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A review of the latest development & a general perspective on whether foreign direct investment in India should be open up for retail sector

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<u>The FDI scenario in Indian retail sector</u>

It is submitted that retail trading in India constitutes as one of those few sectors where FDI is not freely and healthily allowed. Although, FDI is fully admissible in 'cash and carry' wholesale (back-end retail), it is admissible only up to 51 per cent in single-brand front-end retail.

Importantly, there is a complete ban on foreign investment in multi-brand, front-end retail. This has resulted in keeping all the giant corporate – backed retailers of the world like Walmart (USA), Carrefour (France), Tesco (UK), and Metro (Germany), who are very keen to foray into India's retail sector, away from entering into the country. All of these retailers, therefore, to make their presence felt in the country, have either tied-up or trying to tie-up with local corporate, to offer their services for back-end operations like sourcing, logistics, inventory management, among others, for front-end, multi-brand retail operations of such corporates.

The retail industry in India is of late often being hailed as one of the sunrise sectors in the economy. AT Kearney, the well-known international management consultancy, recently identified India as the 'second most attractive retail destination' globally from among thirty emergent markets. It has made India the cause of a good deal of excitement and the cynosure of many foreign investors' eyes. With a contribution of an overwhelming 14% to the national GDP and employing 7% of the total workforce (only agriculture employs more) in the country, the retail industry is definitely one of the pillars of the Indian economy.

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 establish their own chains of retail outlets, or develop franchises.

On the other hand, Indian retail industry is divided into organized and unorganized sectors. 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 supermarkets and retail chains, and also the privately owned giant 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

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pavement vendors, etc. Unorganized retailing is by far the prevalent form of trade in India – constituting 98% of total trade, while organized trade accounts only for the remaining 2% – and this is projected to increase to 15-20 per cent by 2010.

Needless to say, the Indian retail sector is overwhelmingly swarmed by the unorganized retailing with the dominance of small and medium enterprises in contradiction to the presence of few giant corporate retailing outlets. The trading sector is also highly fragmented, with a large number of intermediaries who operate at a strictly local level and there is no 'barrier to entry', given the structure and scale of these operations.

Moreover, the retail sector also acts as an important employment absorber for the present social system. Thus, when a factory shuts down rendering workers jobless; or peasants find themselves idle during part of the year or get evicted from their land; or the stagnant manufacturing sector fails to absorb the fresh entrants into the job market, the retail sector absorbs them all.

According to the Investment Commission of India, the retail sector is expected to grow almost three times its current levels to $660 billion by 2015. It is expected that India will be among the top 5 retail markets then. The organized sector is expected to grow to $100 bn and account for 12-15% of retail sales by 2015.

According to Subha Kalathur, analyst at Valuenotes, there is certainly a lucrative opportunity for foreign players to enter the Indian terrain. Growth rates of the industry both in the past and those expected for the next decade coupled with the changing consumer trends such as increased use of credit cards, brand consciousness, and the growth of population under the age of 35 are factors that encourage a foreign player to establish outlets in India. However, it is not out of place to mention here that the government policies towards FDI are the only hindering factors that do not make this a fairy tale for foreign players.

Concerns of the future:

Needless to say, but FDI inflows has evidently proved to be very advantageous for the overall development of the Indian economy and inter alia has resulted in increased capital flow, improved technology, notable management expertise and favourable access to international markets.

It is to be noted that FDI in India is liberally allowed in all sectors including the services sector, except a few sectors where FDI is either absolutely forbidden on the grounds of national interest, or, other sectors where the existing and notified sectoral policy does not permit FDI beyond a ceiling. Moreover, FDI for all the permissible items/activities can be brought in through the Automatic Route under powers delegated to the Reserve Bank of India (RBI), and for the remaining items/activities through Government approval, which is accorded on the recommendation of the Foreign Investment Promotion Board (FIPB).

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It is submitted that FDI Restrictions in Indian Sectors have been imposed on a few sectors by the Indian government. The various Indian Sectors having restrictions of foreign direct investment are atomic energy, nidhi company, betting and gambling, chit fund business, plantation or agricultural activities, real estate business, business in transferable development rights, lottery business, retail trading ,railway transport, mining of chrome, zinc, gold, diamonds, copper, iron, gypsum, manganese, and sulfur and ammunition and arms.

FDI Restrictions in Indian Sectors have been imposed in order to protect the interests of the country, as these sectors either relate to national security or sensitive enough to keep apart the foreign companies. Foreign direct investment restrictions in Indian sectors have also been imposed in order to allow the domestic companies to make more profits with less competition, than that of in the presence of rivalry international firms.

It is submitted that while in some sectors the restrictions imposed by the government are comprehensible; the restrictions imposed in few others, including the retail sector, are utterly baseless and are acting as shackles in the progressive development of that particular sector and eventually the overall development of the Indian Inc.

Why are FDI flows important for India?

India needs inflows to drive investment in infrastructure, a lack of which is often cited as restricting the country's economic growth. Investment is also needed to expand capacity and technology in sectors such as autos and steel, as well as to offset a big current account deficit.

In 2009, India attracted $36.6 billion in FDI funds, equivalent to 2.7 percent of its gross domestic product. China attracted $95 billion, or 1.9 percent of GDP. But foreign direct investment flows into India fell by over 24 percent in the first seven months this year to $12.56 billion, putting pressure on domestic investment to take up the slack.

Need of the hour is to bring about changes in FDI policy by liberalizing FDI and incorporating laws to govern them to best of the benefit to the nation?

The slow pace of policy reform that would further open sectors such as retail, insurance and real estate to foreign investment have acted as a deterrent.
Delays in framing a new land acquisition act, which would ease availability of land for industry, have also hurt FDI flows into infrastructure and other sectors. FDI flows to India are likely to remain subdued in coming months as well, analysts said, given the shaky global recovery.

That's a contrast to flows of foreign funds into Indian stocks, which are on track to hit a record high this year. FDI flows into India, which held up reasonably well during the global financial crisis, are likely to total between $20 billion and $30 billion in 2010, economists say.

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What would be the impact on FDI due to policy decision on allowing FDI in retail sector?

Now coming to the captioned topic of FDI in the Indian retail sector, it is submitted that the scenario of the same is kind of depressing and unappealing, since despite the ongoing wave of incessant liberalization and globalization, the Indian retail sector is still aloof from progressive and ostentatious development. This dismal situation of the retail sector undoubtedly stems from the absence of an FDI encouraging policy in the Indian retail sector.

However, it needs to be noted here that unfortunately this dismal situation is there to exist, especially in the light of the recent developments – in terms of the abrupt change in the ideology of the political parties filing the Parliament.

Before highlighting the anticipated future of the Indian retail sector in light of the recent unfavourable developments, it would be worthwhile to first briefly take into consideration the existing scenario of FDI in the Indian retail sector and the Indian retail market in general.

Objectives:

The main objectives of the study are as follows:

1) **To bring about the recent developments in FDI with respect to retail sector**
2) **Critical analysis of the ongoing events affecting the future of Indian retail sector**
3) **Whether foreign direct investment in INDIA should be allowed in the retail sector and if so to what extend it should be allowed in terms of holding percentage cap?**
4) **What would be the impact on FDI due to policy decision on allowing FDI in retail sector?**

Methodology:

Macro data is gathered from various sources to arrive at the conclusion on the impact of foreign direct investment in retail sector. As it is a macro analysis no primary data can be gathered on the same secondary data from various official sites as well as articles published in reputed journals and news paper has been taken as the basis for forming and conclusion.

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Utility of the Study:

The study tries to give an insight into the issue of foreign direct investment in retail as a tool for growth of the nation. It intends to suggest whether foreign direct investment in retail sector is desirable for the growth of nation ad whether the same should be allowed and to what extend.

Limitations:

The study involves exploratory approach and is based on observations of other nations and the concerns brought forward by various members of the parliament and committees set up for making decision on FDI in retail and may apply to this particular time frame only. The views may change in along run with the change in the outlook. The scope of the data taken for analysis is from the year 2004 to 2010 it does not cover prior to that.

The recent developments contemplating a sea change in the Indian retail sector

The history has witnessed that the concern of allowing unrestrained FDI flows in the retail sector has never been free from controversies and simultaneously has been an issue for unsuccessful deliberation ever since the advent of FDI in India. Where on one hand there has been a strong outcry for the unrestricted flow of FDI in the retail trading by the ruling UPA government and by an overwhelming number of both domestic and as well as foreign corporate retail giants; to the contrary, the Left wing along with the critics of unrestrained FDI have always fiercely retorted by highlighting the adverse impact, the FDI in the retail trading will have on the unorganized retail trade, which is the source of employment to an enormous amount of the population of India.

However, it is to be noted that lately there has been an remarkable surge in the demand for the liberalization of the Indian retail sector both by at the domestic and as well as at the international front and it seems that the government is giving the matter a very pensive and careful consideration. Some of the factors that have contributed to this trend are the evident profits in the ever growing but conserved Indian retails sector, reduction in tariff, cheaper real time communications, and cheaper transport. The main reasons for such an unequivocal demand stems from the realisation that (i) while the retail sector requires heavy investment for expansion, there is hardly any local capital left in the capital markets as a consequence of global financial meltdown, and (ii) efficient management of multi-brand, multi-product, multi location retail, especially in the area of back-end operations, require heavy dose of technology, which over the years has been developed and perfected by foreign players.

In wake of relentless protests for the opening up of the Indian retail market for the reception of unrestrained FDI, the Investment Commission in July, 2006, suggested that 49% FDI be allowed in the Indian retail sector without any restrictions on the number of outlets or location of stores. The Indian retail boom and the Investment Commission's suggestions renewed the debate on the

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issue of allowing FDI in the retail sector. The Commission opined that that foreign investment would help in improving the retail and supply chain infrastructure, and generate large-scale employment in the country. In addition, the Indian retailers could absorb some of the best operational practices of these international retailers and gain in experience. Ultimately, the consumers would benefit due to the availability of more product offerings, lower prices, and efficient service.

The recommendations of the Investment Commission proved to be very promising and paved the way for a positive feedback by then ruling UPA government and also the BJP government on the issue of liberalization of the retail sector. It is interesting to note that Prime Minister Dr. Manmohan Singh while speaking on the occasion of the mid term appraisal of the Tenth Five Year Plan of the Government announced that his Government has been considering permitting FDI in retail sector ostensibly to attain the target of employment generation.

Moreover, the Indian Council for Research on International Economic Relations (ICRIER) drafted a report which suggested that the opening up of the FDI regime should be gradual—over a 3 to 5 year timeframe – to give the domestic industry enough time to adjust to the changes. In the initial stage FDI up to 49 per cent should be allowed which can be raised to 100 per cent in 3 to 5 years (depending on the growth of the sector). FDI cap below 49 per cent (i.e., 26 per cent) would not bring in the desired foreign investment collaboration

.Furthermore, very lately in her address to Parliament in June, 2009, President Pratibha Patil, had said, "Our country has benefited from large foreign investment flows in recent years. These flows, especially FDI, need to be encouraged through an appropriate policy regime".

However, unfortunately the issue still remains nebulous; with only evident positive thinking on part of the government and with no final affirmative or negative decision on the same whatsoever.

<u>The protest in the Parliament against FDI in retail sector:</u>

Amidst the hope for the liberalization of the retail sector and the expectation for a promising decision by the present UPA government on the issue of according unrestrained reception to FDI in retail trading without any restrictions on the number of brands, outlets or location of stores; the parliamentary standing committee on commerce on 8th June, 2009, while presenting a picture of gloom, recommended a blanket ban on domestic corporate and foreign retailers from entering retail trade and also suggested restrictions to bar organized retail firms from setting up malls and selling other consumer products.

The 42 – member panel, headed by BJP leader Murli Manohar Joshi, has, as reported in the Economic Times Article, cautioned that allowing organized players, domestic and as well as foreign, to enter retail trade would result in the destruction of the economic foundation of the

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small retail supply chain. Moreover, the parliamentary committee has also suggested putting in place a regulation, a National Shopping Mall Regulation Act, to ensure that cartelization dos not take place, and regulate the fiscal and social aspects of the retail sector.

The committee observed that Consumers' welfare would be sidelined, as the big retail giants by adopting a predatory pricing policy would fix lower price initially, tempting the consumers. After wiping out competition from local retailers, the big retailers would be in a monopolistic position and would be able to dictate prices, the panel said. It also said that procurement centers constituted by big corporate for making direct bulk purchases would initially pay attractive prices to farmers and cause gradual extinction of `mandis' and regulated market yards.

The rationale advocated by the panel in shackling the liberalization of the Indian retail sector is that according to government accounts, the total retail business is of the order of rupees 12,00,000 crore, which is roughly one – third of the country's GDP. Of this, 95% is accounted for by the unorganized sector. Moreover, the panel also harped that retail is the largest manpower employer in the country after agriculture and unorganized retail accounts for 8% of total employment, i.e., more than 40 million persons. The committee, therefore, concluded that in allowing the establishment of giant corporate – backed retail stores would result not only in the annihilation of the unorganized retail sector, but would ultimately result in unemployment of the masses and simultaneously would also cause serious disruption to the healthy contributions to GDP .

The panel also contended "in order to counter the adverse effects of corporate retail, there is an urgent need to design a legal and regulatory framework along with an enforcement mechanism that would ensure that the large retailers are not able to displace the small retailers by unfair means".

Further, the panel concluded that the provision of FDI retail in single brand is not strictly adhered to and is in reality flouted. The panel opined that the shops in malls are selling other branded items along with the brands for which they got permission.

In addition to the above the committee also criticized the established of the cash – carry stores by foreign corporate retailers like Wal–Mart and METRO Group and in its report entitled "*Foreign and Domestic Investment in Retail Sector*", suggested that the government should stop issuing further licenses for cash – and –carry, either to transnational retailers or to a combination of transnational retailers and the Indian partner as it is "a camouflage for doing retail trade through the back door".

It is to be noted that the world leading retailer Wal-Mart was very eager to open a retail chain throughout India. The retail giant did everything possible so that the Government of India becomes inclined to liberalize FDI in retail sector. In February 2002, the world's largest retailer,

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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

However, all attempts proved to be futile and the giant retail MNC finally settled up with the establishment of a cash – carry outlet in Amritsar on June 6, 2009. Such stores don't sell to end-users, but to retailers and middlemen. This is the only format under which foreign retail chains are allowed in India. It is submitted that at present, 100% FDI is permitted under automatic route in the wholesale cash – and carry trading.

Critical analysis of the ongoing events affecting the future of Indian retail sector

It is submitted that though the recommendation of the panel are not binding upon the Government; the same have outrageously done the intended harm. In other words, the direct result of the media hype of the recommendations of the Panel was the abrupt stoppage of all the progressive investment plans of various corporate giants all across the globe, who were desirous of investing an irresistible amount of capital in the Indian markets, in order to establish their brand name.

According to Shalini Thukral, Retail Merchandise Manager, Primetex Clothing Pvt. Ltd, Indian retail may lose FDI of up to Rs 400 crore (Rs 4 billion) this fiscal because of recommendations by the Parliamentary Panel on Commerce, which has opposed further leeway to the entry of international retail brands in the country.

Unfortunately, the iconic $ 31-billion Scandinavian home products giant, IKEA, has put on hold its plans to set up 25 showrooms across the country foreign investment of around $ 1 billion. In an internal communication this week, IKEA told its stakeholders that Indian investment rules do not encourage it to go ahead with its investment plans — at least not in the near future.

Moreover, Carrefour, Cartier, Armani, Tesco and UK-based Curry's and Sports Direct International could also be some of the foreign retail players to cut down their investment in India following the government's FDI policy on retail, observes Shalini Thukral, Retail Merchandise Manager, Primetex Clothing Pvt. Ltd

The ban is even extended to the big domestic corporate heavyweights retailers like Reliance, Bharti, Aditya Birla Group owned *'More'* and Pantaloons Group owned *'Big Bazaar'* to trade in grocery, fruits and vegetables. That would rule of Reliance Fresh from the Reliance stable and Bharti's cash and carry stores.

Thus, it is to be noted that even though no decision has been taken by the government on the recommendations given by the panel; the direct ramifications of the recommendations have been evident considerable loss of FDI, managerial expertise, and jobs for the Indian retail industry along with sacrifice of the consumer's interest and welfare.

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Hopes of allowing FDI still alive:

It is interesting to note here that in contradiction to the recommendations of the Parliamentary Committee's, the present UPA government has, as reflected in the Economic Survey 2008-09, which was tabled by the Finance Minister Pranab Mukherjee in the Parliament on 2nd July, 2009, raised hopes of all those who are looking for a favourable response of the government on the subject. While, the Economic Survey has made a strong case for opening up the FDI for multi-brand retail, it has recommended a gradual opening of the sector. Improving the investment environment would require "FDI in multi-format retail, starting with food retailing," said the Survey, adding that initially the FDI could be allowed subject to the setting up a modern logistics system, perhaps jointly with other organised retailers. "A condition could also be put that it must have (for five years say) wholesale outlets where small, unorganised retailers can also purchase items (to facilitate transition)," added the Survey.

It is to be noted that the recommendations made in the Survey do provide direction to the government's thinking on the subject. "It is a welcome suggestion and will help the Indian retail sector grow, by leading to inflow of money from overseas brands," said Kishore Biyani, Chief Executive Officer, Future Group, to PTI. Moreover, according to Biyani, FDI will ensure a bigger playing field and sustained competition, resulting in reduction of prices for the consumer. He, however, recommended fixing a certain threshold investment for entering into the sector.

Spencer's Retail, the retail arm of RPG Group, a wholly owned subsidiary of group company Calcutta Electric Supply Company, also welcomed the Survey's recommendation."We view it in favorable light. There is enough room in the Indian retail sector for everybody to grow and FDI will bring about competitiveness between Indian and foreign players," a Spencer's Retail spokesperson said.

Most modern (organized) retailers, who have been asking for removal of ban on FDI in retail, were excited with the recommendation made by the Survey in its report. However, unfortunately the recommendations embodied in the Economic Survey are not binding on the Parliament and the issue of the liberalization of the Indian retail market, in terms of unrestrained FDI in the retail trading, still needs a decisive affirmation by the Parliament in order to morph as a rule of law. Till then the issue will hang as a sword over the head of the government and would certainly act as a barrier to the healthy development of the Indian retail markets in terms of dearth of enormous amount of FDI and the lack of resultant healthy competition between the major organized retail sector giants.

Conclusion

It is submitted that the antagonists of FDI in retail sector oppose the same on various grounds, like, that the entry of large global retailers such as Wal-Mart would kill local shops and millions of jobs, since the unorganized retail sector employs an enormous percentage of Indian population

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after the agriculture sector; secondly that the global retailers would conspire and exercise monopolistic power to raise prices and monopolistic (big buying) power to reduce the prices received by the suppliers; thirdly, it would lead to asymmetrical growth in cities, causing discontent and social tension elsewhere. Hence, both the consumers and the suppliers would lose, while the profit margins of such retail chains would go up.

However, it can be said that the advantages of allowing unrestrained FDI in the retail sector evidently outweigh the disadvantages attached to it and the same can be deduced from the examples of successful experiments in countries like Thailand and China; where too the issue of allowing FDI in the retail sector was first met with incessant protests, but later turned out to be one of the most promising political and economical decisions of their governments and led not only to the commendable rise in the level of employment but also led to the enormous development of their country's GDP.

Moreover, it is submitted that in the fierce battle between the advocators and antagonist of unrestrained FDI flows in the Indian retail sector, the interests of the consumers have been blatantly and utterly disregarded. Therefore, one of the arguments which inevitably needs to be considered and addressed while deliberating upon the captioned issue is the interests of consumers at large in relation to the interests of retailers.

It is also pertinent to note here that it can be safely contended that with the possible advent of unrestrained FDI flows in retail market, the interests of the retailers constituting the unorganized retail sector will not be gravely undermined, since nobody can force a consumer to visit a mega shopping complex or a small retailer/ sabji mandi. Consumers will shop in accordance with their utmost convenience, where ever they get the lowest price, max variety, and a good consumer experience. Moreover, it is to be noted that the small retailers will still remain in good business owing to the fact of their convenient location near the residential societies and to the fact of the distant location of the mega stores and malls.

From this point of view, it can *inter alia* be concluded that the interest of the consumers should take precedence over the interest of the retailer and consequently healthy flow of FDI in retail should be permitted.

Further, it would be worthwhile to list down certain advantages from the point of view of consumers which will inevitably flow from the establishment and development of larger stores and supermarkets:

In their article entitled "***FDI in Retailing – Is it the need of the hour?"*** L. Dhamayanthi and S. Pradeep Kumar, MBA students of School of Management, Sri Krishna College of Engineering and Technology, have categorically stated that FDI will not just provide access to larger financial resources for investment in the retail sector but simultaneously will rationally allow larger supermarkets, which tend to become regional and national chains – (i) to negotiate prices more

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aggressively with manufacturers of consumer goods and thus pass on the benefit to consumers; and (ii) to lay down better and tighter quality standards and ensure that manufacturers adhere to them.

It is also to be noted that consumer goods manufacturers generally prefer supermarkets since they not just offer a wide range of their (manufacturers) products and services, so the consumer can enjoy single-point shopping, but simultaneously they by their attractive presentation and tempting retailing strategies also account for an increasing share of consumer product sales. Also, the fact that a well-known chain of supermarkets procures its goods from a known manufacturer becomes a stamp of quality. Moreover, with the availability of free flow of finance in conjunction with advent of healthy inflow of FDI, the supermarkets will be in a better position than small retailers to make shopping a pleasant experience by making investments in much needed infrastructure facilities like parking lots, coffee shops, ATM machines, etc.

Apart from this, by allowing FDI in retail trade, India will significantly flourish in terms of quality standards and consumer expectations, since the inflow of FDI in retail sector is bound to pull up the quality standards and cost-competitiveness of Indian producers in all the segments. It is therefore obvious that we should not only permit but encourage FDI in retail trade.

Lastly, it is to be noted that the Indian Council of Research in International Economic Relations (ICRIER), a premier economic think tank of the country, which was appointed to look into the impact of BIG capital in the retail sector, has projected the worth of Indian retail sector to reach $496 billion by 2011-12 and ICRIER has also come to conclusion that investment of 'big' money (large corporates and FDI) in the retail sector would in the long run not harm interests of small, traditional, retailers.

In light of the above, it can be safely concluded that allowing healthy FDI in the retail sector would not only lead to a substantial surge in the country's GDP and overall economic development, but would *inter alia* also help in integrating the Indian retail market with that of the global retail market in addition to providing not just employment but a better paying employment, which the unorganized sector (kirana and other small time retailing shops) have undoubtedly failed to provide to the masses employed in them.

Thus, as a matter of fact FDI in the buzzing Indian retail sector should not just be freely allowed but per contra should be significantly encouraged

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