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Foreign Direct Investment in Retail Sector

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Abstract: ***The Indian Economy has continuously recorded high growth rates over the past decades. As per the Indian Prime Minister, Dr. Manmohan Singh, the Indian economy is expected to grow at 7.5% over the coming years. One of the major contributors to the growth shall be the Foreign Direct Investment (F.D.I) and it is predicted that over the last next two years, India could attract F.D.I. worth U.S $ 80 billion. The latest available data from the Reserve Bank of India shows 77% jump in the F.D.I in the first half of current financial year, compared to what was U.S $ 19.5 billion during the same period a year ago. F.D.I refers to an investment made to acquire lasting or long term interest in enterprise operating outside the economy of the investor. It is a major source of external finance which means that countries with limited amounts of capital can receive finance beyond the national borders from wealthier countries. In case of India, countries such as Singapore, U.S and U.K are amongst the leading sources of F.D.I. The sectors which attract higher inflows are services, telecommunications, construction activities and computer software and hardware. Another sector which is looking at benefiting from F.D.I. is the retail sector. There has been a discussion about F.D.I being opened up in retail which has drawn a lot of support from international retailers like Wal-Mart and Tesco. It is also being seen as the means to put a structure in place to the highly unorganized retail structure prevalent in the country. The additional benefits in the form of lower cost and enhance technologies make it an attractive proportion. However, the policy decision is faced with some resistance from internal organized retailers as well as some representatives of the unorganized sector. The entry of new competitors in the retail sector is being viewed as a threat by current players in the market. With Union Cabinet deciding to allow 51% F.D.I in multi-brand retail on N November 24, 2011 the way has been clear for entry of global supermarket giants in India. T here are doubts and fears amid hopes for long term gains. Though some retailers would suffer, yet it would prove to be a boon for the Indian retail sector due to new technology, cultural exchange, quality goods and others.***

Keywords: Foreign Direct Investment, Retail Sector, Economy, external finance, boon and bane

1. Introduction

Retailing is the interface between the producer and the individual consumer buying for personal consumption. This excludes direct interface between the manufacture and institutional buyers such as the government and other bulk customers. A retailer is one who stocks the producer's goods and is involved in the act of selling it to the individual consumer, at a margin of profit. As such, retailing is the last link that connects the individual consumer with the manufacturing and distribution chain. The retail industry in India is of late often being hailed as one of the sunrise sectors in the economy.

A.T 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 good deal of excitement and the cynosure of many foreign eyes. With a contribution of 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 decision of permitting foreign direct investment (FDI) in the retail sector has been a debate in India for a considerable period of time.FDI has been permitted in several sectors by the government of India; however, retail has been as issue deliberated over in view of its expected effect on several sections of the economy, particularly small businesses.

The government of India has permitted any foreign multinational through FDI, to invest in India up to 51% in joint venture for the retail of its exclusive/ branded product. This only permits investment in retail with respect to branded retail, meaning confined to single brand. It is worth mentioning that at present foreign brands are retaining in India through franchise agreements.

The major rationalization act carried out by the Government of India by bring about changes in the policies pertaining to FDI is with the view of providing more jobs and improving the economy of the country. It is for this purpose that whilst allowing FDI the Government of India has taken due care and has only permitted FDI in retail for single brands. That by doing so it would not displace the existing people in employment and in the alternative it would give a boost to investment and create more employment. Further, by permitting foreign direct investment in single brands it would also not dispense with the retailers in the local markets and the unorganized sector, which employ a huge number of people in the retail sector.

Further, in addition to the permission for FDI in the retail sector FDI has also been permitted in the following sector/ industries, to the extent of 100% though the automatic route;
1) Power trading
2) Petroleum infrastructure
3) Processing and warehousing of rubber and coffee
4) Diamond and coal mining

However, the said decision of the government permitting FDI in retail has drawn a lot of flak from the leftist and the opposition parties. However, the gates have opened for multinationals interested and looking forward to set a foot in the booming retail business in India.

With Union Cabinet deciding to allow 51% F.D.I in multi-brand retail on November 21, 2011 the way has been cleared for entry of global supermarket giants in India. There are doubts and fears amid hopes for long term gains. Though some small retailers would suffer, yet it would prove to be a boon for the Indian retailers sector due to new technology, culture exchange, quality goods and others. There are doubts and fears amid hopes for long term gains. One of the conditions of 51% F.D.I in multi-brand retail proposed is that the players will source at least 60% of their farm produce requirements from small farmers. A small farmer is defined as one with up to 10 hectares.

Small Farmers may not Gain

The operations of domestic fresh food supermarkets in India have not made any difference to the producers share in the consumer's rupee so far. It has only lowered the cost of marketing of the producers as supermarkets have collection centre's in producing areas, unlike the Agricultural Produce Market Committee (APMC) markets (mandis) which are in distant cities. But these supermarkets will buy only "A grade produce". Obviously, they will buy only a part of the output of farmers. The chains produce from contact farmers without any commitments to buy regularly as they do not want to share the risk of growers. Thus, the involvement of supermarket chains with producers is minimal.

The noise about benefits to small-holders in high value crops (fruit and vegetables) due to supermarket linkages is exaggerated. This is because these crops account for only 2% of the gross cropped area, and the direct linkage is either absent or pretty weak. This is not likely to change even with F.D.I in retail. Further, due to the sheer size and buying power of foreign supermarkets, the produce prices may be depressed. The limit of 10 hectares is laughable as there are hardly 1 % farmers who have more than 10 hectares of land.

Small Retailers to be hit:

The supermarkets expansion also leads to employment loss in the value chain as compared to jobs created by traditional retailers. The spread of supermarkets led to 14% reduction in the share of "mom and pop" stores in Thailand within four years of F.D.I. permission. In India, after the spread of supermarkets chains,33%-60% of traditional fruit and vegetable retailers report 15-30% decline in footfalls, 10-30% decline in sales and 20-30% decline in incomes across various cities with a population of more than one million. The question to be asked is: How many cities in India are really below one million populations.

Impact of Food Inflation;

So far as the role of F.D.I driven food supermarkets in containing food inflation is concerned, the evidence from across the world shows that the supermarkets prices for fruits and vegetables and other basic foods were higher than those in traditional markets. Also, the lower procurement prices through direct procurement from farmers need not lead to lower consumer prices in supermarket chains. The reason is procurement price are more about the bargaining power of buyers and suppliers. Thus, there is no direct correspondence between modern retail and lower food prices.

Definition of Foreign Direct Investment:

International Monetary Fund (I.M.F) has defined" Foreign Direct Investment as investment that is made to acquire a lasting interest in an enterprise operating in an economy other than that of investor"

Foreign Direct Investment refers to the net inflows of investment to acquire a lasting management interest in an enterprise operating in an economy other than that of the investor. It is sum of equity capital, other long term capital and short term capital as shown in the balance of payments. It usually involves participation in management, joint venture, transfer of technology and expertise.

2. Objectives and Methods

The objective of the study is to examine the impact of Foreign Direct Investment in Indian retail sector. While preparing this paper both primary and secondary sources of information have been utilized. Various reference books, journals, articles, newspaper etc have been consulted. Some materials have also been drawn from websites. Interaction with retailers and producers were also made to know their views. The method used is used is analytical and descriptive.

The Question of Foreign Direct Investment (FDI) in Retail:

Given this backdrop, the recent clamor about opening up the retail sector the term Foreign Direct Investment (FDI) becomes a very sensitive issue, with arguments to support both sides of the debate. It is widely acknowledged that FDI can have some positive results on the economy, triggering a series of reactions that in the long run can lead to great efficiency and improvement of living standards, apart from greater integration into the global economy. Supporters of FDI in retail trade talk of how ultimately the consumer is benefited by both price reductions and improved selection, brought about by the technology and know-how of foreign players in the market. This in turn can lead to great output and domestic consumption. But the most important factor against FDI driven "modern retailing" is that it is labor displacing to the extent that it can only expand by destroying the traditional retail sector.

Till such time we are in a position to create jobs on a large scale in manufacturing, it would make eminent sense that any policy that results in the elimination of jobs in the unorganized retail sector should be kept on hold. Though most of the high decibel arguments in favor of FDI in the retail sector are not without some merit, it is not fully applicable to the retailing sector in India, or at least not yet. This is because the primary task of government in India is still to provide livelihoods and not create so called efficiencies of scale by creating redundancies. As per present regulations, no FDI is permitted in retail trade in India. Allowing 49% or 26% FDI (which have been the proposed figures till date) will have immediate and dire consequences. Entry of foreign players now will most definitely disrupt the current balance of the economy; will render millions of small retailers jobless by closing the small slit of opportunity available to them. Imagine if Wal-Mart, the world biggest retailer sets up operations in India at prime locations in the 35 large cities and towns that house more than 1 million people. The supermarket will typically sell everything, from vegetables to the latest electronic gadgets, at extremely low prices that will more likely undercut those in nearby local stores selling similar goods. Wal-Mart would be more likely to source its raw materials from abroad, and procure goods like vegetables and fruits directly from farmers at preordained quantities and specifications. This means a foreign company will buy big from India and abroad and be able to sell low- severely undercutting the small retailers. Once a monopoly situation is created this will then turn into buying low and selling high. Such re-orientation of sourcing of materials will completely disintegrate the already established supply chain. In time, the neighboring traditional outlets are also likely to fold and perish, given the 'predatory' pricing power that foreign player is able to exert. As Nick Robbins wrote in the context of the East India Company, " By controlling both ends of the chain, the company could buy cheap and sell dear". The producers and traders at the lowest level of operations will never find place in this sector, which would now have demand mostly only for fluent English-speaking helpers. Having been uprooted from their traditional form of business, these persons are unlikely to be suitable for other areas of work either. It is easy to visualize from the discussion above, how the entry of just one big retailer is capable of destroying a whole local economy and send it hurting down a spiral. One must also not forget how countries like China, Malaysia and Thailand, who opened their retail sector to FDI in the recent past, have been forced to enact new laws to check the profit expansion of the new foreign malls and hypermarkets. Given their economies of scale and huge resources, a big domestic retailer or any new foreign player will be able to provide their merchandise at cheaper rates than smaller retailer. But stopping an Indian retailer from growing bigger is something current public policy cannot do, whereas the State does have the prerogative in whether foreign entry in the retail sector should be stalled or not. It is true that it is a privilege for the individual consumer and it cannot, in any circumstance, override the responsibility of any society to provide economic security for its population. Clearly collective well-being must take precedence over individual benefits.

Merits of Foreign Direct Investment in India Retail Sector:

1) **Raising the Level of Investments:** Foreign investments in retail sector can fill the gap between desired investments and locally mobilized savings. Local capital markets are often not well organized and developed. Thus, they cannot meet the capital requirements for large investments projects. Besides, access to the hard currency needed to purchase investment goods not available locally can be difficult. Foreign Investments solves both these problems at once as it is a direct source of external capital.
2) **Up gradation of Technology**: F.D.I supplies a package of needed resources such as management experience, entrepreneurial abilities, organizational and technological skills. Foreign investment brings with it technological knowledge while transferring machinery and equipment to developing country. Similarly foreign owned enterprise comes into competition with local firms; the latter are forced to improve their technology and standards of product quality.
3) **Exploitation of Mineral Resources:** A number do understanding countries possessed huge mineral resources which await exploitation. These countries themselves do not possess the required technical skill and expertise to accomplish this task. Therefore they have to depend of foreign capital to undertake exploitation of their mineral wealth.
4) **Benefits of Consumers**: Consumers in developing countries stand to gain from foreign investment through new products and improved quality of goods at competitive prices.
5) **Development of Basic Economic Infrastructure:** Underdeveloped of developing countries requires huge capital investment for the development of basic economic structure as their domestic capital is often too inadequate. In such a situation, foreign investment plays a pivotal role in the development of basic infrastructure such as transport and communication system, generation and distribution of electricity, development of irrigation facilities and so on.
6) **Revenue to Government**: Profit generation by foreign investments in the host country contributes to corporate tax revenue in the latter.
7) **Improvement in Export Competitiveness**: Foreign investments help the host to improve its export performance. It has positive impact on host country export competitiveness by raising the level of efface.

Adverse Implications of Foreign Direct Investments

Foreign investments are not an unmixed blessings. Government in developing countries have to be careful while deciding on the magnitude, pattern and conditions of private foreign investments. The possible adverse effects of foreign direct investments are as follows:

1) The historically exploitative character of foreign investment as a partner of colonialism naturally arouses deep-rooted nationalist sentiments and suspicion.
2) The clue to direct investment lies not in the physical movement of capital from a developed country to a less developed country, but in capital formation in the latter through the local operation of a multinational corporations based in the former.
3) Foreign capital has been accused of an attitude of discrimination against employment of local nationals in high salary jobs and against local transport, insurance or credit organizations.
4) When foreign investments compete with home investments, profits in the domestic industries falls, leading to fall in domestic savings.
5) Foreign firms may influence political decisions in development countries.
6) The contribution of the foreign firm to public revenue through corporate taxes is comparatively less because of liberal tax concessions, investment allowances, designed public subsidies and tariff protection provided by the home government.
7) The cost of foreign capital for the host country tends to be very high. Such costly capital imposes a very severe strain on the host country's foreign exchange.
8) There is widespread belief that foreign capital is essentially interested in loco technology and high profitable consumer goods and not in technologically difficult, long gestation industries, which are of high priority from the point of view of host nation.

3. Recommendations

1) **Limited Bank Finance:** The retail sector in India is severely constrained by limited availability of bank finance. The Government and RBI need to evolve suitable lending policies that will enable retailers in the organized and unorganized sectors to expand and improve efficiencies. Policies that encourage unorganized sector retailers to migrate to the organized sector by investing in space and equipment should be encouraged.
2) Establishment of National Commission: A National Commission must be established to study the problems of the retail sector and to evolve policies that will enable it to cope with FDI as and when it comes.
3) 3-Conditionality of Giant Foreign Retailers: The proposed National Commission should evolve a clear set of conditionality on giant foreign retailers on the procurement of farm produce, domestically manufactured merchandise and imposed goods. These conditionality must be aimed at encouraging the purchase of goods in the domestic market, state the minimum space, size and specify details like, construction and storage standards, the ratio of floor space to parking space etc. Giant shopping centre must not add to our existing urban snarl.
4) 4-Social Safeguards: Entry of foreign players must be gradual and with social safeguards so that the effects of the labor dislocation can be analyzed & policy fine-tuned. Initially allow them to set up supermarkets only in metros. Make the costs of entry high and according to specific norms and regulations so that the retailer cannot immediately indulge in 'predatory' pricing
5) Improvement of Manufacturing Sector: In order to address the dislocation issue, it becomes imperative to develop and improve the manufacturing sector in India. There has been a substantial fall in employment by the manufacturing sector, to the of 4.06 laths over the period 1998 to 2001, while its contribution to the GDP has grown at an average rate of only 3.7%. If this sector is given due attention, and allowed to take wings, then it could be a source of great compensation to the displaced workshop from the retail industry.
6) Setting of Co-operatives: The government must actively encourage setting up of co-operative stores to procure and stock their consumer goods and commodities from small producers. This will address the dual problem of limited promotion and marketing ability, as well as market penetration for the retailer. The government can also facilitate the setting up of warehousing units and cold chains, thereby lowering the capital costs for the small retailers.
7) Establishment of Agricultural Perishable Produce Commission: Set up an Agricultural Perishable Produce Commission (APPC), to ensure that procurement prices for perishable commodities are fair to farmers and that they are not distorted with relation to market prices.

Recommendations for the Foods Retail Sector:
With 3.6 million shops engaged in retailing food and employing 4% of total workforce and contributing 10.9% to GDP, the food-retailing segment presents focused opportunity to the Government to catalyze growth & employment.

1) **Training**: Provision of training in training in handling, storing, transporting, grading, sorting, maintaining hygiene standards, upkeep of refrigeration equipment, packing, etc. is an area where ITI's and SISI's can play a proactive role.
2) **Infrastructure**: Creation of infrastructure for retailing at mantis, community welfare centre, government and private colonies with a thrust on easier logistics and hygiene will enable greater employment and higher hygiene consciousness, and faster turnaround of transport and higher rollover of produce.
3) **Quality regulation:** Quality regulation, certification & price administration bodies can be created at district and lower levels for upgrading the technical and human interface in the rural to urban supply chain.
4) **Credit Availability**: Credit availability for retail traders must be encouraged with a view to enhancing employment and higher utilization of fixed assets. This would lead to less wastage(India has currently the highest wastage in the world) of perishables, enhance nutritional status of producers and increase caloric availability.
5) **Integrating Long supply Chains**: Several successful models of integrating very long food supply chains in dairy, vegetable, fish and fruit have been evolved in India. These one off interventions can be replicated in all states, segments and areas. *Cross integrations* of these unique foods supply chains will provide new products in new markets increasing consumer choice, economic activity and employment.

Government Intervention: Government intervention in food retail segment is necessitated by
A) The lack of any other body at remote/ grassroots level.
B) Need to provide market for casual and distant self-employed growers and gatherers.
C) Maintain regulatory standards in hygiene.
D) Seek markets in India and abroad (provide charter aircrafts, freeze frying, vacuuming, dehydrating, packing facilities for small producers at nodal points)
E) Provide scope and opportunity for productive self-employment (since Govt. can't provide employment).

At a subsequent stage, these interventions can be integrated into the supply chains of the foreign retailers in India and abroad, creating synergy between national priorities, market realities, globalization, and private-public cooperation. In this fashion, the government can try to ensure that the domestic and foreign players are approximately on an equal footing and that the domestic traders are not at an especial disadvantage. The small retailers must be given ample opportunity to be able to provide more personalized service, so that their higher costs are not duly nullified by the presence of big supermarket and hypermarkets.

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