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A Review of the Impact of Foreign Direct Investment on Indian Retailing

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Abstract

Retailing is the largest private industry in India and second largest employer in the Indian economy. At present, India's retail sector is largely unorganized, with about 15 million tiny outlets. Organized retail is restricted to few cities and catering largely to a small portion of population. In spite of development in organized retailing and its immense contribution to economy, the growth of organized retailing in India has been much slower as compared to rest of the world and one of the major reason is that retailing is one of the few sector where foreign direct investment (FDI) is not fully allowed. Liberalizing flow of FDI into the retail sector has been a subject of active debate for a long time. This paper examines the global trends of FDI in retailing and its contribution in economic development. The paper reviews that post liberalization, FDI has stimulated the growth in different sector in India. The paper finds that FDI in retailing can be a powerful catalyst for development of organized retail and the fears being perceived by unorganized retail have no logical or historical base. The intense competition will have positive impact for all the stakeholders.
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Keywords: Foreign Direct Investment; Organized Retailing; Unorganized Retailing; Stakeholders; Economic Development

1.0 Introduction

Retailing is the largest private industry in India and second largest employer in the Indian economy. Comprising of organized and unorganized sectors, Indian retail industry is one of the fastest growing industries in India. India has witnessed a revolution in Retail Trade during the last two decades owing to rapid urbanization and changing consumption. This has led retailers to concentrate their energies and leverage their capacities to harness the potential. The entry of the leading corporate houses into retail created a surge into the growth of the industry. One of the most striking developments during the last two decades is the spectacular growth of FDI in the global economic landscape. foreign direct investment is integrating developing countries into the global economy, creating large economic benefits to both the global economy and to the developing countries themselves. FDI can be a powerful catalyst to spur competition in industries, characterized by low competition and poor productivity. Examples include the cases of consumer electronics in Brazil and India, food retail in Mexico, and auto in China, India, and Brazil. Since economic reforms initiated in 1991, Government of India has taken many programs to magnetize FDI inflows to improve the Indian economy. According to the Global Retail Development Index 2012, India ranks fifth among the top 30 emerging markets for retail. India is one of the most desirable retail destinations in the world. India's economic growth and demographic profile make it a perfect case for all global retailers to enter in India. A low penetration by organized market, big market which is growing at a healthy rate, a young population, increasing personal income, customer acceptance for new formats, are reasons for foreign retailers to enter this market provided FDI is permitted in the sector.The recent announcement by the Indian government with Foreign Direct Investment (FDI) in retail, especially allowing 100% FDI in single brands and 51% FDI in multi-brand, has created positive sentiments in the retail sector. The changing FDI climate has provided an interesting dynamic to several international retailers' entry and expansion plans for India. It has also raised a lot of concern over long term impact on various stakeholders. This article discusses that the intense competition will have positive impact for all the stakeholders.

2.0 FDI trends in India

Foreign investment is investment in an enterprise by a Non-Resident irrespective of whether this involves new equity capital or re-investment of earnings. Foreign investment is of two kinds – (i) Foreign Direct Investment (FDI) and (ii) Foreign Portfolio Investment.

FDI is defined under Dictionary of Economics as ―Investment in a foreign country through the acquisition of a local company or the establishment thereof an operation on a new site. It refers to capital inflow from abroad. It is a form of long term international capital movement, made for the purpose of productive activity and accompanied by the intention of managerial control or participation in the management of foreign firm.

International Monetary Fund (IMF) and Organization for Economic Cooperation and Development(OECD) define FDI similarly as a category of cross border investment made by a resident in one economy (the direct investor) with the objective of establishing a 'lasting interest' in an enterprise (the direct investment enterprise) that is resident in an economy other than that of the direct investor.

Indian companies can receive FDI under two routes [1].

1. Automatic Route – It does not require prior approval either of Reserve Bank of India (RBI) or government. It is allowed in all activities / sectors except where the provisions of consolidated FDI policy paragraphs as Entry route for investment issued by government of India from time to time is attracted.
2. Government Route –'Government Route'means that investment in the capital of resident entities by non-resident entities can be made only with the prior approval from FIPB, Ministry of Finance or SIA, DIPP as the case may be. FDI in sectors, not covered under automatic route requires prior approval of the government which is considered by Foreign Investment Promotion Board (FIPB), Department of Economic Affairs, and Ministry of Finance.

The table 1 shows that service sector has received maximum FDI since 2000.The table 2 presents that in the Indian scenario Trade or retailing is the single largest component of the Services Sector in terms of contribution to GDP. Its massive share of 14% is double the figure of the next largest broad economic activity in the sector.

Table 1. Ranking of Sector wise FDI inflow in India (April 2000- Dec 2010)

Rank	Sector	% of FDI inflow
1	Service Sector	32
2	Computer Hardware and Software	14
3	Telecommunication	12
4	Housing and Real Estate	11
5	Construction Activities	11
6	Power	6
7	Automobile Industry	6
8	Metallurgical Industry	4

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9	Petroleum and Natural Gas	3
10	Chemicals	1

Source: Fact sheet of FDI-DIPP (2010) [2].

Table 2. Components of Service Sector and contribution in GDP of India at factor cost (current prices)

Components	**2009-10***
Trade , hotels & restaurants	16.3
Trade	14
Hotels & restaurants	1.4
Transport, storage & communication	7.8
Railways	1
Transport by other means	5.2
Storage	0.1
Communication	1.5
Financing, insurance, real estate & business services	16.7
Banking & insurance	5.4
Real estate, ownership of dwellings &business services	11.4
Community, social & personal	14.4
Public administration & defence	6.3
Other services	8.1
Construction	8.2
Total Services (excluding Construction)	55.2
Total Services	63.4
Total GDP	100

Source: CSO

3.0 Retail trends in India

Retailing in India is one of the pillars of its economy and accounts for 14 to 15 percent of its GDP[3]. The Indian retail market is estimated to be USD 518 billion and one of the top five retail markets in the world by economic value. India is one of the fastest growing retail markets in the world, with 1.2 billion people.

India's retailing industry is essentially owner manned small shops. In 2012, larger format convenience stores and supermarkets accounted for about 8 percent of the industry, and these were present only in large urban centers.

India's retail and logistics industry employs about 40 million Indians (3.3% of Indian population) [4].The typical Indian retail shops are very small. Over 14 million outlets operate in the country and only 4% of them being larger than 500 sq ft (46 m^2) in size [5]. India has about 11 shop outlets for every 1000 people [6].

The figure 1 shows that the Indian retail industry has experienced growth of 10.6% between 2010 and 2012 and is expected to increase to USD 750-850 billion at CAGR of 18.6 % by 2015. The size of Retail industry was $ 424 billion which increased to $ 518 in 2012 and is expected to move to $ 869 billion in 2015 [7].

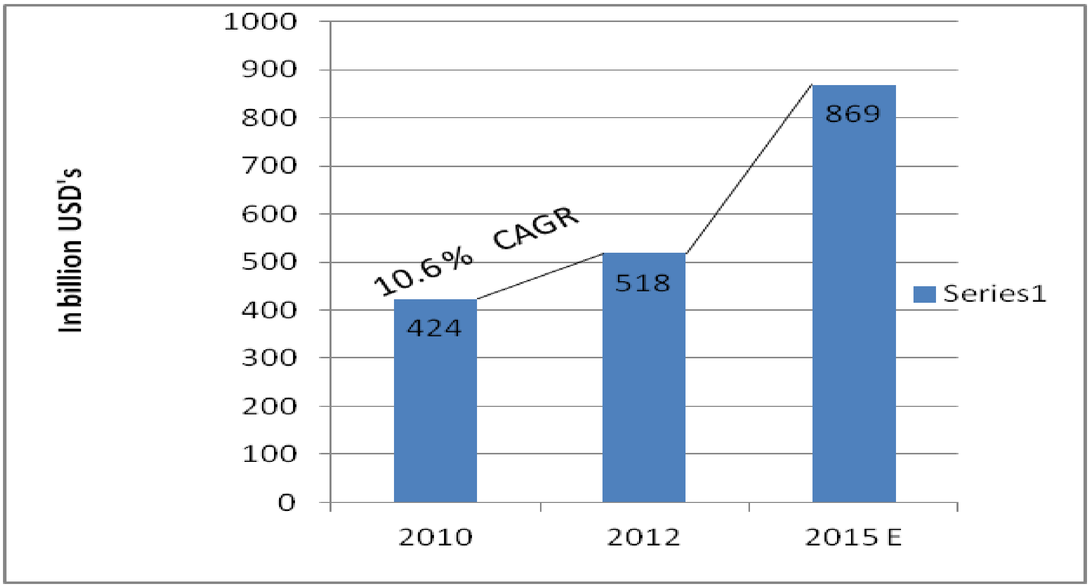

Figure1. Growth rate and size of Indian Retail market

Source: India Retail Report 2013, Images Group [8].
Note: For the purpose of above graph currency value for $1 is taken as INR 50 in 2010 and INR 55 in 2012 and 2015

Figure 2 presents that Food and Grocery is the largest category within the retail sector with 60 per cent share followed by Apparel at 8 % and Mobile segment at 6 %. The Food and Grocery segment is going to have major beneficiary of FDI decision in multi brand retail.

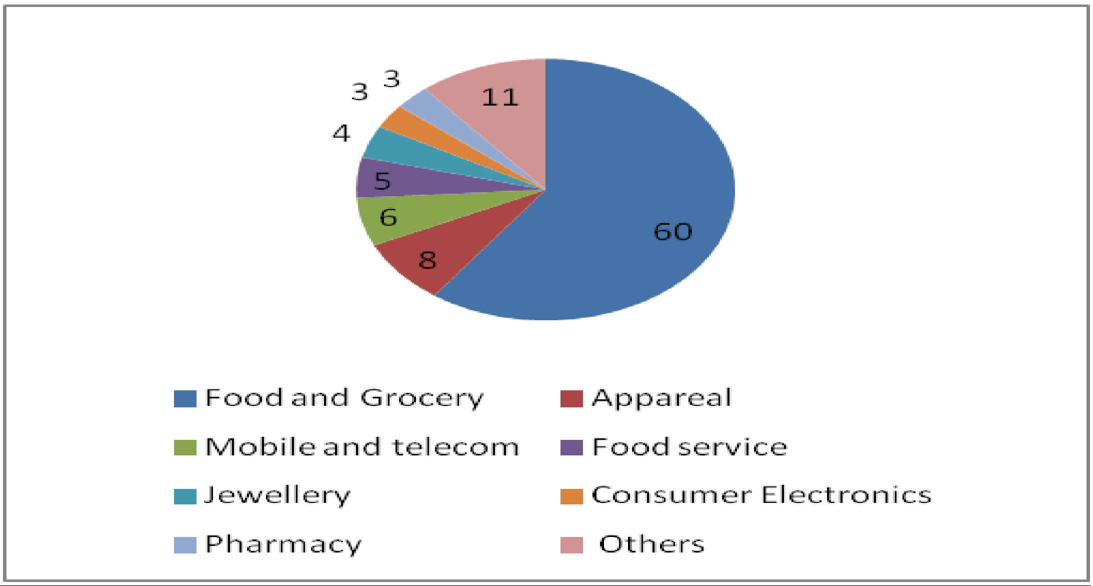

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Figure2. Category wise market share of retail- 2012

Source: India Retail Report 2013, Images Group

Note- For the purpose of above graph currency value For $ 1 is taken as INR 50 in 2010 and INR 55 in 2012 and 2015.

The retail industry is divided in to two parts i.e. organized and unorganized. Organized retailing refers to trading activities undertaken by licensed retailers, that is, those who are registered for sales tax, income tax, etc. 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 pavement vendors, etc. [9]. Table -3 depicts that unorganized market contributes around 92 % of retail trade. Figure 3 shows that apparel is the biggest category in organized trade followed by food and grocery in value terms.

Table3. Organised and Unorganised Trade in India

Year	Organised	Unorganised	Total	% Organised	% Unorganised
2006	13	301	313	4	96
2011	33	422	455	7	93

Source: Booz & Company analysis, FICCI, 2012 [10].

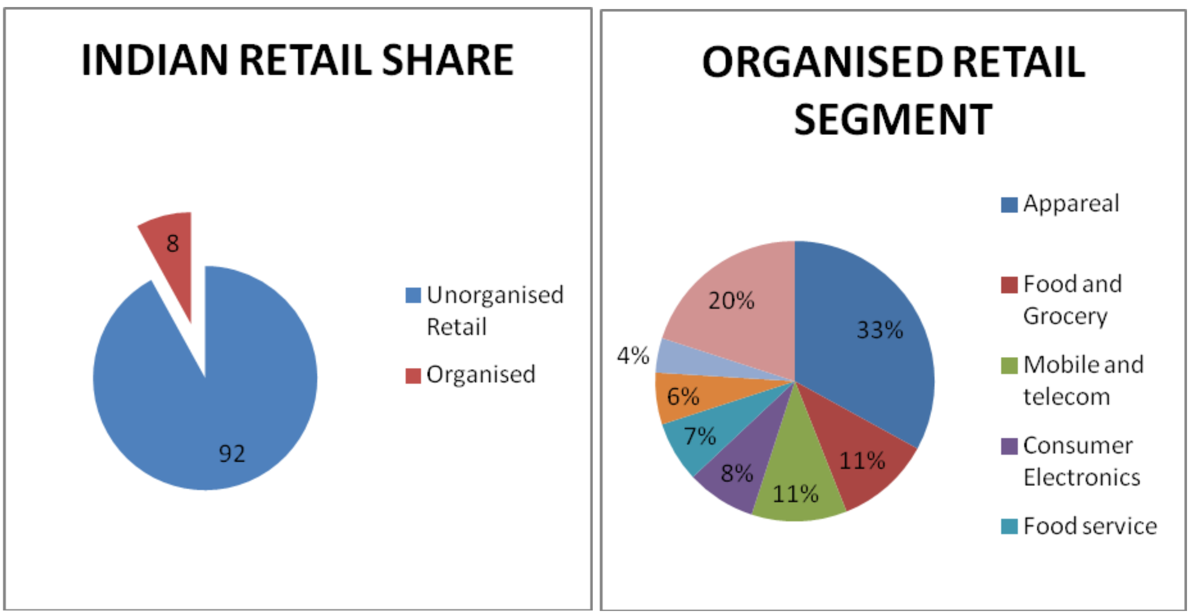

Figure3. Indian organised retail share and segment

Source: India Retail Report 2013, Images Group

3.1 Retail trend in India and South East Asia

The table-4 shows the quantum of trade in India and South East Asia in organized and unorganized retail. From the table it is clear that India occupies first place in the unorganized retail trade and there is ample scope of converting it to organized trade.

Table 4. Quantum of retail trade

	Organised Trade	Unorganised Trade
India	6	94
China	20	80
Indonesia	30	70
Thailand	40	60
Malaysia	55	45
Taiwan	81	19

Source: Booz & Company analysis, FICCI, 2012

3.2 Challenges in Indian retail market

While India presents a large market opportunity given the number and increasing purchasing power of consumers, there are significant challenges as well given that over 90% of trade is conducted through independent local stores. Some of these challenges are:-

- Geographically dispersed population,
- small ticket sizes,
- complex distribution network,
- little use of IT systems,
- limitations of mass media and
- existence of counterfeit good

4.0 FDI in retail in India

There have been slow but steady changes taking place on FDI front in India. FDI was initiated around the year 2005 by Government of India. It was around 1990 when the modern retailing process started gradually in India. Initially Government of India had allowed 100% investment in the cash and carry or wholesale trading. The single brand retailing in 2006 was initially restricted to 51% but later it was allowed up to 100% subject to 30% sourcing from within India. Since last few years we had been emanating discussion towards multi-brand retailing and presently, 51% investment in multi-brand retail is permitted but it is left to the discretion of the State Governments to finally implement it in the respective states of India.

With the recent changes in FDI in retail the current regulation is summarized as following:

- Single Brand Retail
    - 100% FDI with 30% local sourcing (average over five years at cost)
    - 51% FDI with no sourcing requirements

- Multi-Brand retail
  - 51% FDI permitted, in cities with population >1Mn
  - 30% sourcing from MSME mandatory, along with capital and supply chain investment requirements
  - Dependent on approval by individual state; 18-20 cities with > 1Mn population
- Cash & Carry
  - 100% FDI permitted

5.0 International experience of FDI in retail

FDI is permitted in the retail sector in Brazil, China, Argentina, Singapore, Indonesia, China, and Thailand without limits on equity participation.

- **China**

China introduced 26 % FDI in retail sector in 1992, restricted to few areas initially. The foreign ownership restrictions have progressively restricted by Dec., 2004. Some of the changes that have taken place in China are

- Over 600 supermarkets were opened between 1996 to 2001
- The no of small outlets increased from 1.9 million to 2.5 million.
- Chinese retailers dominate the market in retail industry.
- The FDI has increased market consolidation and production efficiency
- Investment in rural infrastructure has increased.
- Employment has increased from 4 5 to 7 % in total labor force from 1992 to 2001.

- **Thailand**

100 % ownership in retailing with no limits on ther number of outlets was introduced in 1997 in Thailand. It is one of the countries where FDI ahs negative impact on small family run stores.

- development of organized retailing has made it one of important shopping destination
- Agro processing industries have developed very fast and led to increase in export of Thai made goods through network of foreign retailers

- **Chile**

The Chilean supermarket sector is a case of a take-off driven by domestic capital followed by nascent multinationalization, followed by abrupt “demultinationalization”. Today the three market leaders are expanding rapidly into other Latin American countries and becoming regional multinationals.

- **Indonesia**

Indonesia permits 100 % foreign equity in retail business, with no limit on the no of outlets since 1990. It also does not impose any capital requirement.

- Domestic retail chain Matahari is dominant player.
- 90 % of fresh food and 70 % of all food is in traditional retailers
- No abuse of dominance form forign retailers
- Induatrial competetiveness ahs increased due to FDI

- **Brazil**

Research on the impact of big players on small retailers in Brazil indicates that since its opening up to the FDI in 1994, the traditional small retailers managed to increase their market share by 27 % (report of CUTS International) .

The rise in market share came about when they were able to increase their productivity by adopting better technology and give a tough competition to forign firms [11].

6.0 FDI in Indian organised retailing: impact on stake holders

The major objections to FDI in Multi brand retail are:

- Foreign retailers will kill local industry leading to closure of small retail shops.
- FDI may lead to unfair co competition and ultimately result in large-scale exit of incumbent domestic retailers. Domestic organised retail sector is an infant industry, still under-developed and in a nascent stage.
- Single foreign entity may become a dominant player, because of unlimited capital and expertise.
- Closure of independent retail will lead to massive job losses.
- It is detrimental to farmers as foreign retailers will try to procure at lowest possible rates.
- Big players like wall mart will lower prices to dump goods, get competition out of way and will become monopoly.

These doubts or objections does not hold ground totally when we see the retail industry development across the world and also our own experience in the country.The FDI issues need to be understood in relation to Indian Retailing landscape through table -5.

Table 5. Indian retail landscape

PARTICULAR	2001	2012	2021
GDP ($ Billion)	450	1958	3310
Estimated Merchandise Consumption 9in $ Billion) (Retail Market Opportunity)	120	490	810
Share of Independent Retail($ Billion)	115	455	648
No. Of Direct Employees in Independent Retail(Mn)	18	22	31
Share of Modern/corporate Trade	~4	~7	~20
Size of Corporate Retail in $ Billion	5	34	162
No of Direct Employees in Corporate Retail (Mn)	0.1	0.7	3.3

Source- Technopak Analysis [12].

Indian Retail has witnessed sustained growth in merchandise retail in the last decade. Going forward Indian economy will continue to grow at a modest rate of 6 % in next decade also despite all uncertainty and slowdown associated with Indian Economy.

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Urban India's share in merchandise retail will continue to grow due to rapid urbanization witnessed in last 2 decades and will continue further in coming decade. Many new towns and sub centers will come and dependence on agriculture will come down below 50%. Today we have 53 indian cities with 1 million + population. In 1991 this no was 19 only and in 1951 there were only 5 cities. Unorganized trade will also grow though at lesser growth rate as compared to organized trade but in value terms growth will be healthy.

The share of organized retail will grow to not more than 20 % of the total retail merchandise retail by 2021. Presently, share of organized retail stands at 7 % despite the private investment from domestic and international players (to the extent allowed) since last 15 years.

6.1 Unorganised/ organised trade retailers

The retail pie is large enough for everyone to get a slice [13]. Though organized retail will grow at much faster rate of 20% + rate, but unorganized trade will also see a very good growth in value terms. The experience of other developing countries indicates that the presence of foreign retail and consumer Companies contributes to building a new middle class, which drives economic success, prosperity and social progress for all.

The impact are:

- Overall increase in consumption
- Opportunities to improve operational efficiencies
- Potential Migration of customer bases
- Larger cost effective suppliers base for Indian Organised players
- Access to new technology,capital infusion from PE plasyer and international retailers

There is no evidence that the huge investments have hurt mom-and-pop operations or domestic retail chains in China [14]. Since 1992 it has attracted huge investments in the retail sector without affecting either small retailers or domestic retail chains. In fact, since 2004 the number of small Chinese outlets has increased to around 2.5 million from 1.9 million. It is because the market is so large and growing so quickly that even today, hypermarkets, convenience stores and other examples of organized retail make up less than half of the urban food market. After 20 years of FDI, unorganized market is 80 % of total retail merchandise in China.

In China, unorganized retail, represented by street vendors and neighborhood "community retailers", has continued to thrive, offering cheaper prices than supermarkets and retail chains [15]. Small retailers in India have inherent advantages. They are located next to the consumer, making it convenient for top-up purchase. They know them well, some even by name. They give credit too - which no large retailer does. Their fixed costs are so low that their breakeven point is as low as 46% of sales. Level of threat, if any to small retailers from an international retailer, will be the same as the one from a domestic retailer.

Figure 4 clearly shows that consumption increases as a result of organized player and share of unorganized players is not impacted significantly.

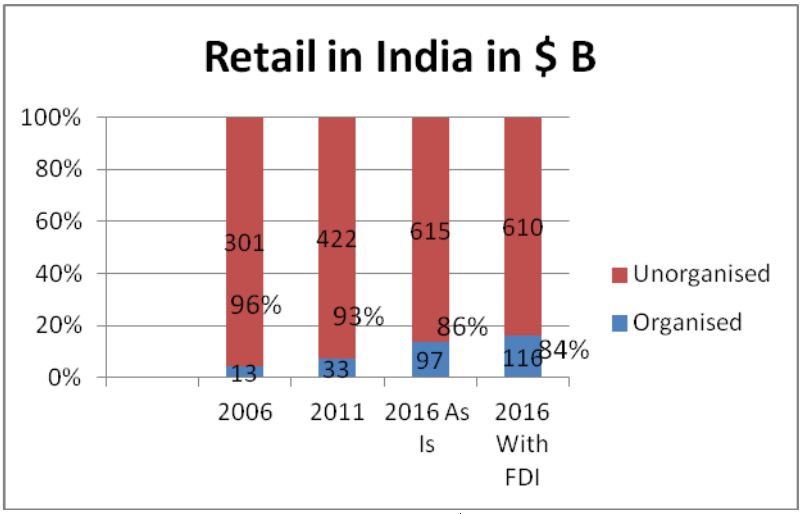

Figure 4. Retail in India in $ B

Source : Booz & Company analysis, FICCI,2012
Note : Projections assume a 30% market penetration of organized retail in 18 cities amenable to FDI and a 13% market penetration of organized retail in the Rest of India

Secondly retail is a local play. Over a period of time many Indian companies will manage a healthy share of retail trade. An analysis of the extent of globalization of the world's leading retailers also brings out the fact that retailing is essentially a local play [16]. Table- 6 compares the share of sale of above retailers in domestic and international marlket. Despite the long globalisation journey, the major sales are coming from domestic market only . The key inference is that expanding retail beyond domestic market is very challenging and no one can dominate the market. It is not easy to replicate a successful model in amother market.

Table 6. Total Revenue of World Top Retailers in 2011

Name Of Company	Revenue 2011 ($bn)	Home Country	Share of Revenue From Home Country (%)	Share of International market	Operation in No of Countries(apart from Home Country)
Walmart	421	USA	74	26	26
Carrefour	120.3	France	43	57	32
Tesco	94	UK	68	32	13

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Metro AG	89	Germany	39	61	31
Costco	78	USA	70	30	7
Home Depot	68	USA	88	12	2
Targer	67.4	USA	100	0	0
Aldi	58	Germany	65	35	16

Source- Technopak Analysis[s]

Data from different countries country (Table 7) indicate that the share of smaller stores would remain to be large, with no large retailer having a dominant market share. Large retailers must learn to co-exist and may have to help them modernize. It is also imperative for government to create policies that help smaller retailer improve their performance.

Table 7. Retail Brand Share : % Value of 2008-2011

CHINA		Malaysia	
Suning	1.1	Giant	4.0
Gome	1.0	Tesco	3.10

T mall	0.7	Jusco	2.50
RT Marts	0.6	Carrefour	1.70
Others	92.2	Others	74.7
Taiwan		Chile	
7- Elevan	4.30	Hipper di Lider	7.50
Shin Kong Mitsukoshi	2.70	Sodimac	5.90
PX Mart	2.20	Falabella	4.90
Others	75.60	Others	45.50
Mexico		Russia	
Sam’s Club	3.40	Pyaterochka	4.0
Walmart	3.0	Magnit	3.0
OXXO	2.70	Eldorado	1.2
Others	72.2	Others	82.90

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UK		Japan	
Asda	6.10	7-Elevan	3.0
Sainsbury's	5.90	AEON	2.40
Morrisons	4.40	Lawson	1.70
Others	58.40	Co-op	1.30
		Others	80.20

Source: AITM,2012 [17].

6.2 Government

There is a positive relationship between the increase in tax receipts and the increasing share of corporatized retail. Modern trade players are tax-compliant and are large tax-payers. The organised retail sector also facilitates the generation of significant tax revenues through the building of a sophisticated supply chain. This impacts the logistics, transportation, warehousing, freight forwarding and other similar service sectors, all of which contribute to the exchequer through payment of indirect taxes, primarily the service tax. Also direct tax receipt like income tax will also increase as large no of employees engaged in this stream will get salaries/benefits in transparent way as per laws and rules of employment. FDI in retail will increase tax revenues (in form of VAT etc.) nearly fivefold, from the current annual $ 3.4 billion to $ 8 billion in next five years to $ 16.2 billion, by 2021 .
It is expected that FDI investment will be between a conservative estimates of $ 5-6 billion (FICCI) to $ 10 billion (CRISIL Research Estimate) over the next five years . In addition to this sourcing by global retailers from India will improve BOP. So the major gains for the Government are -

- Improvement in Balance of Payment
- Surge in employment opportunities
- Higher Tax collection

6.3 Farmers/Rural India

India is predominantly an agricultural economy; the share of agriculture to India's GDP is only about 25%. India is among the top two producers of milk, fruits and vegetables in the world. Yet, the organized food retail business in the country is among the least developed in the world. If one looks at the Indian food chain, from the farm to the fridge, distribution of most food items involves multiple intermediaries, high cycle times and wastage during transportation and storage. A large chunk of fresh fruits and vegetables is lost because of inadequate post-harvest handling, cold storage, processing facilities and convenient marketing channels. Existing intermediaries cause delays and eat up a large portion of the earnings that essentially belong to the farmer. The result is a chain replete with inefficiencies. The variation between the price at which the produce is sold by the farmer and the price, at which it was bought by the ultimate consumer, varies widely from 24% to 58%. According to some reports, Indian farmers realize only 1/3rd of the total price paid by final consumer, against 2/3rd by farmers in nations with a higher share of modern retail.

With the growth of organised retailing, new supply chain structures using global technologies and best practices and offering customised product and services will be the order of the day minimising wastage at each stage of the supply chain through improvements in handling, packing, transportation and storage. This will help in

- non-agricultural employment to rural youth
- Direct farm initiatives shall also provide better remuneration to farmers- will educate farmers in improving yield and crop selection as per end consumer's requirement.
- Reduction in wastage/leakage owning to better back-end infra
- Establishing freely accessible information platforms for a transparent brokerage of prices and qualities of agricultural products.
- Better Price realization due to disintermediation in supply chain/ Direct Farm Initiative
- Improvement in food and hygiene levels.

6.4 Manufacturer/SME

With clause of 30 % sourcing from MSME mandatory, a precautionary approach has been taken to safeguard and promote MSME sector. The presence of global retailers in the Indian market will enhance sourcing and exports from India, as retailers develop and leverage relationships with local suppliers. Once the supplier relationship is established and proves to be viable, these retailers can source for their global operations from India. Foreign players are better able to provide access to export markets through their global distribution networks, market position and brands.

The impacts on MSME are:

- Sourcing large volumes from MSME
- Growth in Export Opportunities
- Overcoming marketing weaknesses of SSIs by developing branding skill in SSIs through partnering, demanding product development skills from SSIs for private label exclusivity
- Improvement of quality standards through enforcement of quality production standards on SSIs, thus enabling them for exports (such as RFID compliance)
- Imports from other low cost manufacturing countries

In recent survey done by CII among SSI units, it is found that 98 % SSI units are optimistic on the positive impact of FDI on growth in ale and impact on size whereas 56 % see improvement in quality whereas 68 % sees improvement of efficiency [18].

6.5 Consumers

Mega retail chains need to keep price points low and attractive, that is the USP of their business. This is done by smart procurement and inventory management, good practices from which Indian retail can also learn. There is no dispute that modern trade will help the customer in getting all above benefits [19].

- Lower prices compared to unorganised retail
- Better shopping option and experience
- Merchandise choices and assortment

- Food safety , Better hygiene and quality

6.6 Society

Instead of job losses, retail reforms are likely to be massive boost to Indian job availability with improved working conditions. Over 80 % of employment opportunity will be for people with minimum qualification. These jobs will offer better salaries, work environment, social security as compared to unorganized trade.

- Employment generartion
- Indirect employment-
- Potetial –ve impact on employment, on intermediaries
- Better salaries
- Defined career path
- Better work environment

Due to typical Indian retail straucture , the share of organised trade can not go beyond 20 % in next decade. Secondly there will be growth of unorganised trade also. The employment in organsied trade in last decade has not grown at the cost of employment in unorganised trade. The unorganised trade has added 4 million jobs in last decade.The employment generation is not a zero sum game.

In China FDI in retail was permitted in 1992 and between 1992 to 2001 employment in retail and wholesale sectors incraesed from 28 million people to 54 million people with corresponding increase in unorganised retailers from 1.9 million to over 2.5 million outlets. In this period over 600 hypermarkets have opened in the country (captured 20 % retail share) .

7.0 Conclusion

FDI has proved to stimulate growth and development of the countries. In addition to direct capital financing, FDI can be a source of valuable technology and know-how while fostering linkages with local firms, which can help jumpstart an economy. In order to promote competitive markets, restrictions on FDI must be reduced. FDI's potential for impact can be greater because of the combination of scale, capital, and global capabilities which allow MNCs to close existing large productivity gaps more aggressively.

The Indian retail industry is witnessing large and far reaching changes in last 2 decades of development. Many big Indian corporate have already build significant businesses in different format and sectors of retail. The modernization process started by modern retailers has made positive impact on independent retailers who have also upgraded in terms of assortment, delivery and ambience.

The concern about the competition to domestic companies, monopolization of market, loss of employment, procurement of produce from farmer at low price have been addressed properly through provisions in the scheme announced on FDI in retail . The international experience of FDI in retail and our own retail condition shows that doubts and rhetoric associated with the opposition of FDI need to be analyzed in proper perspective. Our regulatory system is strong enough and capable of handling most of the doubts associated with it. Government should facilitate the FDI so that we get maximum benefits of FDI that outweighs the losses we may suffer.

With the right vision, and the right policies, there is no reason to believe that a progressive and healthy retail ecosystem would not support various forms of retailers including the street vendors, independent small grocers and other retailers, medium size modern independent retail outlets, and corporatized retail behemoths. This dynamic and vibrant retail eco system can be developed through these policies which are going to beneficial to all stakeholders and will remove efficiency and make this industry more productive and competitive.

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