FDI in Retail Is the Need of the Hour

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Abstract- **FDI in retail is a much debated topic in present times. There are numerous arguments and counter-arguments on this issue. We must set aside personal and political interests and dwell on larger perspective. Taking into consideration the times when we are presently living, is it possible for any country or economy to survive without adopting the measures related to liberalization and globalisation? An economy needs to integrate itself with the world economy in order to be part of competitive business world. The Indian government needs to pull up its socks and bring about bolder measures in order to stop the downhill movement of economy. Retail reforms are one such measure which would prove beneficial for the economy. This paper highlights that the Indian Government's decision allowing 100 percent FDI in single brand retail and 51 percent FDI in multi-brand retail is a welcome and positive move. Many business groups, consumers and farmers are welcoming the transformation of a long protected sector that has left Indian shoppers bereft of the scale and variety of their counterparts in more developed markets. The traditional distribution channels adopted by businesses are being transformed and slow counterrevolution is taking place in the retail sector. Organised retailing with its share of 4 percent in the retail trade is still in the nascent stage. Opening up of retail sector would bring in big global retailers, which would increase percentage of organised retailing thereby changing the traditional retail trade. Organised retailing would bring about reduction in middlemen, improved logistics and supply chain management, better prices for farmers as well as reduced cost for consumers. Indian government is cautious about protecting its domestic retailers from foreign giants by including certain riders like certain percentage of manufacturing product needs to be procured from SME sector and at least certain percentage of job needs to be reserved for rural youth. FDI would lead to a more comprehensive integration of India into worldwide market and, as such it is imperative for the government to promote this sector for the overall economic development and social welfare of the country. If done in the right manner with precautionary measures, it can prove to be blessings not curse.**

Keywords: Retail, FDI, Liberalization, Globalization, Organized retailing, Integration, Economy.

1. INTRODUCTION

Indian economy cannot remain untouched by the sweeping winds of globalization which has integrated economies throughout the world. FDI (Foreign Direct Investment) is an important ingredient of the globalization effort of the world economy. Liberalization of the economies has taken place leading to investment opportunities in various countries. Countries are in need of capital which would be available with the help of FDI. Governments throughout the world in both developed and developing nations have been attracting MNCS to come to their countries with their FDI. Since 1990's export and economic growth has gained attention among policy makers.

The 'Investment led Economic Development' has become the order of the day, thereby promoting the idea that the outward and inward FDI position of a country is linked to economic development relative to the rest of the world . In this 21st century, business and trade had become diversified than ever before.

As traditional market is shrinking down in a faster pace, operators are looking for options for expansion and international trade is getting accelerated at a faster rate and different countries of the world are trying their best to attract more and more FDI as it proves to be a great force for triggering the domestic economic development.

2. MEANING OF FDI

Foreign Direct Investment is a direct investment into production in a country by a company located in another country, either by buying a company in the target country or by expanding operations of an existing business in that country. It is a cross border investment, where foreign assets are invested into the organization of the domestic market excluding the investment in stock. As part of the national accounts of a country, and in regard to the national income equation Y=C+I+G (X-M), I is investment plus foreign investment, FDI refer to the net inflows of investment (inflow minus outflow) to acquire a lasting management interest (10 percent or more of voting stock) in an enterprise operating in an economy other than that of the investor. It is the sum of equity capital, other long-term capital, and short term capital as shown in the balance of payment. It usually involves participation in management, joint venture transfer of technology and expertise. There are two types of FDI: inward foreign direct investment and outward foreign direct investment, resulting in net FDI inflow (positive or negative) and "stock of foreign direct investment" which is cumulative number for a given period.

2.1 Types

a) **Horizontal FDI** arises when a firm duplicates its home country based activities at the same value chain stage in a host country through FDI. If a car company like Volkswagen assembles cars in its home country then it performs the same activity in different host countries as well.

b) **Platform FDI** is a foreign direct investment from a source country into a destination country for the purpose of exporting to a third country.

c) **Vertical FDI** takes place when a firm through FDI moves upstream or downstream in different value chains i.e., when firm performs value-adding activities stage by stage in a vertical fashion in a host country. If a car company only assembles in its home country but it manufactures components also in its host country then it is said to be upstream vertical FDI. If the same car company does not engage in distribution in its home country but invests in car dealership in host country then it is called downstream vertical FDI.

The foreign direct investor may acquire voting power of an enterprise in an economy through any of the following methods.

a) By incorporating a wholly owned subsidiary
b) By acquiring shares in an associated enterprise
c) Through a merger or an acquisition of an unrelated enterprise
d) Participating in an equity joint venture with another investor or enterprise.

2.2 Routes

An Indian company may receive foreign direct investment under the two routes as given under:

i. Automatic route – FDI is allowed under the automatic route without prior approval either of the government or the reserve bank of India in all activities / sectors as specified in the consolidated FDI policy, issued by the Government of India form time to time.
ii. Government route – FDI in activities which are not covered under the automatic route requires prior approval of the Government which are considered by the foreign investment promotion board (FIPB) department of economic affairs, Ministry of Finance.

2.3 Authorities dealing with foreign investment in India

The authorities who are responsible for foreign investment related matters are the following.

a) Foreign Investment promotion board (popularly known as (FIPB): The board is responsible for expeditious clearance of FDI proposals and review of the implementation for cleared proposals. It also undertakes investment promotion activities and issues and reviews general and sectoral policy guidelines.
b) Secretariat for Industrial Assistance (SIA): It acts as a gateway to industrial investment in India and assists the entrepreneurs and investors in setting up projects. SIA also liaison with other government bodies to ensure necessary clearances.
c) Foreign Investment Implementation Authority: The authority works for quick implementation of FDI approvals and resolution of operational difficulties faced by foreign investors.
d) Investment commission
e) Project Approval Board
f) Reserve Bank of India

2.4 Instruments for receiving foreign direct investment in Indian company

Foreign investment is reckoned as FDI only if the investment is made in equity share, fully and mandatorily convertible preference share and fully and mandatorily debentures with the pricing being decided upfront any foreign investment into an instrument issued by an Indian company which gives an option to the investor to convert or meet to convert it into equity or does not involve upfront pricing of the instruments a data would be reckoned as ECB and would have to comply with the ECB guidelines.

The FDI policy provides that the price conversion formula of convertible capital instruments should be determined upfront at the time of issue of the instruments. The price at the time of conversion should not in any case be lower than the fair value worked out, at the time of issuance of such instruments, in accordance with the FEMA regulations.

2.5 Background and recent developments in FDI in retail sector

There has been series of steps though which government of India has brought retail reforms in the country. These reforms are part of liberalization process which has been initiated by the Indian government since 1991.

1995: World Trade Organization (WTO) general agreement on trade in services, which includes both wholesale and retailing services, came into effect.

1997: FDI cash & carry (wholesale) with 100% rights allowed under the government approval route.

2006: FDI in cash and carry (wholesale) brought under the automatic route. Up to 51 percent investment in a single brand retail outlet permitted, subject to press Note 3/2006 series)

2011: 100% FDI in single brand retail permitted.

2012: On September 13, Government approved the allowance of 51% percent foreign investment in multi-brand retail.

The Indian government is cautious in opening of the retail sector so that the domestic retailers do not suffer and global retail giants should not dominate the market. Therefore, government has put certain limitations in this perspective. Government has stated that retail trading in any form would not be permitted for companies with FDI engaged in the activity of single-brand retail trading. The minimum amount to be brought in by a foreign investor would be 100 million in multi-brand retail.

In August the cabinet headed by Prime Minister Manmohan Singh diluted the mandatory 20% local outsourcing norms for multi-brand retailers and permitted state to include cities with population less that 1 million for multi brand retailing. In the new announcement, the government retained the 30% local outsourcing norms for multi brand retailers and permitted state to include cities with population less than 1 million for multi-brand retailing. In the new announcement, the government retained the 30 percent sourcing requirement but said it can be met over a period of five years initially and after that it has to be met on annual basis. It also said that global chains will only have to invest 50 percent of an initial mandatory investment of $ 100 million in setting up cold storages and warehouses as against the earlier policy which said half of the entire investment by foreign chains in India had to be in building back-end infrastructure. The new rules have removed same major road blocks and should encourage foreign retailers to enter India.

2.6 Independent decision making power to state governments in multi-brand retail

Although 51% FDI in multi-brand retail has been allowed by the Indian government, final authority for granting trade license lies with the state governments. The governments of Congress ruled states like Andhra Pradesh. Assam, Delhi, Haryana, Kashmir, Maharashtra, Manipur, Rajasthan, Uttarakhand, Daman and Diu and Dadra and Nagar Haveli have said that they will allow supermarkets to open in their state. Other states including BJP ruled states have opposed the move and have said that they will not allow foreign supermarkets to open in their state. These states are West Bengal, Gujarat, Bihar, Karnataka, Kerala, Madhya Pradesh, Tripura and Orissa. The final say in the implementation of FDI in multi-brand retail gives states choice of weighing pros and cons of the policy and make decision which would be best suited for their state.

2.7 FDI inflow in India: Present scenario

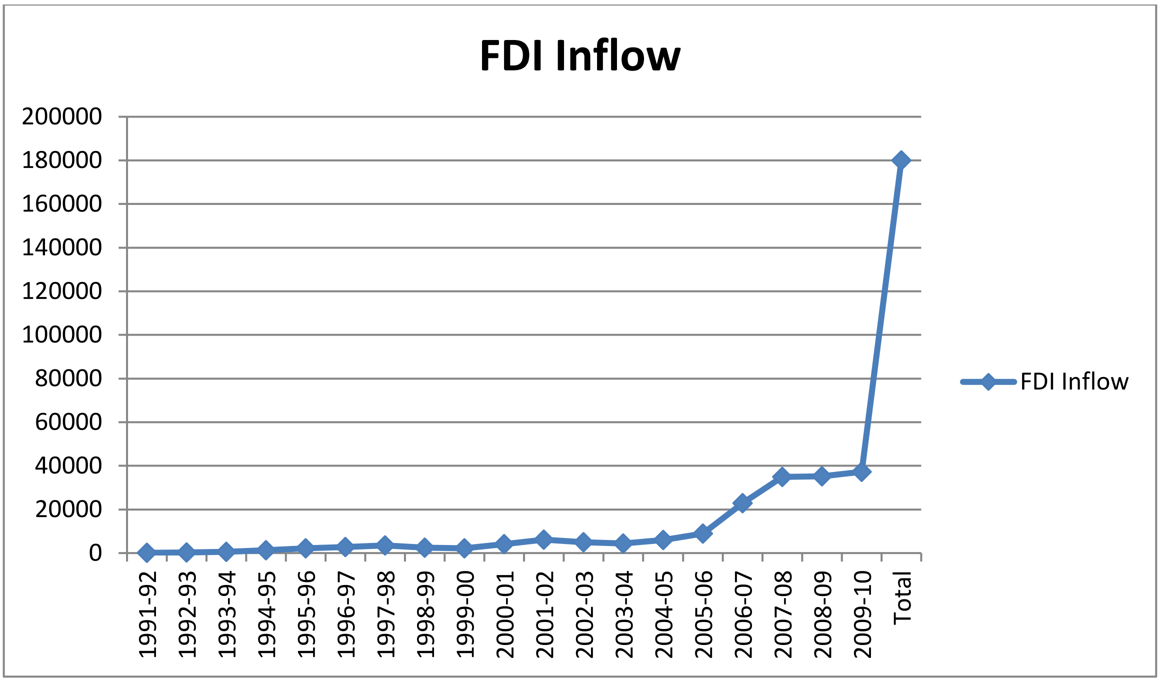
Since liberalization reform measures have been an attraction in drawing FDI inflows in India. The main objective of promoting FDI in India and other developing countries has been to improve efficiency in production & increase exports. It is a challenging task for India as well as developing countries to channelize and use its capital inflow through FDI into a potential source productivity gain from domestic firms. India has received total FDI of US$ 180,034 million from the year 1990-1991 to 2009-10 which is due to several measures adopted by the Government of India in attracting FDI inflows in India. The FDI inflows have shown a rising trend from 1991-92 to 1997-1998 owing to structural liberalization and open-market reforms. The size in FDI till 1997 was not only due to liberalization policy but also due to the sharp expansion in the global scale of FDI outflows during 1990's.The other cause may have been the recovery of the Latin American economics, which had begun to emerge from the debt crisis of the 1980's. During 1998-99 and 1999-2000 there was decline in FDI in flow which was due to the decline in industrial growth rate in the economy and also due to the result of the East Asian Financial Crises.

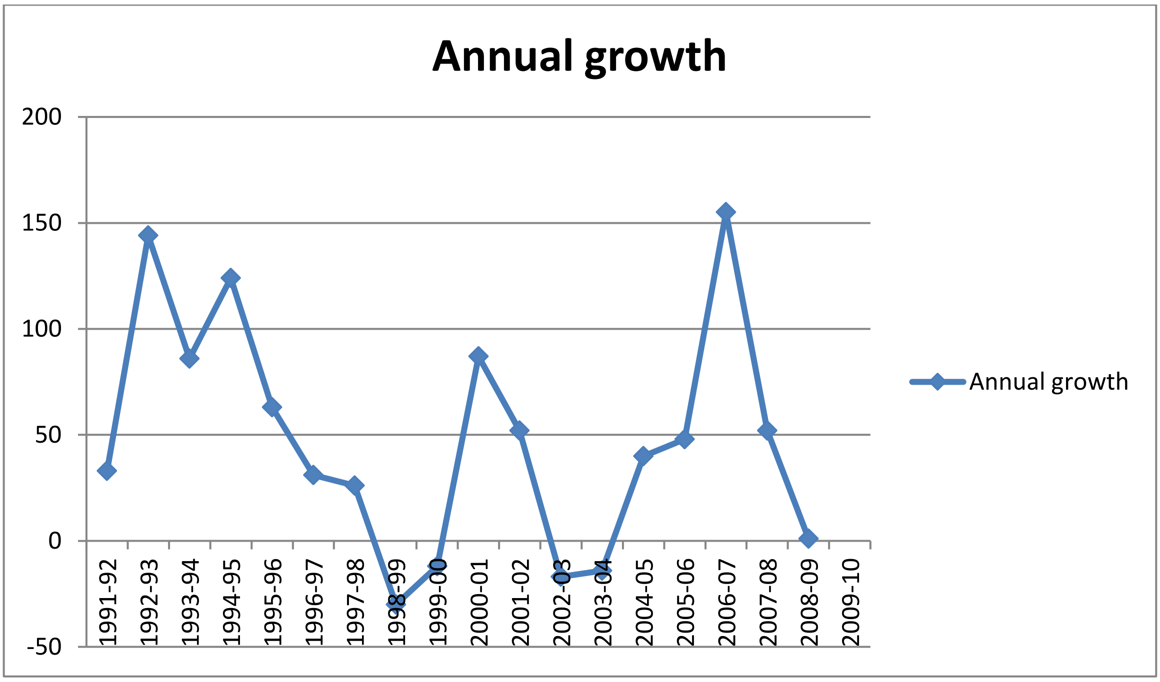
In 2002-03 and 2003-04, again there was a fall in the flow of foreign direct investment which was due to the impact of Global Recession on the Indian economy. The FDI equity inflows during the five years 2005-2006 to 2009-10 showed a massive increase of more than seven times than those of the previous years from 1991-2004. The increase was due to revised FDI policy in March 2005. An important decision of this policy was to allow FDI up to 100% foreign equity under the automatic route in townships, housing, built – up infrastructure and construction – development projects. In the financial year 2012-13 (for the month of July, 2012) FDI inflow was US $ 1.47 billion and amount of FDI equity inflows for the financial year 2012-13 (from April 2012 to July 2012) stood at US $ 5.90 billion.

Table 1: Statement showing FDI inflows in Indian (Amount in US $ million)

Year	FDI Inflows	Annual Growth rate (%)
1991-92	129	33
1992-93	315	144
1993-94	586	86
1994-95	1314	124
1995-96	2144	63
1996-97	2821	31
1997-98	3557	26
1998-99	2462	-30
1999-00	2155	-12
2000-01	4029	87
2001-02	6130	52
2002-03	5035	-17
2004-05	6051	40
2005-06	8961	48
2006-07	22826	155
2007-08	34835	52
2008-09	35180	1
2009-10	37182	5
Total	180034	

Source: FDI statistics, DIPP, Ministry of Industry and Commerce as cited in Anitha & Dr. K. Maran (2011)



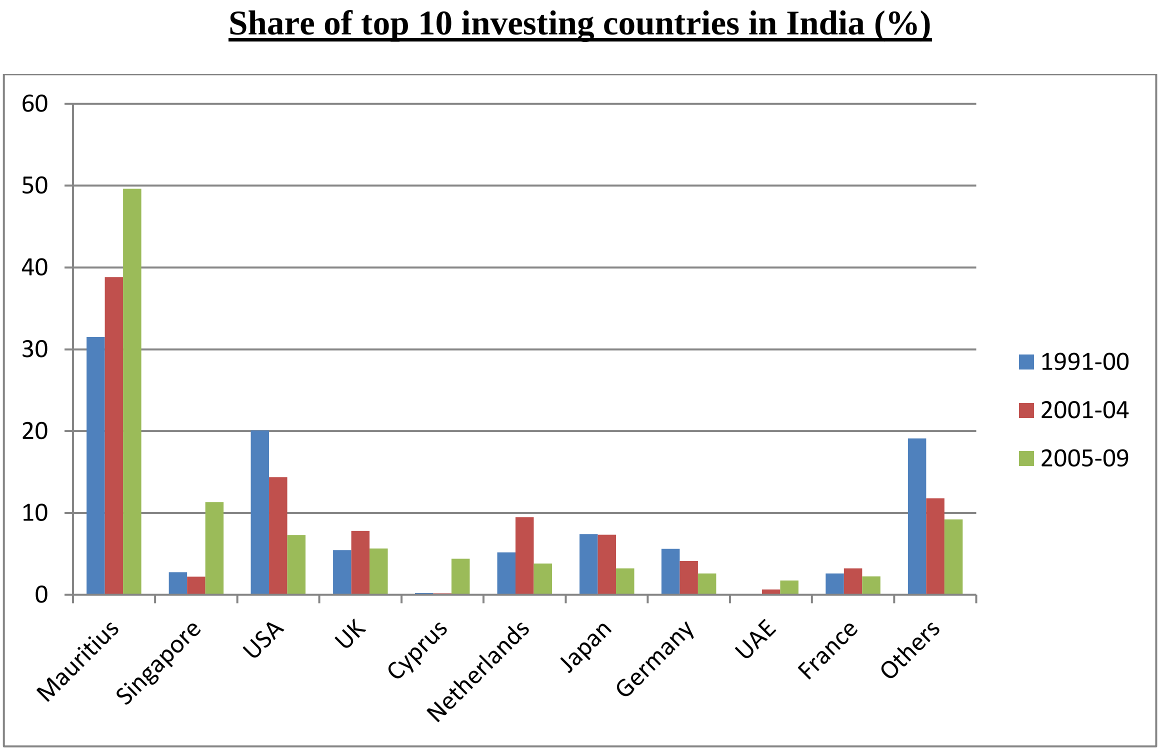


The top 10 investing countries in India since August 1991-2009 are Mauritius, USA Singapore, UK, and Netherlands, Japan, Germany and others as depicted in the Table 2. Mauritius has been the biggest contributor of FDI in India in the period 1991-2005. This can be due to cultural similarities and close bilateral and political ties between two countries. Mauritius has low rates of taxation and there has been an agreement with India on double tax avoidance regime. Due to this reason some countries have established companies in Mauritius before investing in India.US in the second major investor in India from 1991-2004 contributing about 16% of total inflow. Singapore has replaced US as the second major investor in India from the period 2005-2009. India is losing its attraction as FDI destination. India has fallen to 14th position from 8th position in 2009 according to “World Investment Report 2011” by United Nations Conference on Trade and Development (UNCTAD). India is ranked 134 out of 183 countries in the latest study from World Bank “Ease of Doing Business in India 2011”

Table 2: Share of top 10 ten investing countries in India (%)

S. No.	Country	Aug 1991-Dec 2000	2001-2004	2005-2009
1.	Mauritius	31.51	38.81	49.62
2.	Singapore	2.76	2.22	11.33
3.	USA	20.10	14.36	7.28
4.	UK	5.44	7.80	5.64
5.	Cyprus	0.20	0.18	4.41
6	Netherlands	5.19	9.48	3.83
7.	Japan	7.41	7.32	3.22
8.	Germany	5.61	4.13	2.61
9	UAE	0.08	0.66	1.75
10.	France	2.59	3.22	1.24
	Other	19.10	11.81	9.20
	Total FDI Inflows	100	100	100

Source: SIA Newsletter, as citied in Anitha & Dr. K. Maran (2011)



2.8 Foreign investor's concern regarding FDI policy in India

Although foreign investors are happy with the recent retail reforms but there are several concerns as well.

Those foreign retailers who have adopted franchising route, the current FDI policy would not make any difference. Consumer durable majors such as LG and Samsung have exclusive franchise owned stores, are unlikely to shift from preferred route right away. Foreign companies which choose to adopt 51% partnership, they must find suitable local partners. The partner needs to have sound knowledge of domestic retail market and understanding of Indian consumer. There are large Indian business groups like Tata, Raheja group, Future group who have already made inroads into the retail sector and would be tough competitors. The forcing investors have to negotiate their joint venture agreements carefully, with an option for a buy-out of the Indian partner's share if and when the government further liberalizes the regulations. Foreign companies are aware and apprehensive of the regulations which states that once a foreign company enters into a technical or financial collaboration with an Indian partner, it cannot center into another joint venture with another Indian company or setup its own subsidiary in the same field, without the first partner's consent if the joint venture agreement does not provide for a conflict of interest clause.

2.9 Rationale behind allowing FDI in retail sector

FDI can be a powerful catalyst to spur competition in the retail sector. According to the latest Central Statistical Organization (CSO) data, the Indian economy grew at a sluggish 5.5 percent in the April-June 2012 period. Growth has slowed to 4-5% in 2013; inflation at 10% is worse than in any other big economy and the government was criticized for policy paralysis. The decision taken by the Indian government to allow 51% in multi brand retail was "much awaited and much required" at a time when business sentiments have taken a beating. There are several benefits accruing to the rationale behind allowing FDI in retail sector.

2.9.1 Important driver for the country's economic growth

Present economic scenario is grim and needs a boost. FDI would create a competition among the global investors which would ultimately ensure better and lower prices thus benefitting people in all sections of society. It will increase retail employment, better wages, further triggering consumption and production thereby increasing market growth and expansion.

2.9.2 Long term cash liquidity

FDI inflow would give much needed financial liquidity to the domestic retailers for their infrastructure development and other expansions.

2.9.3 Consumers would be the biggest beneficiary

Liberalization process brought in several benefits to the consumers in terms of varieties, availability of foreign brands etc. Similarly FDI in retail would bring about quality improvements in products, reduction in prices and multiple choices to the consumers.

2.9.4 Farmers would get their due share

Indian economy is agriculture based economy and still 70 percent of the population resides in rural areas. Farmers are the worst sufferers of middle man based trade. FDI in multi-brand retail would induce organized retailing and large retailers would directly deal with the farmers giving them a much better deal for their agricultural produce. Big retailers prefer contract farming which would lead to improved and better quality yield for the farmers and regular & improved income from their produce.

2.9.5 Investment in backend infrastructure

The rider put by the Indian government for investment in back-end infrastructure would improve transportation in the form of increased used of refrigerated vans and pre-cooling chambers as well as state-of-the art warehouses which would be mechanized and see lead to reduction in wastage. Improved technology in the sphere of processing, grading, handling and packaging of goods and further technical developments in areas like electronic weighing, billing, barcode scanning would be brought in by technology driven global retailers.

2.9.6 FDI can bring quality employment to people

Most of the small retailers are employing unskilled and untrained staff. They employ very few staffs and pay minimal wages. With the entry of big retailers, they would be creating jobs in new skills such as accounting, stock-keeping, marketing etc. Further, the new employment would come with higher compensation for the employees than what a small retail shop offers now.

2.10 Criticisms of FDI in multi-brand retail

Opponents of FDI feel that large Corporate houses would swallow the small kirana shops and render millions jobless. According to them there would be monopoly of global retailers and they would raise prices for the consumers and reduce margin for supplies reaping maximum benefits for themselves. Critics fear that India would be slave again of the foreign global retailers.

However these fears are unfounded as Indian Council of Research in International Economic Relation (ICRIER) study conducted in India in 2008 showed the rate of closure of unorganized retail shops in gross terms was found to be 4.2% per annum, which was much lower than the international rate of closure of small businesses. Similarly, the rate of closure on account of competition from organized retail was found to be still lower, at 1.7 percent per annum. This was achieved through competitive response from traditional retailers and through improved business practices and technology up gradation. 'Mom and Pop' stores have been co-existing in developed nations like US, UK, FRANCE, Germany etc. in spite of presence of big retailers like Walmart, Tesco, Carrefour & Harrods.

3. Conclusion

The benefits far outstrip the disadvantages of FDI in multi-brand retail in India as stated in the above arguments. The example of China clearly shows that increased FDI in retail sector does not lead to complete closure of local retailers. China permitted 100 percent FDI in 2004 and since then local Chinese grocery stores have grown from 19 million to more that 2.5 million. Thailand and China demonstrate the success of unrestrained FDI in retail sector. In both countries, the issue of allowing FDI in retail sector was first met with incessant protests but allowing such FDI led to GDP growth and a rise in the level of employment. Confederation of Indian Industry (CII) Chairman Kishore Biyani had rightly said that FDI in Indian retail should be allowed in a phased manner so that it could serve the purpose of much-needed capital and bring boom to the sector. Government of India can and has introduced regulatory frameworks which can be a controlling factor for large global retailers. So FDI in retail improves growth prospects, does not harm equity and discourages monopoly rents and therefore is beneficial. FDI would lead to integration of Indian economy with the world market leading to its economic growth and development.

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