FOREIGN DIRECT INVESTMENT (FDI)

IN

INDIAN RETAIL SECTOR

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Introduction

India is in the midst of a retail boom. The sector witnessed significant transformation in the past decade from small-unorganized family-owned retail formats to organized retailing. Indian business houses and manufacturers are setting up retail formats while real estate companies and venture capitalist are investing in retail infrastructure. Many international brands have entered the market. With the growth in organized retailing, unorganized retailers are fast changing their business models. However, retailing is one of the few sectors where foreign direct investment (FDI) is not allowed at present.

FDI in retail industry

FDI in retail industry means that foreign companies in certain categories can sell products through their own retail shop in the country. At present, foreign direct investment (FDI) in pure retailing is not permitted under Indian law. Government of India has allowed FDI in retail of specific brand of products. Following this, foreign companies in certain categories can sell products through their own retail shops in the country.

It is a very **positive step** and it will encourage international brands to set up shop in India. On the other hand, this will also lead to competition among Indian players. it will be the consumers who stand to gain," This would not change the market dynamics immediately as it will take some time for these plans to fructify. The growing dominance of multinational companies in the country's $200 billion retail business, had warned that any move to increase FDI in the retail sector would ruin the business of small and medium traders scattered over the country

Organized retailers in India are opposing the entry of MNCs in retail trading because of their predatory pricing strategy that wipes out competition, when the Government decides to allow foreign players to enter the retail space, it should first restrict them to lifestyle products segment before permitting them to spread their wings into other areas like grocery marketing that has a direct impact on `kirana stores'.

FDI in retail trade has forced the wholesalers and food processors to improve, raised exports, and triggered growth by outsourcing supplies domestically. The availability of standardized products has also boosted tourism in these countries. FDI in retail sector has been a key driver of productivity growth in Brazil, Poland and Thailand. This has resulted in lower prices to the consumer, more consumption and higher profit for the producer.

Foreign Direct Investment - Impact and Analysis

Market liberalization, a growing middle-class, and increasingly assertive consumers are sowing the seeds for a retail transformation that will bring more Indian and multinational players on the scene. The big Indian retail players looking to expand their operations include Shopper's Stop, Pantaloon, Lifestyle, Subhiksha, Food World, Vivek's, Nilgiris, Ebony, Crosswords, Globus, Barista, Qwiky's, Café Coffee Day, Wills Lifestyle, Raymond, Titan, Bata and Westside.Well-established business houses such as Wadia, Godrej, Tata, Hero, Malhotras, etc., are drawing up plans to enter the fast-growing organized retail market in India. According to reports, Reliance Industries Ltd plans to enter the retail business in a big way and has identified 18 cities, starting with Ahmedabad, to set up malls. It will spend Rs 30-50 crore on each mall, that are to be modeled after those in Dubai and East Asia. The international players currently in India include McDonald's, Pizza Hut, Dominos, Levis, Lee, Nike, Adidas, TGIF, Benetton, Swarovski, Sony, Sharp, Kodak, and the Medicine Shoppe. Global players are entering India indirectly, via the licensee/franchisee route, since Foreign Direct Investment (FDI) is not allowed in the sector.

Despite all these developments, the organized retail business still comprises a small proportion of the total size of the Rs 9,00,00-crore ($200 billion) retail sector. Retail business growing at 5-6 per cent per annum. The size of organized retailing was estimated around Rs 26,000 crore in 2004, about three per cent of the total. However, it is now set to grow at 25-30 per cent per annum. In developed countries, organized retailing makes for over 70 per cent of the total business.

Recently, the Government announced its intention to open up the retail sector to foreign investment. It is still, however, debating whether to allow 26 per cent or 49 per cent FDI in the sector. Initially, the idea was to begin with 26 per cent and then gradually liberalize it further. However, since China moved from 49 per cent to 100 per cent FDI in this sector last year, the Commerce Ministry and the Prime Minister's Office (PMO) appear to be inclined to go for 49 per cent FDI at one go, despite opposition from Left parties.

Even as the government is debating the level FDI in of retail, a number of foreign players, including the world's largest corporation, the $288- billion Wal-Mart Stores, Inc., have announced their intention to enter India in a big way. With the impending opening up of the sector to overseas investment, they are now keen on forays into the sector in partnership with multinational chains. According to industry analysts, as many as 20 big Indian companies are working on plans to enter the sector in partnership with foreign investors.

For instance, it has opened up the real estate sector by allowing 100 per cent FDI in the construction projects. The move is expected to attract foreign funds and new technology into the market. Second, Foreign Trade Policy 2005-06 has extended the benefit of the export promotion capital goods (EPCG) scheme to the real estate sector. This is expected to tremendously boost the organized retail sector by enabling it to create better and modern infrastructure. Also, the extension of concessional duty scheme for import of capital goods by retailers with minimum area of 1,000 square metres and implementation of VAT will significantly help organized retailing.

Despite all these favourable developments, the Government appears to be still dithering in giving a green signal to FDI in this sector in view of the opposition from Left parties and some sections within the Congress. It is indeed unfortunate that this issue is hanging fire for nearly four years now, even as the government has allowed foreign investment in a number of sectors including banking, telecom and insurance.

As of now, the Indian retail sector, largely due to its fragmented structure, suffers from limited access to capital, labour and suitable real estate options. In contrast, China, which allowed 49 per cent FDI in the retail sector since 1992, benefited immensely with foreign players bringing capital and new technologies and growing export market for domestic products. At present, around 40 foreign retail players account for almost 20 per cent of the organized retailing in that country. India is tipped as the second largest retail market after China, and the total size of the Indian retail industry is expected to touch the $300 billion mark in the next five years from the current $200 billion. The size of organized retailing is expected to touch $30 billion by 2010 or approximately 10 per cent of the total. Various retailers from across the word have been visiting India over the past few months with a view to establishing their presence in a market that is expected to witness exiting developments.

On the contrary, the opening up of the sector to FDI will lead new economic opportunities and there will be more employment generation. According to a policy paper prepared by the Department of Industrial Policy and Promotion (DIPP), FDI in retail must result in backward linkages of production and manufacturing and spur domestic retailing as well as exports.

According to sources in the PMO, the opening up of retail to FDI would be designed in a such as way that many sectors — including agriculture, food processing, manufacturing, packaging and logistics — reap benefits. It is understood that the multinationals that invest in retail business in India would also source Indian goods for their international outlets in a big way and thus provide a boost to Indian exports. Indian retail chains would get integrated with global supply chains since FDI will bring in technology, quality standards and marketing.

According to the World Bank, opening the retail sector to FDI would be beneficial for India in terms of price and availability of products. Experience everywhere has shown that organized retailing tends to have a major controlling effect on inflation because large organized retailers are able to buy directly from producers at most competitive prices. The scale of operation and technology help organized retailers score over the unorganized players, giving the consumers both cost and service advantages.

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Drawbacks

One, the entry of large global retailers such as Wal-Mart would kill local shops and millions of jobs.

Two, the global retailers would collude and exercise monopolistic power to raise prices and monopolistic (big buying) power to reduce the prices received by the suppliers.

Hence, both the consumers and the suppliers would lose, while the profit margins of such retail chains would go up.

Three, it would lead to lopsided growth in cities, causing discontent and social tension elsewhere.

View by Mr.Biyani

The foreign direct investment (FDI) in the Indian retail sector should be allowed in a phased manner so that it could serve the purpose of much-needed capital and bring boom in the sector, according to Confederation of Indian Industry (CII) Chairman Kishore Biyani.

1.FDI should be gradually allowed first in a relatively less sensitive sectors like garments, lifestyle products, house ware and entertainment."

2. Alternative funding mechanisms and investment opportunities should be considered like FIIs and venture capital in the primary market, besides FDI. Hence they should be legalized and encouraged in the primary market.

3.He said the industry needed time for capital formation, which would take at least two-three years. The gradual inflow of FDI should not be a hindrance for the growth of the retail sector.

Objective:

1. To serve the purpose of much needed capital and bring a boom in this sector.

2. To enhance infrastructure.

Should India Allow F.D.I?

Three arguments are generally extended against allowing FDI in the retail sector. First, this will prevent the growth of domestic organized retail industry. Second, it will result in closure of small retail stores, the so-called mom-and-pop stores and third, that it will disrupt the social community and the given way of life. The first argument is passes simply because with the entry of Reliance, Tatas and other large domestic players the domestic retail industry has surely come of age. These corporates don't need protection. Actually, if these infants are protected any longer they have good chances of becoming delinquent adults. Soon enough, monopoly rents will begin to accrue and bad habits will get entrenched and it will then be more difficult to open the sector. Domestic players have the best locations anyway and a clear head start. The equity argument does not have solid empirical basis. As the ICRIER study on the same subject has shown, liberalization of retail raises overall economic welfare and does not result in loss of employment.

Some restructuring will take place but local markets will not close down. My favourite example is that the entry of Haldiram has not led to the demise of Nathus and Agarwal mishthan bhandars. Both can coexist as they fulfill different needs and serve different clientele. Organized retailing generates additionality of demand by reducing costs, lowering prices and also improves returns to producers by eliminating unnecessary intermediaries.

The third argument has greater substance. Malls could lead to greater urban anonymity and a complete break down of the bazaar culture and the disappearance of the 'down town' space that has its own charm. But in France, Germany, the Nordic countries and also other parts of Europe, experience has shown that local communities can thrive if they are empowered and involved in urban planning. Organized retail does not necessarily result in the dreaded mid-west. So FDI in retail improves growth prospects, does not harm equity and discourages monopoly rents and therefore should be allowed

Reviews

Retailing is one of the few sectors where foreign direct investment (FDI) is not allowed at present. Stakeholders, trading associations, politicians, etc. have given various arguments for and against FDI in retailing. However, such arguments are largely based on perception and there has not been serious academic research in this area. To fill this lacuna, this survey-based study analyses the current retail scenario in India, investigates the growth across different segments of retailing and evaluates the likely impact of allowing FDI on various stakeholders in different retail segments. Experiences of other countries in allowing FDI and its impact are also discussed. Presently, foreign players are entering the market through different routes. The entry process and their perception about the Indian market are analyzed. The study investigates the structural, regulatory, fiscal and other barriers affecting the performance of retail trade and suggests reforms for the removal of such barriers. It also provides valuable policy inputs in terms of the time frame in and the process through which the Indian government can open up this sector to FDI so as to maximize the welfare and minimize the adjustment. It also lists the conditions that may be imposed on foreign retailers if FDI is allowed.

Conclusion:

India is in the reckoning and the figures appear to be improving by the day. While FDI equity flows were US$ 5.5 billion in 2005-06, it increased almost three times to US$ 15.7 billion in 2006-07, representing a growth rate of 184 per cent. In fact, calculating the total

FDI inflows into India by international best practices places the total inflow at US$ 19,531 million. This huge inflow of FDI has in turn reversed the past trend, with FDI inflows overtaking the portfolio investment inflows by almost US$ 5.6 billion in 2006-07, according to the RBI's report on International Investment Position.

India was the fourth-largest recipient of FDI during 2005-06 and was instrumental in FDI inflows to South Asia surging by 126 per cent, amounting to US$ 22 billion in 2006, reveals UNCTAD's World Investment Report. During April-July 2007-08, FDI inflows amounted to US$ 5,614 million as against US$ 2,848 million during the corresponding period last year, recording a growth rate of 97 per cent.

Cumulative FDI inflows during the period August 1991 to July 2007 amounted to US$ 60,242 million. Between 2001-02 and 2006-07, inflows increased by about two and a half times. The principal sources of FDI during August 1991 to June 2007 have been Mauritius (US$ 20,808 million), US (US$ 6,215 million), UK (US$ 3,979 million), Netherlands (US$ 2,789 million), Japan (US$ 2,585 million), Singapore (US$ 2,033 million) and Germany (US$ 1,917 million), accounting for 41.89 per cent, 12.03 per cent, 7.98 per cent, 5.59 per cent, 5.07 per cent, 4.05 per cent and 3.69 per cent, respectively.

The principal sectors attracting FDI during August 1991 to June 2007 have been services (US$ 9,443 million), electrical equipment (US$ 8,964 million), telecommunication (US$ 4,880 million), transportation (US$ 3,856 million), fuels (US$ 2,892 million), chemicals (US$ 2,465 million) and construction (US$ 1,912 million).

Clearly, investors' interest in India is on a high, with a host of companies lining up major FDI proposals in the next few years.

- Steel tycoon Lakshmi Niwas Mittal has pledged an investment of about US$ 20 billion for building two 12-million-tonne steel plants in the states of Jharkhand and Orissa.
- Vodafone, the world's second-biggest mobile firm, plans to spend US$ 2 billion a year on capital expenditure in India.
- Eyeing the projected 15 per cent growth in the luxury car market segment, Dailmer Chrysler India Pvt Ltd, makers of Mercedes-Benz cars, has decided to set up a new plant in Pune.
- Israeli mall developer Plaza Center NV will invest US$ 1.22 billion over the next five-seven years to set up 50 malls in India.
- Nokia plans to invest US$ 100 million in India in the next three years to ramp up its capacity in Chennai.
- US-based aircraft engine manufacturer, Pratt and Whitney, plans to invest about US$ 30 million in the infotech and spare parts manufacturing sector.

Thank You