Impact of FDI on Indian Retail Sector: Challenges and Opportunities

Richa Arora, Supriya Mathew and Anupama Suresh

E-mail: dydirector@scmsug.ac.in; supriya.mathew@scmsug.ac.in; director@scmsug.ac.in

ABSTRACT

Even though organized retail sector in India is at the infant stage but is being seen as a potential gold mine for retailing by investors all over the world. With a robust economy experiencing un-relented growth, the country is enticing global companies looking to expand overseas. As per the latest research by AT Kearney[1], a global management consulting firm, India is rated as the most attractive destination globally and has become the potential target for the foreign investors. According to the BMI India Retail report from private consulting company recommends that there is the rapid growth in the Indian retail market despite of many restrictions on FDI. In their third-quarter report published in year 2010, forecasts that the total retail sales will grow from US$ 353 billion in 2010 to US$ 543.2 billion by 2014.[2]

Despite these encouraging signs, India's retail markets remain largely off-limits to large international retailers like Carrefour. Resistance to liberalizing FDI in this sector raises concerns about employment losses, unfair competition resulting in large-scale exit of incumbent

[1] Global Retail Development Index, AT Kearney, 2009. Available for download at http://www.atkearney.com/index.php/Publications/global-retail-development-index.html.

[2] BMI India Retail Report, Business Monitor International, August 2010. Available for download at http://store.businessmonitor.com/retail/india_retail_report.

* Symbiosis Centre for Management Studies, Pune, Maharashtra.

ISSN 2348–0661 Print

Annual Research Journal of Symbiosis Centre for Management Studies, Pune
Vol. 1, Januray 2013 – January 2014, pp. 137–151

domestic and the death knell on the small traders who will be in no position to compete with the big players. Thus it will kill the small entrepreneur initiative; as these traders do not have the capital and expertise to compete with big retail chains.

The phenomenal growth and change in the India Retail Sector over the years has resulted in many issues and challenges for the retail industry, the very recent being the Foreign Direct Investment policy in India. This would change the face of the retail sector. In this context, the present paper attempts to analyze the various factors concerning the influx of foreign direct investment its repercussions as well as the opportunities for FDI in the Indian retail industry. Though based on secondary data this paper tries to analyse the impact of FDI on Retail sector in India in future particularly with respect to challenges for local and small retailers.

Keywords: Foreign Direct Investment, Liberalization, Retail, India, Multi Brand and Single Brand Retailing

Introduction

The retail industry in India is expected to grow at a rate of 14% by 2013. The first step towards allowing Foreign Direct Investment in Retail was taken in the year 2006. Since then 54 FDI approvals have been granted by the government and the country has received a cash inflow to the tune of about Rs 901.64 crore.

The scenario at present is:

- 100% FDI is allowed in wholesale cash and carry trade
- 51% FDI in Single Brand Retail
- No FDI in Multi Brand Retail

Some of the concerns against allowing of foreign direct investment in multi brand retail were that FDI would lead to unfair competition and result in large-scale exit of domestic retailers, especially, the small family managed outlets.

Another concern was that organized retail is still under-developed and in its nascent stage, and there for it is important that the domestic retail sector is allowed to grow and consolidate first, and then this sector should be opened to foreign investors.

As per the report prepared by FICCI and ICICI Property Services in Feb 2005, FDI can be a powerful catalyst to spur competition in the retail industry. It can bring about the improvement in various areas such as:

- Supply Chain Improvement
- Investment in Technology,
- Manpower and Skill development
- Tourism Development
- Up gradation in Agriculture
- Efficient Small and Medium Scale Industries
- Growth in market size
- Greater Productivity
- Benefits to government through greater GDP
- Tax income and employment generation

The arrival of foreign companies into the Indian retail sector is a sensitive issue, as small shopkeepers fear being driven out of business by multinationals. Industry bodies want the retail sales sector to be liberalized gradually but calls for the market to be opened up to foreign competition have increased in recent months, notably during visits by Western leaders. Both US President Barack Obama and his French counterpart Nicolas Sarkozy urged India to remove restrictions on foreign trade and investment.

Statement of the Problem and Need for Study

In developing countries like India, the unorganized retailers play a dominant role by offering products or services to the consumers at the convenient locations, i.e. Kirana Stores or Apana Bazar with effective selling and buyer's retention strategies. But due to the recent changes in the field of retailing and with the entry of big domestic corporations as well as multinational and foreign companies into the field of various retailing ventures, the existing unorganized retailers have also been forced to change their existing business structure. The perception of consumers, industrialists, academicians and policy makers in respect of the organized and unorganized retailers keep on changing. The organized and unorganized retailers are also in a dilemma about the perception of the different segments as mentioned above. Because of these kinds of issues emerging in today's retail markets, this topic has become very important, which needs an in-depth probing.

Review of Literature

Indian traditional retailers have a number of inherent strengths which helped them not merely survive the competition from organized retail but flourish. These include proximity to consumers, consumer goodwill, credit sales and amenability to bargaining, sale of loose items, convenient timings and home delivery. The Indian Council for Research on International Economic Relations (ICRIER) study (M. Joseph and N. Soundararajan, 2009) has shown that hardly 1.7 percent of small shops have closed down due to competition from organized retail. They have competed successfully against organized retail through adoption of better business practices and technology. FDI has positive and proven spillover effects in automobiles, telecom and consumer electronics on the economy as its ownership advantages get disseminated to locally owned enterprises, enhancing their productivity.

The domestically driven organized retail expansion in India is facing difficulties. The food inflation in the country has stayed high for some time now. The gap between the farm level prices and consumer prices is very high in India which has not come down with the expansion of organized retail. Why? While the number of domestic restrictions on the operation of organized retail in India is partly responsible for this, the ban on foreign entry into multi-brand retailing is also partly responsible. India permitted foreign direct investment in cash-and-carry wholesale trade up to 100 percent through the automatic route and in single-brand retail up to 51 percent in 2006. The former brought in US$ 1.8 billion during April 2000 to March 2010 and the latter just US$ 195 million during April 2006 to March 2010.The reason why India has not allowed FDI in multi-brand retail is the fear that it will harm the traditional small retailers.

Organized retail, one of the most notable emerging sectors of the Indian economy, continues to attract significant investments and interest from leading national and international retail players. It has also generated considerable opposition from small traders and shopkeepers who are worried about the impact of large-scale organized retail on their businesses. As a result, the government has been forced to carefully examine the long-term implications of organized retail in India

According to the authors, the main reason why the third wave countries which include China, India and Russia lagged behind was the severe restrictions on foreign direct investment (FDI) in retailing in these countries. The demand side features of these countries, such as income, size of the middle class, urbanization, and the share of women in workforce, etc., have been similar to countries in the second wave. In China and Russia these restrictions were progressively relaxed in the 1990s and in India only partially in the 2000s. In January 2006, India allowed foreign companies to own up to 51 percent in single-brand retail joint ventures (JVs), but multiple brand foreign firms are still barred in retail although they can set up wholesale operations.

India stands out as an example for the late coming of modern organized retail in emerging markets and also for the kind of restrictions placed on foreign investments in retail. The arrival of modern retail in developing countries occurred in three successive waves (Reardon and Hopkins, 2006; Reardon and Berdegue, 2007). The first wave took place in the early to mid-1990s in South America, East Asia outside China, North-Central Europe and South Africa. The second wave happened during the mid to late 1990s in Mexico, Central America, Southeast Asian countries, Southern-Central Europe. The third wave began in the late 1990s and early 2000s in parts of Africa, some countries in Central and South America, Southeast Asia, China, India, and Russia.

A study conducted by Mukherjee and Patel (2005) found that foreign retailers are working with small manufacturers for in-house labels and are providing them technologies like packaging technologies and bar coding. Sourcing from India has increased with the advent of foreign retailers and they also bring in an efficient supply-chain management system. Joint ventures with foreign retailers are helping the Indian industry to get access to finance and global best practices. Besides, retailing being a non-tradable service there is no possibility of improved efficiency through import competition and foreign investment is the way forward.

Research Objectives

Having presented the immense potential and current status of the entry of the global giants to Indian retail industry, this paper continues to flesh out the Indian retail story with the objective of highlighting some of the major concerns that organized retailers will have to consider as they venture into the Indian market.

The objective of the paper has four dimensions:

1. The myths and realities of global giant's entry to India, with special reference to Wal-Mart and Carrefour
2. Overview the two faces of retail sector – Challenges and key Success factors.
3. Impact of FDI on Indian Retailers, Consumers and Farmers.
4. Recommendations and policy suggestions before allowing FDI in Multi brand Retailing.

Global Giants in India: Myths and Realities with Special Reference to Wal-Mart and Carrefour

Table 1: Myths and Realities about the Global Giants arrival to India

	Myths	*Realities*
Price	Prices of different items are less here.	The rates at which the vendors sell are less as those in the corporate retail shops.
Middlemen	Corporate retail is throwing away Middlemen.	They are becoming the new mega middlemen and creating monopolies by becoming the wholesaler, distributor and the retailer.
Employment	They are creating employment. The Employment potential projected is 2 million jobs.	They are robbing livelihoods many more times than the number of jobs they are going to create. For creating 2 million jobs they going to destruct 40 million livelihoods in retail sector.
Better deal or best deal	Corporate retail sell fresh.	The hawker sells much fresher than any of these shops. Long distance supply chain and refrigeration means stale fruits and vegetables.

	Myths	Realities
Local economy promotion	Corporate retail is promoting local economy.	They have destructed local economy wherever they have gone, and are doing the same in India. Attacks on the reliance stores in Ranchi and Indore are preemptive action by people dependent on local economy.
Efficient supply chain management	Corporate entry will make the supply chain more efficient. They are more scientific than the existing system.	The supply chain gets more centralized, and the average distance traveled by food increases manifolds. In scientific, social and ecological terms this is inefficient compared to our hawkers.
Push or pull strategy	There is huge consumer demand for corporate retail.	The corporations are pushing the agenda, never have people in India demanded for corporation led retail.
Grow without kill	There is room for all, as Indian economy is growing at an enormous pace.	The corporate retail chains cannot prosper without killing the small businesses. The experience of west shows us the truth.
Money saving or money wasting shopping	Corporation led shops sell cheap and consumers save money shopping there.	Corporations are propagating the habit of wasteful consumerism among the Indian consumers.

Overview of the Two Faces of Retail Sector

The one side of the Retail mirror is challenges and the other side is Key success factors which boost up the Retail Sector.

Challenges faced by the Retail Sector: Overview of the Two Faces of Retail Sector

The one side of the Retail mirror is challenges and the other side is Key success factors which boost up the Retail Sector.

Challenges Faced by the Retail Sector

1. **Supply chain:** Finance Minister Pranab Mukherjee in his 2010-11 budget speech had emphasized on the reduction of wastages estimated at 40 percent of National Produce in storage as well as in the operations of the existing food supply chains in the country. Catering to people in 35 states and union territories is equivalent to catering to people in 35 countries, leading to complexities in merchandise/ inventory

management.

Infrastructure has been developing at a rapid pace over the past decade but has still a significant ground to cover; the planned expenditure of US$ 1 trillion in the 12th five year plan will help bridging this gap.

2. **Location and rental:** Finding the right location with the right rental for stores has been a challenge for all retailers. Rent forms a large portion of the total expenditure (6 to 11 percent of the revenue) in retailer's income statement and can more often than not convert a profitable store into loss making. The challenge for a retailer would be to find the right location for their stores either in malls or as a standalone store to be able to generate enough footfalls.
3. **Channel conflicts:** The retailers need to maintain a direct relationship with their suppliers. Due to the complex taxation structure and geographic spread of the country, most FMCG companies have developed regional distribution and re-distribution network. Cutting out the distribution network will hurt operating structures of distributors, who as an industry body in the past have opposed FMCG companies selling directly to retailers.
4. **Regulatory:** Currently, indirect taxation structure is complex in India with varying tax rates, multiplicity of taxes and multiple tax enforcement authorities. Goods and Service Tax likely to be implemented in 2011 will replace a host of levies like excise, sales tax, value-added tax, entertainment tax and luxury tax.. Opening a new store requires a lot of licenses, which have to be obtained from different government departments leading to considerable lead time in opening up of the stores. A push has been made by existing retailers to get the government to have a single window clearance for getting all the licenses at one place to speed up the process.
5. **Unique Indian customer:** The Indian consumer experiencing modern retail has now warmed up to this idea. Buying habits have still not changed, where people prefer to buy most of the fruits and vegetables on a daily basis.
6. **Private labels:** Private labels enable retailers to offer products at a better price point attracting footfalls to the store. This, in turn, not only translates to better margins by cutting out middlemen but also