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Foreign Direct Investment in Retail Market in India: Some Issues and Challenges

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Abstract

India being second most-populous country has immense scope for retail expansion as along with time urbanization and consumerism has also been increasing. Further, India's GDP has also been growing at fast rate as it continued to be the second fastest growing economy in the world after China and as the income of the country increases, demand for goods also increases because there is positive relation between demand and income. Initially India was conservative regarding FDI; it imposed restriction on foreign companies to limit their share in equity capital of their Indian subsidiaries but over the time Government of India gradually liberalized foreign investment in various sectors. Recently in 2011 India permitted 100% FDI in single brand retail and in 2012, 51% FDI permitted in multi brand. In this paper we are analyzing the impact of such decision on various sectors like food retail sector, farmers, traditional & employment and food inflation.

Keywords: Foreign Direct Investment (FDI), Retail Sector, India, Food Sector, Multi-brand Retail

1. Introduction

India is now the latest major frontline for globalized retail market. In the last twenty years since the economic liberalization of India in 1991, India's middle class has significantly expanded, and so has its expanding purchasing power. However, over the years, unlike other major emerging economies, India has been slow to open its retail sector to foreign investment. Foreign Direct Investment (FDI) is defined by the Reserve Bank of India (RBI) as when a foreign company wants to establish any business operation in India which may include company under the company Act, 1956 (joint venture or wholly owned subsidiary) or set up a Liaison office or project office or a branch office of the foreign company which can undertake activities permitted under the Foreign Exchange Management Regulation, 2000.

At present, almost all the developing countries liberalizing there FDIs and India is not different. Since liberalization India's Gross Domestic Product (GDP) has been increasing and India's middle class has expanded as well. India has been slow in opening economy for FDI in retail sector, but recent policy changes suggest that perspective of government is changing. In 2006, the government first time relaxed retail policy and since then, there has been gradual increase in FDI in the retail sector. It may bring in investment in completely backward area like infrastructure required for Food transfer from farmers to consumer that will improve efficiency in food sector, we can expect that retail sector will become organized and will save farmers from middlemen exploitation or it may also result in job loss in unorganized sector, it may become tough to procure food for Public Distribution System (PDS). In this paper we will study few aspect of FDI liberalization into retail sector; mainly we will study effect of FDI in food retail sector, farmers, traditional & employment and food inflation.

2. Research Objective

a) To discuss the policies undertaken by Government of India (GOI) for FDI issue in retail marketing,

b) To study FDI root and scenario in Retail market in India,

c) To analyze the impacts of FDI into retail market on Farmers, Employment and Food Inflation.

3. Data Analysis/ Findings

3.1. Policy Adopted

Indian foreign policy regarding investment can be study on four phases i.e. First phase consist of the Period 1948-66 in which India welcome foreign investment cautiously. In late sixties crises emerged as a result of which India adopted relative and restrictive policy from 1967 till the second oil crisis in 1979. In order to attract resources from oil exporting, developing countries, foreign investment policy has been revised in October 1980 and in 1982-83. It has been further liberalized. Fourth phase started in 1991 with liberalization and open door policy as the main aim of these reform was to encourage investment and accelerate economic growth.

The retail sector in India is organized into three categories. According to the Department of Industrial Policy and Promotion (DIPP) of the Government of India, the single-brand retail comprises those retailers selling products "of a 'single brand' only, such that products should be sold under the same brand internationally; and single-brand product retailing covers only products which are branded during manufacturing. "In this category, FDI is allowed to the extent of 51 per cent. From 2006 to March 2010, around 94 foreign firms applied to invest through the single-brand route of which 57 were approved. Consequently, the percentage increase in FDI flows in the retail sector between 2008 and 2010 was even higher than that in sectors such as the services sector, trading and telecommunications, which have a much higher share in the country's overall FDI" (DIPP, 2010). The second category is that, in contrast to the first category, no FDI is allowed in the multi-brand retail category. This includes all firms in organized retail that seek to stock and sell multiple brands, such as large international retailers like Wal-Mart and Carrefour. This is the sector that is most under dispute. The third segment, called 'cash and carry', refers to the retailing at wholesale level. The government defines this segment as the "sale of goods and merchandise to retailers, industrial, commercial, institutional or other professional business users or to other wholesalers and related subordinated service providers". In India, FDI of 100 per cent is permitted in this category.

The FDI policy has been revised on a continuing basis and several measures has been taken over time for liberalization. Over the last decade several such steps has been taken starting from 2000 when 100% foreign equality allowed in infrastructure projects. In 2002, limited FDI in print media was also allowed. FDI further liberalized in Airlines sector in 2004. In 2005-06, FDI cap has been increased from 49% to 74% in basic and cellular telecom services (Economic survey 2005-06). Likewise many steps has been taken regarding FDI liberalization in pharmaceutical industry, Banking sector, Insurance sector, Oil corporation power etc..

Specifically considering retail sector in 1995 World Trade Organization's (WTO) general agreement on Trade and services, which included both wholesales and retailing services, came into effect. FDI in cash and carry wholesales with 100% rights allowed under government approval route further in 2006, FDI in cash and carry (wholesales) brought under the automatic route, up to 1% investment in a single brand retail permitted. Subject to press Note 3 (2006 series).Then in 2011, 100% FDI in single brand retail permitted and in 2012, 51% FDI in multi brand retail permitted.

3.2. FDI In Retail Sector

'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: (a) via independent retailers ('vertical separation') and (b) directly from the producer ('vertical integration').' In the latter case, the producers found their own chains of retail outlets, or develop franchises. On the other hand, Indian retail industry is divided into organised and unorganised sectors. The Organised 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. On the other hand, the unorganised 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% of total trade in retail market, while organised trade accounts only for the remaining 2%. However, this is projected to increase to 15-20 per cent by 2010 (Singhal 2009).

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% of total retail by 2020 (from a current 5-6%) (Gupta, 2012). 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.

3.3. Conditions For FDI Route In Retail Sector

The conditions for 51% FDI in MBRT include a minimum investment of $100 million by each player, 50% of it in back-end infrastructure, 30% procurement from micro, small and medium enterprises (MSMEs), and the government's right to procure the farm produce first. Further, the permission for MBRT has been granted for cities with a population of one million or more, which brings in 53 cities. Some of entrance routes used by them have been discussed in sum as below:

a) Franchise Agreement

Franchise agreement is written contract between the franchisor and franchisee. It is the easiest mode to enter Indian market. One can enter through this route with RBI approval under the Foreign Exchange Management Act. Many of the players like Spencer, Lacoste, Mango, Nike etc. entered through this route only.

b) Cash And Carry Wholesale Trading

Cash & Carry wholesale trading would mean sale of goods/merchandise to retailers, industrial, commercial, institutional or other professional business users or to other wholesalers and related subordinated service providers. 100% FDI is allowed to wholesale trading which include building local infrastructure for manufacturers that will improve distribution. First Global Player entered through this route was Metro AG.

c) Strategic Licensing Agreements

Through strategic licensing developer of intellectual property, technology or a product give exclusive license and distribution rights to Indian companies. It is beneficial for both the companies. Using these Indian companies can sell it through their own shops or distribute the brand to franchises. Mango, the Spanish apparel brand has entered India through this with an agreement with Piramyd, Mumbai, SPAR entered into a similar agreement with Radhakrishna Foodland Pvt. Ltd.

d) Manufacturing And Wholly Owned Subsidiaries

In a wholly owned subsidiary, the parent company owns all the Shares of the company and there are no minority shareholders. The subsidiary operates with the permission of the parent company. Foreign brands have their subsidiaries in India and these companies have the authority to sell products to Indian consumers by franchising, internal distributors, existent Indian retailers, own outlets etc. Some examples are Nike, Reebok, Adidas, etc. that have wholly-owned subsidiaries.

3.4. Implications Of FDI In Food Retail Sector

a) Impact On Farmers

Indian supply chain is very complicated and moreover it has remained same since long time. With the growth of economy as well development of agriculture sector, the supply chain requires some changes. The Indian Farmers receive only 30% share of most of the food grains while in developed country this share ranges from 50% to 70% for most of the commodities. The main cause behind this difference is large number of intermediaries involved in the chain. All the intermediaries take some margin at various level as well as they also result in delay of supply of product to final consumer. The margin increases the final price at which the retailer sells the product to consumer. Entry of organized retailer through FDI in Indian market would result in efficiency and effectiveness of food supply chain as it will eliminate the unnecessary intermediaries from chain as a result the farmers will get decent prices as well as goods will be available to consumer at cheaper price. FDI will bring investment that is needed to modernize the farm sector.

The Indian agricultural sector is dominated by small farms (83% of total farms). Large corporations of farms are unlikely to stomach the transaction costs involved in dealing with the millions of small suppliers. Furthermore, small farmers are less likely to have access to technology in order to meet the quality standards required by these corporations. Without such business relationships, many small farmers may not realize their desirable higher incomes, or worse, be put out of business by the economically competitive larger farms.

b) Impact On Traditional Retail And Employment

"The key factors that drive growth in retail industry are young demographic profile, increasing consumer aspirations, growing middle class incomes and improving demand from rural markets." Also, the increasing incomes and improvements in infrastructure are broadening consumer markets and hurrying the convergence of consumer tastes. Economic liberalization of the Indian economy, increased in spending per capita income, even for the common citizen. Moreover, the coming up of dual income families in urban area also help in the growth of retail sector, even in small towns. In addition to that, "the consumer preferences for shopping in new vicinities, availability of quality real estate and mall management practices and a shift in consumer demand to foreign brands like McDonalds, Sony, Panasonic, etc. also contributes to the spiral of growth in this sector."

'The Government of India recommends that retail firms source a percentage of manufactured products from the small and medium domestic enterprises' (DIPP Report, 2010). With a restriction of this, the opening up of the retail sector to FDI could therefore provide a boost to small-and-medium enterprises. Moreover, the expansion in the retail market could also create substantial employment potential, especially among the rural youth and semi-urban youth.

Supermarket expansion leads to a phenomenon of "retail Darwinism" in which only the fittest survive (Bijoor 2011) that means as compared to unorganized sector like street vendor traditional retailer & shop vender the organized sector like supermarkets would need few people to handle same volume of produce. Retail sector is in India has been the largest source of employment after agriculture. Nearly 40 million people employed in retail sector which accounts for 8% of the total employment and 4% of the entire population (Rao, 2013) but large proportion of Indian retail sector is unorganized, that means supermarket expansion is going to affect employment negatively. According to a report by UNI Global Union (2012) without adequate safeguards put in place, FDI in multi-brand retail will lead to widespread displacement and poor treatment of Indian workers in retail, logistics, agriculture and manufacturing. For example Metro's cash carry employed 1.2 workers per ton of tomatoes sold in Vietnam compared with the 2.9 persons employed by traditional wholesale channel for the same quantity sold. In India traditional sector has been a major employer which employs large number of people.

It is also important here to include the potential loss of employment in the traditional retail sector when calculating the employment benefits from modern retailing and the net employment effect should be considered in policy decisions. Whereas, the urban educated middle class people can get more employment from opening up the multi-brand retail market, but much more uneducated or less educated poor people from rural India may lose their job in a sudden. Further, as supermarkets use modern technology, not many jobs may be forthcoming from their operations even with 50% investment in back-end operations.

c) Impact On Food Inflation

It is evident, from the United States that FDI in organized retail market could help to tackle the growing level inflation, particularly with wholesale prices of food items. Inflation is a politically sensitive subject, particularly for incumbent governments in a democratic country such as India, in particular because rising food prices tend to be regressive in their impact.

Food logistic system in India has many problems like lack of transport facility, storage facility etc. Most of the food items are perishable and because of improper transport and storage facility most of the produce got wasted. The major reason behind this problem is dominant part of the food industry consists of unorganized players and they fall short of funds as well as they lack behind in management. This problem can be solved through allowing FDI in this sector. FDI may fuel the funding requirement in logistics. Apart from this they generally operate at large scale and get benefit of economies of scale. Some of the big players in this industry are ITC and Bharti Wal-Mart. Past record reveals that they directly purchase products from farmers, pay them decent prices as well as they have good arrangement of transportation and storage facility which result in minimum loss and this reap them huge benefit. This system is beneficial for farmers as well as consumers because these companies work at very small margin and as result products are available at cheap prices. One of the reason for this is Scale at which they operate is very large because of which their cost of production is cheap. We can say that FDI will decrease inflation in food market.

4. Conclusion

India being one of the major economies in the world has been enjoying huge and regular FDI from Investor of all around the world. Majority of this FDI in India has been made in the sectors of telecommunication, construction, computer software and hardware etc. At the time of independence India welcomed FDI cautiously but as it developed FDI has been liberalized gradually. FDI in retail sector has been permitted to enter in 2006 and gradually it liberalized and recently in 2011, 100% FDI in single brand retail permitted and in 2012, 51% FDI in multi brand retail permitted. This has led to debate regarding implication of this policy; in this paper we have analyzed implication of these policies on farmers, traditional retail & employment and on food inflation. FDI has positive impact on some sectors while negative on others. In our analysis we have seen that FDI will bring investment for modernizing farm as well as retail sector and will also improve supply chain. As a result of these factors food inflation will come down and it will benefit consumers as well. On the employment side it can have negative impact as major part of retail sector is unorganized and as a result of FDI many global players will enter in this sector, this may displace the small players.

In this paper, it is argued that the potential benefits from allowing large retailers to enter the Indian retail market may outweigh the costs. Evidence from developed countries like, the United States suggests that FDI in organized retail could help to curb the increasing trend of inflation, particularly with wholesale prices. One can also expect that technical knowledge from foreign firms, such as warehousing technologies and distribution systems, for example, will also help to improve the supply chain in India, especially for the perishable goods, like agricultural produce. It can also create better linkages between demand and supply; and this way it create the potentiality to improve the price signals that farmers receive. Thus, it eliminates both wastage of food items and middlemen. And it also increases the division of the final sales prices that is paid to farmers. An added benefit of improved distribution and warehousing channels may also come from enhanced exports.

However, much of the Indian retail trade (particularly grocery) still has traditional features: small family-run shops and street hawkers dominate the situation in most of the country. However, the retail trade in India is now undergoing an intensive structural change. And that could cause irretrievable damage to commodity supply chains at local level and competition of competitive markets. To, protect from these ill-effects, an economy needs a proper system of regulations. However, the existing regulations are not adequate to fulfill the new requirements in the changing scenario of Indian retail market in recent time. At the time of this juncture, India can learn from the experiences of south-east Asian countries which are improving regulatory frameworks and handling the multi-brand retail issues efficiently. Some advanced economies like Germany which are already considered more successful regulators in this sector.

Opening up the economy for the multi-brand retail sector to FDI will help to develop the farm sector and it would modernize the farm sector in India and it may generate higher level incomes for the certain section of farmers. However, the story is not very straight and bright. Large corporations, such as Wal-Mart and Carrefour are less interested and likely to work with the millions of small farmers in India that comprise over 83% of the sector. Therefore, in order for small farmers to truly realize the benefits that FDI can provide to the multi-brand retail markets, they must adapt and pursue one of two routes. One is that the small farmers can either come together to form producer companies that would work directly with the corporations thereby enjoying higher revenues. Otherwise, the small farmers must willingly abandon small-scale farming altogether and move into the new jobs directly or indirectly created by FDI—in sectors such as retail, food processing and supporting industries. The structural change in job markets, especially in Indian farm sector is unavoidable.

The government should play, in this respect, a leading role with legal provisions and institutional mechanisms for helping the cooperatives of the farmers, producer companies and producer groups in a smooth functioning of the retail market linkage and to avoid its ill-effects.

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