pottery Barn, The Gap and Ralph Lauren have made India one of their major sourcing hubs. Up to 100 per cent FDI is allowed in 'cash and carry' operations. The Great Wholesaling Club Ltd is one such example. In February 2002, the world's largest retailer, Wal-Mart, opened a global sourcing office in Bangalore. In November 2006, it announced its entry under a joint venture with the Indian corporation Bharti. For the time being, Bharti is to own the chain of frontend retail stores, while the two firms will have an equal share in a firm that will engage in wholesale, logistics, supply chain and sourcing activities. This is seen as a preliminary step by Wal-Mart pending the removal of all restrictions on FDI in retail trade.⁸

INDIA AS A RISING DESTINATION FOR FDI

India today represents the most compelling investment opportunity for mass merchant and food retailers looking to expand overseas. According to A.T. Kearney's annual global retail development index for 2005, India retail market totaling \$300 billion is vastly undeserved and has grown at an average rate of 10% in the last five years. Present Government policy on FDI allows to have a presence of international brands through different routes i.e. Franchise, Joint venture, Manufacturing, Distribution, Cash and carry. For Indian Consumers the gradual and phase wise entry of foreign companies in retail involves three pivotal changes 1) New Technology 2) Improved Transparency in trade 3) sharing best practice. Foreign Players would displace the unorganized retailers because of their superior financial strengths Induce Unfair trade practices like predatory pricing, in the absence of proper regulatory guidelines. Create monopoly and promote cartels Give rise to cut throat competition rather than promoting incremental business. Increase in real estate prices and marginalize domestic entrepreneurs.⁹ Hence checks are to be injected to ensure the overall growth of small and big retailers and to create a level playing field for all.

Impact and Benefits to the Country

- Growth of Infrastructure
- Franchising Opportunity for local Entrepreneurs
- Inflow of funds and investments
- Implementation of IT in Retail
- Investment in Supply Chain, cold Chain and warehousing
- Increase number and Improve Quality of Employment
- Reduced cost and Increased Efficiency
- Provide better value to end Customer.

Hence it will lead to overall economic growth and create Benchmark.

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G. Urfi

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