FDI IN RETAIL SECTOR:
OPPORTUNITIES AND CHALLENGES

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I. INTRODUCTION

Retailing in India is one of the pillars of its economy and accounts for 14 to 15% of its GDP. The Indian retail market is estimated to be US$ 450 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 2010, larger format convenience stores and supermarkets accounted for about 4% 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).

Until 2011, Indian central government denied foreign direct investment (FDI) in multibrand retail, forbidding foreign groups from any ownership in supermarkets, convenience stores or any retail outlets. Even single-brand retail was limited to 51% ownership and a bureaucratic process.

In November 2011, India’s central government announced retail reforms for both multi-brand stores and single-brand stores. These market reforms paved the way for retail innovation and competition with multi-brand retailers such as Walmart, Carrefour and Tesco, as well single brand majors such as IKEA, Nike, and Apple. The announcement sparked intense activism, both in opposition and in support of the reforms. In December 2011, under pressure from the opposition, Indian government placed the retail reforms on hold till it reaches a consensus. In January 2012, India approved reforms for single-brand stores welcoming anyone in the world to innovate in Indian retail market with 100% ownership, but imposed the requirement that the single brand retailer source 30% of its goods from India. Indian government continues the hold on retail reforms for multi-brand stores. Given India’s large population and rapidly expanding middle-class, there is robust and growing demand and a rapidly expanding market. In this paper we argue that opening up FDI in India to multi-brand retailers from abroad may be a catalyst to growth and the development of the retail industry, with positive externalities for the rest of the economy.

II. THE HISTORY OF RETAILING RESTRICTIONS

The retail sector in India is organized into three categories.

According to the Department of Industrial Policy and Promotion (DIPP) of the Government of India

1) Single-brand retail comprises those retailers selling products “of a ‘single brand’ only, such that products should be sold under the same brand internationally; and single-brand product retailing covers only products which are branded during manufacturing.

2) Multi-brand retail category.

This includes all firms in organized retail that seek to stock and sell multiple brands, such as large international retailers like Wal-Mart and Carrefour. This is the sector that is most under dispute.
3) ‘cash and carry’, refers to wholesale retail.

The government defines this segment as the “sale of goods and merchandise to retailers, industrial, commercial, institutional or other professional business users or to other wholesalers and related subordinated service providers”. In India, FDI of 100 per cent is permitted in this segment.

In India, the wholesale and retail entities are maintained as separate entities without any cross-shareholdings. The retail entity is owned and controlled by the Indian partner while the wholesale entity can be owned by the foreign partner up to 100 per cent. Wal-Mart, for example, has already established a successful presence in this category of wholesale operations by entering into a joint venture with Bharti Enterprises Ltd. of India. The new entity, Bharti-Wal-Mart, is in operation with stores opening around the country.

Present Position

Foreign Direct Investment (FDI) is prohibited in retail trading, except in single-brand product retail trading, in which FDI, up to 100%, is permitted, under the Government route, subject to specified conditions.

Revised Position

The Government of India has reviewed the extant policy on FDI and decided to permit FDI, up to 51%, under the Government route, in Multi-Brand Retail Trading, subject to specified conditions.

Accordingly, the following amendment is made in ‘Circular 1of 2012- Consolidated FDI Policy’, issued on 10.04.2012, by the Department of Industrial Policy & Promotion:

Prohibited Sectors

FDI is prohibited in:

- (a) Lottery Business, including Government/private lottery, online lotteries, etc.
- (b) Gambling and Betting, including casinos etc.
- (c) Chit funds
- (d) Nidhi company
- (e) Trading in Transferable Development Rights (TDRs)
- (f) Real Estate Business or Construction of Farm Houses
- (g) Manufacturing of Cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes
- (h) Activities / sectors not open to private sector investment e.g. Atomic Energy and Railway Transport (other than Mass Rapid Transport Systems).

Foreign technology collaboration in any form, including licensing for franchise, trademark, brand name, management contract, is also prohibited for Lottery Business and Gambling and Betting activities.”

Advantages Of FDI In Retail

Opportunities

Indian companies are exporting different types of products to numerous retailers across the globe. However the common belief is that there is a difference in the quality of the products sold to foreign retailers and the same products sold in the Indian market. Higher disposable incomes for Indians enable them to go for quality and “one-stop shop” destinations which will have a wide range of different products.

Opening of the retail market would change the pricing and the monopoly of certain domestic Indian companies will be challenged. Ultimately, the consumers will benefit from lower prices due to tough competition in the market.

Benefits for the Farmers

The food and packaging industry will get an impetus. India has a very limited integrated cold-chain infrastructure. This causes heavy losses to farmers in terms of quality and quantity of produce in general. The new reforms are expected to bring together the fragmented supply chain infrastructure. Extensive backward integration by multinational
retailers, coupled with their technical and operational expertise, can hopefully remedy such structural flaws. Also, farmers can benefit with the “farm-to-fork” ventures with retailers which helps
   (i) to cut down intermediaries ;
   (ii) give better prices to farmers, and
   (iii) provide stability and economics of scale which will benefit, in the ultimate analysis, both the farmers and consumers.

Improved Technology and Logistics

Improved technology in processing, grading, handling and packaging of goods and the recent developments like electronic weighing, billing, barcode scanning etc. could be a direct consequence of foreign companies opening retail shops in India,. Transportation facilities through refrigerated vans and pre cooling chambers can bring down wastage of goods.

Real-Estate Development

Retail shops of multinationals require substantial spaces for setting up business.

Real estate in India has gone through a revamp due to the demand of high-end retail malls. Thus real estate is expected to receive more investment with the opening up of FDI in multi-brand retail.

Retail Sector Growth in India

The data from private consulting company reports suggest that growth in the retail market has been rapid despite major restrictions on FDI. In the third-quarter report of 2010, the BMI India Retail Report forecasts that the total retail sales will grow from US$ 353 billion in 2010 to US$ 543.2 billion by 2014. Global Retail Development Index of 2009 has rated India highest four times in the last five years.

According to McKinsey, a research and consulting firm, organized retail in India is expected to increase from 5 per cent of the total market in 2008 to 14-18 per cent of the total retail market and reach US$ 450 billion by 2015.3

Even if growth is more conservative than estimated, the spill-over effects of this rapid expansion could be felt by many other sectors of the economy. A report published by Knight Frank India in May 2010 looks at the question of land and available retail space. It estimates that, during 2010-12, around 55 million square feet of retail space will be ready in the major cities like Mumbai, between 2010 and 2012, the organized retail real estate stock is expected to grow from the existing 41 million square feet to 95 million square feet.4 Arguably, this could drive up real estate prices, with consequent knock-on effects.

Concerns about Opening up Indian Retail

1. The entry of large global retailers such as Wal-Mart would kill local shops and millions of jobs.
2. 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.
3. It would lead to lopsided growth in cities causing discontent and social tension elsewhere.

A number of issues have been raised regarding the opening up of the retail sector for FDI in India.

The first concern is the potential impact of large foreign firms on employment. Retail trade employed 7.2% of the total workforce which translates to 33.1 million jobs (DIPP Report, 2010). The share of retail employment has risen significantly for both males and females, in rural, and in urban areas.

Secondly unfair competition may ultimately result in large-scale exit of incumbent domestic retailers. Given the large unorganized component of the retail sector Kalhan (2007) highlights how small shops in Mumbai are adversely affected by shopping malls in the city. Moreover the organized retail may not be able to absorb the displaced labourers from these small shops.
The third concern is regarding infant industry argument: the Indian domestic retail sector is under-developed and in a nascent stage. So wouldn’t it be ideal that the domestic retail sector grow and consolidate first, before opening up.

However, the experience of organized retail in other parts of the world does not always bear this out. With respect to the impact of entry by big-box stores such as Wal-Mart on retail employment and earnings, evidence from the United States is mixed. Using county-level data, a recent study finds that Wal-Mart entry increases retail employment in the year of entry (Basker, 2005a) while contrasting evidence indicates that each Wal-Mart worker replaces approximately 1.4 retail workers representing a 2.7 percent reduction in average retail employment (Neumark, Zhang and Ciccarella, 2008). Yet other work on Wal-Mart expansion suggests that store openings reduced both average earnings of retail workers (Dube, William and Eidlin, 2007). Recent evidence also suggests that having a chain store in a market makes roughly 50% of the discount stores unprofitable and that Wal-Mart's expansion over the 1990s explains about 40–50% of the net reduction in the number of small discount stores (Jia, 2008).

The retail experience in Thailand furthers this concern. Sarma (2005) chronicles how traditional shopkeepers continued to suffer even when the Thai economy recovered, after the Asian crisis of the late 1990s.

The UK Competition Commission found in a 2000 study of major retail chains including Marks & Spencer, Sainsbury and Tesco that “the burden of cost increases in the supply chain has fallen disproportionately heavily on small suppliers such as farmers.” Supermarkets requirement for large volumes of each product actually pushes farmers to grow single crops rather than the multiple produce they would usually grow to minimise risk. Supermarkets chains sell some products at lower than market prices, Though it benefits consumers, it puts pressure on small local stores. It also adversely affect low-income and elderly consumers who rely on local shops. Supermarkets “price-flexing” works to the disadvantage of local mom-and-pop stores. Guruswamy et al (2005) argue that firms with deep pockets are able to bear sustained losses, eventually forcing higher cost businesses (“small and dispersed competition”) out of business. This has a large effect on employment too.

The share of fresh produce retail in supermarkets, as opposed to from so-called ‘wet markets’ has also increased substantially.

The Food and Agriculture Organisation concluded that organized retail increases pressure on farmers to produce standardized produce, pushes down prices and margins, and over time weeds out larger numbers of smaller suppliers in favour of fewer and larger “preferred suppliers”.

**Benefits of FDI and Competition**

The growth of retailing has the potential to impact the performance of interlinked sectors such as manufacturing of consumer goods and agriculture-based industries.

1. **Lowering Inflation and Food Prices**

Evidence from the United States suggests that FDI in organized retail could help tackle inflation, particularly with wholesale prices.

Recent studies 1) using average city-level prices of various consumer goods, price dynamics in 165 US cities before and after Wal-Mart entry suggest robust reduction in prices for several products while magnitudes vary by product and specification, but generally range from 1.5–3% in the short run to four times as much in the long run (Basker, 2005b) with significant increases in consumer surplus especially for lower income households (Hausman and Ephraim, 2007).

2) Wal-Mart decreases prices by 6%-7% for national brand goods and by 3%-8% for private label
goods. Price decreases are most significant in the dry grocery and dairy departments. Moreover, Wal-Mart sets grocery prices significantly lower than its competitors (Volpe and Lavoie, 2008).

3) Hausman and Leibtag (2004) also argue that estimates using their new approach shows lower domestic food inflation by about 0.32 to 0.42 percentage points, in turn lowering the estimated inflation rate by about 15% per year (Hausman and Leibtag, 2004).

In India, Inflation is a politically sensitive subject and the fact that the weight of food in rural and agricultural Indian household consumption baskets is approximately 65-70% and the impact on inflation reduction could therefore be significant.

Improving Distribution and Warehousing Technologies

It is expected that warehousing technologies and distribution systems will lend itself to improving the supply chain in India, especially for agricultural produce. Multiple inefficiencies in the supply chain leads rotting or wastage of stockpile in India is the world’s second largest producer of fruits and vegetables in the world after China, producing around 180 million tonnes per year. Official estimates are that about 25-30 per cent of this produce goes waste between harvest and consumption.

Encouraging wholesale trading can create demand throughout the supply chain.

If fresh produce is collected efficiently at the farm-gate, and end-to-end cold-chain is maintained in storage and transportation till it reaches the consumers this wastage can be eliminated. Creating better linkages between demand and supply will reduce the uncertainty arising out of price signal lags. DIPP’s discussion paper points out that the farmers get just a third of the total price paid by the final consumer, as against two-thirds realized by farmers in nations with a higher share of organized retail. FDI in retail, therefore, could be an efficient way of addressing concerns of farmers and consumers (DIPP Report, 2010).

A recent study notes that each of the world’s largest retailers— Wal-Mart, Carrefour, Tesco, and Metro— entered China after 1995 and that their subsequent expansion in China may have influenced Chinese exports through bilateral exports between the retailers’ operations and city-level exports to all destinations may have grown if multinational retailer presence enhanced the general export capabilities of local suppliers.

Employment Effects

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

Challenges for Foreign Firms in Organized Retail

- Competition from the unorganized sector. Traditional retailing shops develop strong networks with local neighborhoods. The informal system of credit adds to their attractiveness. Low labor costs also allow shops to employ delivery boys, such that consumers may order their grocery list directly on the phone.

- The storage setup of households. Congested urban living conditions imply that few Indian households might be equipped with adequate storage facilities.

- Retailers looking to set up large stores at a distance from residential neighbourhoods may struggle to attract consumers away from their traditional sources of groceries and other products.
III. CONCLUSION

In this paper, we argue that the potential benefits from allowing large retailers to enter the Indian retail market may outweigh the costs. Various studies and country evidences have been explained to prove the point. However, the opening of the retail sector for FDI has its own consequences which have to be analyzed carefully before we realize it.

IV. REFERENCE

1) Department of Industrial Policy and Promotion, 2010. “Foreign Direct Investment (FDI) in Multi-


