Foreign Direct Investment Policy in Retail Sector

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Abstract : India is one of the largest budding markets, with a population of over one billion. Indian retail industry is one of the sunrise sectors with huge growth potential. According to the Investment Commission of India, the retail sector is expected to grow almost three times its current levels to $660 billion by 2015. However, in spite of the recent developments in retailing and its immense contribution to the economy, retailing continues to be the least evolved industries and the growth of organized retailing in India has been much slower as compared to rest of the world. Undoubtedly, this dismal situation of the retail sector, despite the on-going wave of incessant liberalization and globalization stems from the absence of an FDI encouraging policy in the Indian retail sector. This paper is going to try to give a better view of what is the Retailing, what are the types of retailing, Retail trade in India also explains different polices of FDI in India, and role of FDI in Indian retail industry, benefits of FDI. In this paper has also we tried to give an analytical perspective on FDI in retail sector and it's repercussions on competitive market environment in India.

Keywords: Foreign direct investment, Retailing, sunrise sectors, liberalization, globalization.

I. INTRODUCTION

India being a signatory to World Trade Organization's General Agreement on Trade in Services, which include wholesale and retailing services, had to open up the retail trade sector to foreign investment. There were initial reservations towards opening up of retail sector arising from fear of job losses, procurement from international market, competition and loss of entrepreneurial opportunities. However, the government in a series of moves has opened up the retail sector slowly to Foreign Direct Investment ("FDI"). In 1997, FDI in cash and carry (wholesale) with 100 percent ownership was allowed under the Government approval route. It was brought under the automatic route in 2006. Retailing is one of the most important sectors of India economy. It provides 9% employment to the total workforce and contributes around 15% to the Indian GDP. It could have been a welcome step in strengthening India's FDI regime with making it in tune with country's needs. The FDI policy has been moving away from the license mentality of protection against imagined foreign dictators towards a more open, healthy and competitive environment. This policy would have provided a window for the world class retailer Hermes, Tiffany & Co and Wal- Mart, etc. to set their foot in the booming Indian retail sector. The Indian Government believe that the opportunity of FDI in multiband retail and further liberalization of single-brand retail trade will facilitate greater FDI inflows providing new opportunities and benefits besides quality improvement. At a time when declining investments have led to slower GDP growth, however, a healthy competition, between the large domestic retailers and those with FDI, should be maintained. Imposing socially- desirable constraints on FDI funded retailers would lead into unfair competition. In spite of the recent developments in retailing and its immense contribution to the economy, retailing continues to be the least evolved industries and the growth of organized retailing in India has been much slower as compared to rest of the world. One main cause for this is that retailing is one of the few sectors where foreign direct investment is not allowed. Within the country, there have been protests by trading associations and other stakeholders against allowing FDI in retailing.

II. DEFINITION OF RETAIL

In 2004, The High Court of Delhi defined the term 'retail' as a sale for final consumption in contrast to a sale for further sale or processing (i.e. wholesale). A sale to the ultimate consumer.

Thus, retailing can be said to be the interface between the producer and the individual consumer buying for personal consumption. This excludes direct interface between the manufacturer and institutional buyers such as the government and other bulk customers retailing is the last link that connects the individual consumer with the manufacturing and distribution chain. A retailer is involved in the act of selling goods to the individual consumer at a margin of profit.

III. OBJECTIVES OF THE STUDY

The following are the main objectives of this paper relevant to the current market.

- To study the FDI inflows in Indian retail industry.
- To examine the FDI policies towards retail industry.
- To examine the FDI benefits and impact on the country. Penetration into rural India generating more than 10 per cent of India's GDP. The

performance of this sector has a strong influence on consumer welfare.

Division of Retail Industry – Organized and Unorganized Retailing

The retail industry is mainly divided into: -

❖ Organized and

❖ Unorganized Retailing

Organized retailing refers to trading activities undertaken by licensed retailers, that is, those who are registered for sales tax, income tax, etc. These include the corporate-backed hypermarkets and retail chains, and also the privately owned large retail businesses.

Unorganized retailing, on the other hand, refers to the traditional formats of low-cost retailing, for example, the local kiranashops, owner manned general stores, paan/ beedi shops, convenience stores, hand cart and pavement vendors, etc. The Indian retail sector is highly fragmented with 97 per cent of its business being run by the unorganized retailers. The organized retail however is at a very emerging stage. The sector is the largest source of employment after agriculture, and has deep penetration into rural India generating more than 10 per cent of India’s GDP.

Reasons for promotion of FDI in Retail

The major benefit of FDI is that it is both supplementary and complimentary with regards to local investment. FDI lets a company gain better access to top class technology and supplementary funds. They are also exposed to management practices in vogue around the world and also get the chance to become a part of the global market system. The Indian government had commissioned **Indian Council for Research on International Economic Relations (ICRIER)** to perform a study on the effect of organized retailing practices on its unorganized counterpart. ICRIER submitted the report during 2008. The study hinted at the advantages that the growth of organized retail will have for various participants like the consumers, manufacturers, and farmers. The government has decided on the basis of the results in other countries and the ICRIER study that this decision will result in a greater influx of FDI in both back and front end infrastructure. It is expected that the agricultural sector will become more efficient and be in a better position to use technology. It is also expected that this decision will result in more and better jobs being created and the best practices around the world will be introduced in India. Both farmers and consumers will see more convenient prices and higher quality in future and this will help both the classes. The government has also put in an obligatory condition for procuring 30 percent in order to provide a fillip to the manufacturing sector in India. Jobs are expected to be available in both rural and urban areas thanks to greater back and frontal operations resulting from more FDI. Present retail entities and traders are also expected to brush up their acts and increase their efficiency as a result of this decision. As a result of this the consumers are expected to receive better services and the producers who provide the source products can also gain better payment.

Process of FDI in retail

There is no such procedure for short listing the companies. International companies who are willing to invest in either single or multi brand retail can put in their applications with the Department of Industrial Policy and Promotion. Here the applications will be reviewed in an effort to determine their suitability as per the stated guidelines. Afterwards the Foreign Investment Promotion Board, Ministry of Finance will consider the applications before providing the final approval.

FDI Policy in India

FDI as defined in Dictionary of Economics (Graham Bannock et.al) is investment in a foreign country through the acquisition of a local company or the establishment there of an operation on a new (Greenfield) site. To put in simple words, FDI refers to capital inflows from abroad that is invested in or to enhance the production capacity of the economy. The Ministry of Commerce and Industry, Government of India is the nodal agency for motoring and reviewing the FDIpolicy on continued basis and changes in sectoral policy/ sectoral equity cap. The FDI policy is notified through Press Notes by the Secretariat for Industrial Assistance (SIA), Department of Industrial Policy and Promotion (DIPP).

Foreign Investment in India is governed by the FDI policy announced by the Government of India and the provision of the Foreign Exchange Management Act (FEMA) 1999. The Reserve Bank of India (‘RBI’) in this regard had issued a notification, which contains the Foreign Exchange Management (Transfer or issue of security by a person resident outside India) Regulations, 2000. This notification has been amended from time to time. The foreign investors are free to invest in India, except few sectors/activities, where prior approval from the RBI or Foreign Investment Promotion Board (‘FIPB’) would be required.

New FDI Policy to Drive Retail Growth in India

The $428 Bn retail sector in India has received a shot in the arm by the Indian Government’s recent policy decision to allow Foreign Direct Investment (FDI) of up to 51% in multiband retail and up to 100% in single brand retail. Given that 95% of the sector constitutes unorganized retail consisting largely of „mom and pop‟ stores, the Government has treaded cautiously by building adequate safeguards for the domestic stakeholders in the unorganized sector

Foreign investments in retail will have to go through Government approval first. The policy mandates a minimum investment of $100 Mn with at least half the amount be invested in back-end infrastructure, including cold chains, refrigeration, transportation, storage, packaging etc. Further, foreign retailers will have to source a minimum 30% from the Indian small and micro industry. Another key policy initiative to safeguard small/unorganized sector retailers is that FDI is being allowed only in 53 cities having a population of over 1Mn out of nearly 8000 cities/towns in India. Finally in India's federal structure, retail trade is a „state level" regulation and it will be upto the states to allow foreign participation in the respective 53 cities within their states. However the current policy decision is clearly a point of inflexion for Indian retail. Further, Corporate India and leading Indian organized retail players have come out in strong support of the policy.

FDI Policy with Regard to Retailing in India

It will be prudent to look into Press Note 4 of 2006 issued by DIPP and consolidated FDI Policy issued in October 2010, which provide the sector specific guidelines for FDI with regard to the conduct of trading activities.

- FDI up to 100% for cash and carry wholesale trading and export trading allowed under the automatic route.
- FDI up to 51 % with prior Government approval (i.e. FIPB) for retail trade of 'Single Brand' products, subject to Press Note 3 (2006 Series)
- FDI is not permitted in Multi Brand Retailing in India.

Role of FDI in Indian retail trade

In January 2006, the Government relaxed FDI (foreign direct investment) controls on retailing to allow foreign retailers to participate directly in the Indian market for the first time by allowing equity ownership in `single brand' retailing. Thus, foreign entities are now allowed to operate their stores, but only if they are single-brand stores and only up to 51 per cent ownership.

The impact of the consequent increase in FDI, in Indian retail, is expected to not just develop strong backward linkages but also create a domestic supply chain of international standards. What is encouraging now for these global majors is the new policy thrust, which intends to further liberalize the FDI regime in Indian retail. Though FDI in retail trade is as yet

restricted, the Government of India has a more liberal policy towards wholesale trade,

Franchising, and commission agents' services, thus preparing the ground for FDI in retail as well. Foreign retailers have already started operations in India through various routes:

1. Joint ventures where the Indian firm is an export house.
2. Franchising
3. Sourcing of supplies from small scale Sector

4. Cash and carry operations

5. Non-store formats

Impact and Benefits to the Country

- Growth of Infrastructure
- Franchising Opportunity for local Entrepreneurs
- Inflow of funds and investments
- Implementation of IT in Retail
- Investment in Supply Chain, cold Chain and warehousing
- Increase number and Improve Quality of Employment
- Reduced cost and Increased Efficiency
- Provide better value to end Customer

Hence it will lead to overall economic growth and create Benchmark.

Statistical analysis in FDI :

FDI INFLOWS DURING FINANCIAL YEAR 2014-15 (from April, 2014 to September, 2014):

1. TOTAL FDI INFLOWS INTO INDIA (Equity inflows + 'Re-invested earnings' + 'Other capital') (as per RBI's Monthly bulletin dated: 10.11.2014). - US$ 21,511 million
2. FDI EQUITY INFLOWS Rs. 86,939 crore US$ 14,472 million

FDI EQUITY INFLOWS (MONTH-WISE) DURING THE FINANCIAL YEAR 2014-15:

Financial Year 2014-15 (April-March) Amount of FDI Equity inflows (In Rs. Crore) (In US$ mn)

s. no	Month & year	Rs in crores	US $ in millions
1	April , 2014	10,290	1,705
2	May ,2014	21,373	3,604
3	June,2014	11,508	1,927
4	July ,2014	21,022	3,500
5	August,2014	7,783	1,278
6	Sep,2014	14,963	2,458
7	Total	86,939	14,472

Foreign Investor's Concern Regarding FDI Policy in India

For those brands which adopt the franchising route as a matter of policy, the current FDI Policy will not make any difference. They would have preferred that the Government liberalize rules for maximizing their royalty and franchise fees. They must still rely on innovative structuring of franchise arrangements to maximize their returns. Consumer durable majors such as LG and Samsung, which have exclusive franchisee owned stores, are unlikely to shift from the preferred route right away. For those companies which choose to adopt the route of 51% partnership, they must tie up with a local partner. The key is finding a partner which is reliable and who can also teach a trick or two about the domestic market and the Indian consumer. Currently, the organized retail sector is dominated by the likes of large business groups which decided to diversify into retail to cash in on the boom in the sector – corporate such as Tata through its brand Westside, RPG Group through Food world, Pantaloon of the Raheja Group and Shopper's Stop. Do foreign investors look to tie up with an existing retailer or look to others not necessarily in the business but looking to diversify, as many business groups are doing?

An arrangement in the short to medium term may work wonders but what happens if the Government decides to further liberalize the regulations as it is currently contemplating? Will the foreign investor terminate the agreement with Indian partner and trade in market without him? Either way, the foreign investor must negotiate its joint venture agreements carefully, with an option for a buy-out of the Indian partner's share if and when regulations so permit. They must also be aware of the regulation which states that once a foreign company enters into a technical or financial collaboration with an Indian partner, it cannot enter into another joint venture with another Indian company or set up 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. In effect, it means that foreign brand owners must be extremely careful whom they choose as partners and the brand they introduce in India. The first brand could also be their last if they do not negotiate the strategic arrangement diligently.

IV. CONCLUSION

Inward FDI has boomed in post reform India. At the same time, the symphony and type of FDI has changed considerably. The above analysis shows that FDI has positive and negative effects on India economy. It can be concluded that to keep pace with the forecast of Indian GDP, government should encourage foreign investment. To avoid its negative impact on local player's regulatory framework should be redesigned. Government should encourage FDI on gradual basis like currently it is allowed for single brand. India's retail sector remains off limits to large international chains especially in multi-brand retailing. A number of concerns have been raised about opening up the retail sector to FDI in India.

In this paper we quarrel that the potential benefits from allowing large retailers to enter the Indian retail market may balance the costs. Proof from the US suggests that FDI in organized retail could help begin inflation, particularly with wholesale prices. It is also expected that technical know-how from foreign firms, such as warehousing technologies and distribution systems, for example, will lend itself to improving the supply chain in India, especially for agricultural produce. India's experience between 1990-2010, particularly in the telecommunications and IT industries, showcases the various benefits of opening the door to large-scale investments in these sectors. Arguably, it is now the turn of retail.

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