‘FDI IN RETAILING’

-*A FUTURE PROSPECT*

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ABSTRACT

The opportunities in Indian retail are immense, all players must be aware that the consumer culture, business practices and industry dynamics in India can differ substantially from what they are accustomed to at home, often leading to pitfalls for the unprepared. Opening up the retail sector to foreign direct investment (FDI) would be beneficial for India in terms of price and availability of products India with a population of more than one billion has become a magnet for many international industries who found their growth to be stagnating due to a saturated domestic market in their countries. With a robust economy experiencing sustained growth, India is proving to be an irresistible temptation to companies looking to expand their scope of operations. With the government showing proclivity in allowing FDI for high end and grocery retailing, the idea of permitting FDI in the Indian retail sector is slowly gaining momentum. Things had begun to look up since the late 1990s, with a boom in the consumer durable industry, and improved services. With rising income and changes in life style, demand for better products became insistent. Foreign direct investment (FDI) inflows into the country have more than trebled in the first six months of calendar year 2007 to $11.4 billion as compared to inflows of $3.6 billion received in same period last year, registering a growth of 218 per cent. India offers vast potential in retail business and this potential must be fully realised by exploited, by making the country an attractive destination for FDI. The study suggests the measure & techniques to overcome the legal restarints

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INTRODUCTION

The Indian retail sector is in the midst of a boom. A report by KPMG, India and the Federation of Indian Chambers of Commerce and Industry (FICCI), estimated the retail market in India to be around US$ 200 billion, of which organized retail accounted for US$ 6.4 billion. Organized retail was expected to increase to US$ 23 billion by 2010.

It is evident that the organized retail is only 3 percent of $230 billion retail trade , it is expected to grow 400 percent from $7 billion to $30 billion by 2010. it is noteworthy that 2/3rd of the total FDI inflows went into services sector, 30 percent into the manufacturing sector and only a meager 4 percent to the primary sector. As services are not tradable, the only way to bring services to foreign markets is through FDI. The Government has allowed foreign Direct investment (FDI) in real estate since early 2005. FDI in real estate is likely to boost joint ventures between Indian and international developers. This means that in recent years, India would see a marked improvement in warehousing as well as the quality of malls and shopping centers. A healthy 7%-8% economic growth, increasing disposable incomes among the middle class, changing consumer tastes and preferences, and a young population with a propensity to spend, were some of the key factors driving growth in the organized retail market in India. Given the attractiveness of the Indian retail sector, foreign retailers like Wal-Mart, Carrefour SA, Europe’s largest retailer, and Tesco Plc, the UK’s largest retailer, were keen to enter this growing market, despite the Indian retail sector being closed to foreign direct investment (FDI). In February 2006, the Indian government had announced its decision to allow FDI of upto 51% in single brand retailing. Wal-Mart had said that India was high on its priority and that it was closely monitoring the government’s policy on FDI in the retail sector.

In July 2006, the Investment Commission suggested that 49% FDI be allowed in the Indian retail sector without any restrictions on the number of outlets or location of stores. The Indian retail boom and the Investment Commission’s suggestions renewed the debate on the issue of allowing FDI in the retail sector.

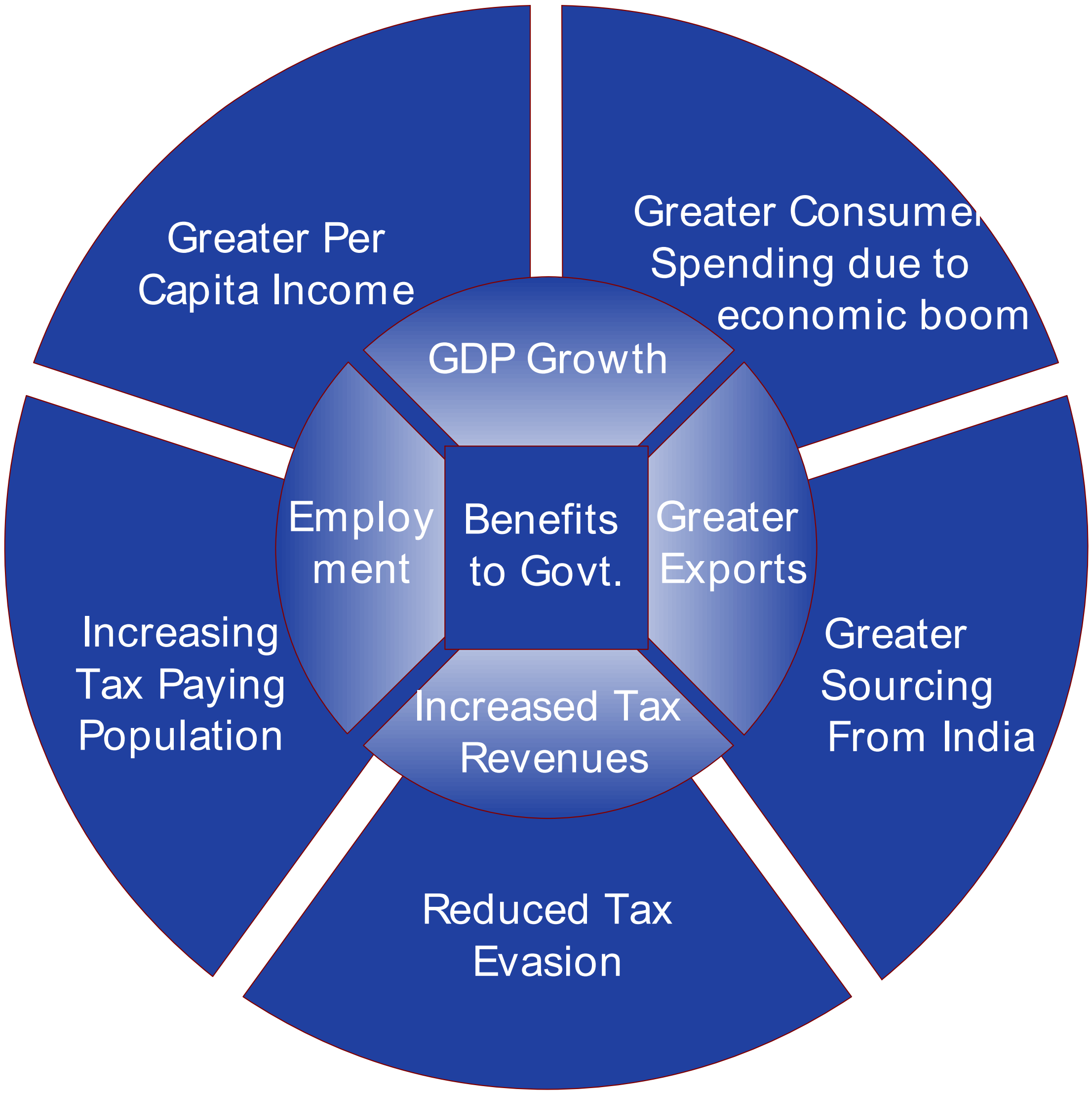
QUESTION OF FDI IN RETAILING:

The recent clamour about opening up the retail sector to Foreign Direct Investment (FDI) becomes a very sensitive issue, with arguments to support both sides of the debate. It is widely acknowledged that FDI can have some positive results on the economy, triggering a series of reactions that in the long run can lead to greater efficiency and improvement of living standards, apart from greater integration into the global economy. Supporters of FDI in retail trade talk of how ultimately the consumer is benefited by both price reductions and improved selection, brought about by the technology and know-how of foreign players in the market. This in turn can lead to greater output and domestic consumption. One major benefit cited by most supporters of FDI is that the foreign capital would flow into India which would help in improving efficiency and cost-effectiveness. But, this is strongly countered by the fact that most global retailers who have set up base here, have borrowed locally to fund their operations rather than bringing in fresh capita from abroad. Since, there are many such financial institutions, both government and private, lending them capital at competitive rates. Hike in exports will be a possibility. More sales-outlets and better marketability would occur for Indian goods. Our herbal products, handicrafts, cosmetic items, cuisine system etc. can earn global acclamation. By restricting the sale of imported goods, these giants sellers may be encouraged to identify & boost up the production of indigenous products and sell them within & outside the country. But the most important factor against FDI driven “modern retailing” is that it is labour displacing to the extent that it can only expand by destroying the traditional retail sector. Till such time we are in a position to create jobs on a large scale in manufacturing, it would make eminent sense that any policy that results in the elimination of jobs in the unorganised retail sector should be kept on hold. Though most of the high decibel arguments in favour of FDI in the retail sector are not without some merit, it was not fully applicable to the retailing sector in India, or at least, not yet. This is because the primary task of government in India is still to provide livelihoods and not create so called efficiencies of scale by creating redundancies. As per previous regulations, no FDI was permitted in retail trade in India. Allowing 49% or 26% FDI (which have been the proposed figures till date) will have immediate and dire consequences. Entry of foreign players now will most definitely disrupt the current balance of the economy, will render millions of small retailers jobless by closing the small slit of opportunity available to them. The indigenous units manufacturing and processing variety of products with local resources would suffer, as they may not have widespread market for their wares. This condition would effect the volume of employment in the organized sector. Imagine if Wal-Mart, the world’s biggest retailer sets up operations in India at prime locations in the 35 large cities and towns that house more than 1 million people. The supermarket will typically sell everything, from vegetables to the latest electronic gadgets, at extremely low prices that will most likely undercut those in nearby local stores selling similar goods. Wal-Mart would be more likely to source its raw materials from abroad, and procure goods like vegetables and fruits directly from farmers at preordained quantities and specifications. This means a foreign company will buy big from India and abroad and be able to sell low – severely undercutting the small retailers. Once a monopoly situation is created this will then turn into buying low and selling high. Such re-orientation of sourcing of materials will completely disintegrate the already established supply chain. In time, the neighbouring traditional outlets are also likely to fold and perish, given the 'predatory' pricing power that a foreign player is able to exert. It is true that it is in the consumer's best interest to obtain his goods and services at the lowest possible price. But this is a privilege for the individual consumer and it cannot, in any circumstance, override the responsibility of any society to provide economic security for its population. Clearly collective well-being must take precedence over individual benefits. The cost of capital incurred by an Indian retailer, especially the smaller players, is significantly higher than that of foreign players. In case of the mom and pop stores in India, availability of capital from the formal lending sources is pretty difficult. Such a situation would lead to a huge price disparity between the foreign owned retail chains and local Indian retailers. Devising alternate credit delivery mechanism in the markets can provide loans to smaller retailers at lower rates which will reduce the cost of capital to the domestic retailers making them more competitive.

FDI- HOW MUCH & HOW FAR?:

In spite of the opposition presented by the Left parties, some headway has been made in this regard. In January 2006, the Union Cabinet approved a major rationalization of the policy onFDI in retail to further simplify procedures for investing in India and to avoid multiple layers of approvals required in some activities. Till now, Government approval was required for FDI in wholesale cash and carry trading and FDI beyond 51% in export trading. To facilitate easier FDI inflow, instead of having to seek FIPB approval, FDI up to 100% will now be allowed under the automatic route for cash and carry wholesale trading and export trading. The Cabinet has also allowed FDI up to 51% with prior Government approval for retail trade in 'Single Brand' products with the objective of attracting investment, technology and global best practices and catering to the demand for such branded goods in India. This implies that foreign companies can now sell goods sold globally under a single brand, such as Reebok, Nokia and Adidas. Retailing of goods of multiple brands, even if the goods are produced by the same manufacturer, is not be allowed. Going ahead, the Government is expected to adopt a highly calibrated approach to allowing further FDI in the retail space. There is a possibility that the relaxation of FDI restrictions may take another 3-5 years. This may deter some international retailers from investing in a big way. However, regardless of the restrictions, international retailers are entering India in droves. The returns on FDI in retailing in India are likely to be greater than those in China because large Indian retailers are much smaller than their Chinese counterparts. International retailers will find the competitive environment easier on the market share and the growth fronts.

Benefits to the government



CHANGING RETAIL SCENERIO OF INDIA:

Then

• Self reliant mindset; closed economy

• High import tariff; high excise duty; low per capita incomes

• International brands unheard of; not much variety available

• Shopping: a task

• Savings oriented; high interest rates on small savings schemes

Now

• Liberal, open economy; entry of MNCs; high entrepreneurial spirit

• Reduced excise duty; low tax; high disposable income; affordable price

• Availability of variety

• Shopping: an experience;

• Policy direction: more consumption oriented

Shift to organized formats (from kirana shops to hypermarkets)

• Capital no longer a constraint –easy loans

• Availability of quality real estate

–Easing land regulations and releasing more land for retail; investment in real estate by organized players is on the up

–100% FDI under automatic route for real estate development -townships over 25 acres of land or commercial/retail developmenton floor space of over 500,000 sq. ft.

- **Regulatory framework falling into place**

  –Implementation of VAT (no tax evasion by traditional players)

  –Increasing availability of quality real estate

- **Retail—ripe for consolidation**

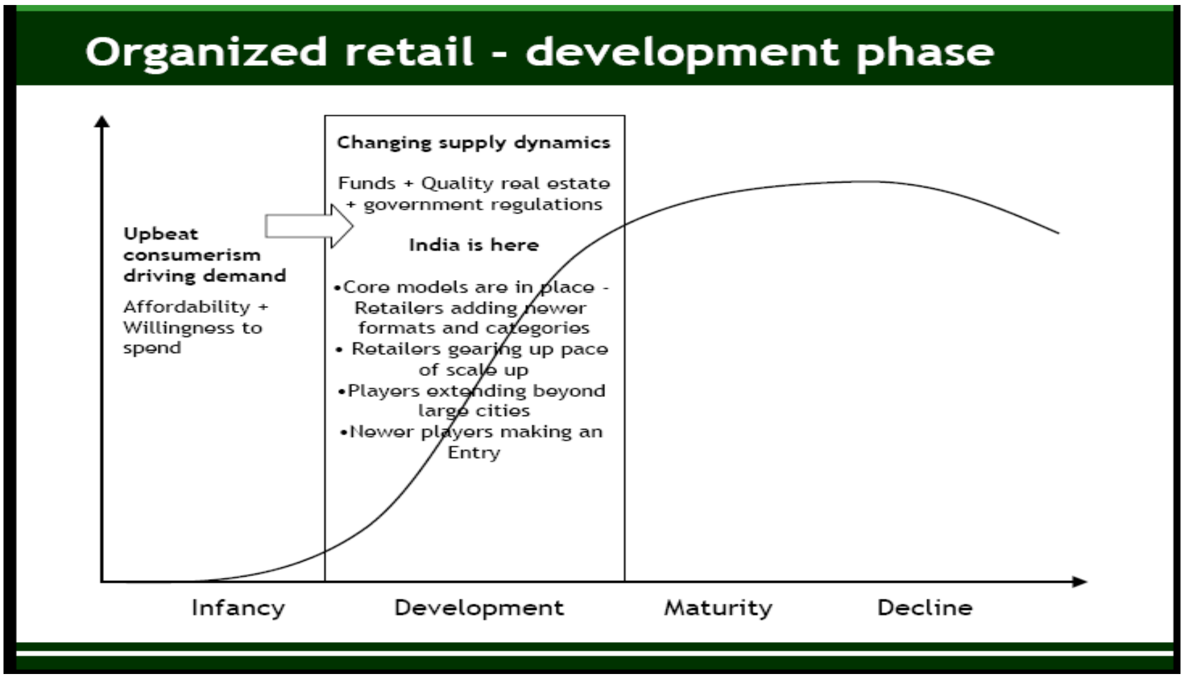
  –India: 1 retail outlet for 280 people

  –Global: 1 retail outlet for 1,800

(mm. sq. feet)	FY05	FY07E
NCR	3.7	22.5
Mumbai	4.95	20.25
Bangalore	1.8	3.75
Hyderabad	3.5	5.25
Pune	2	3.75
Rest of India	9.05	19.75
Total	**25**	**75**

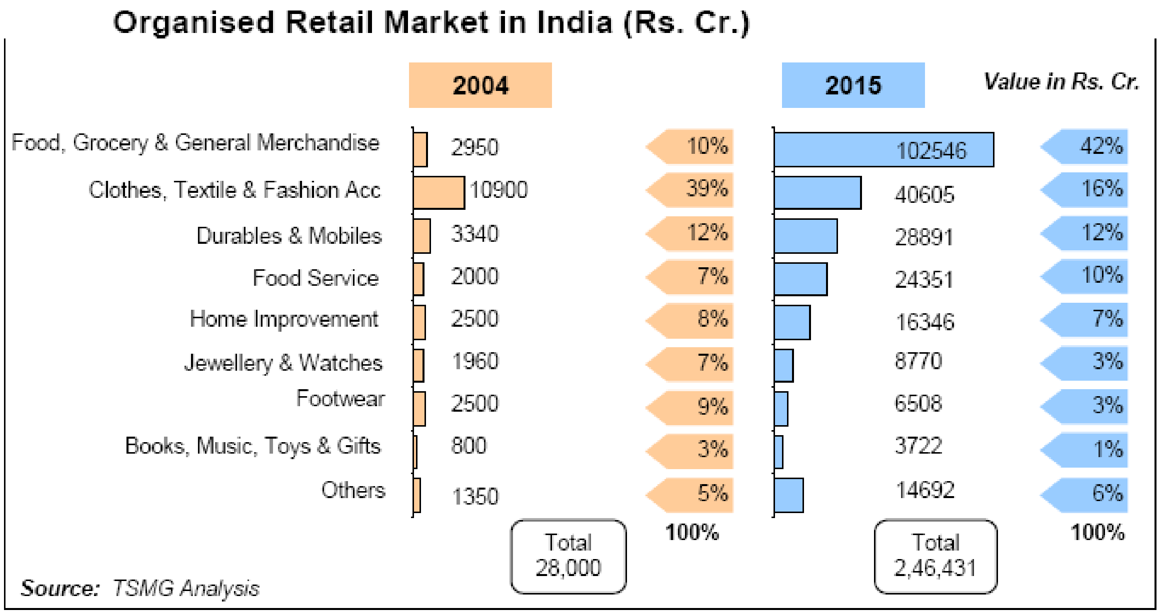
HOW FDI ?

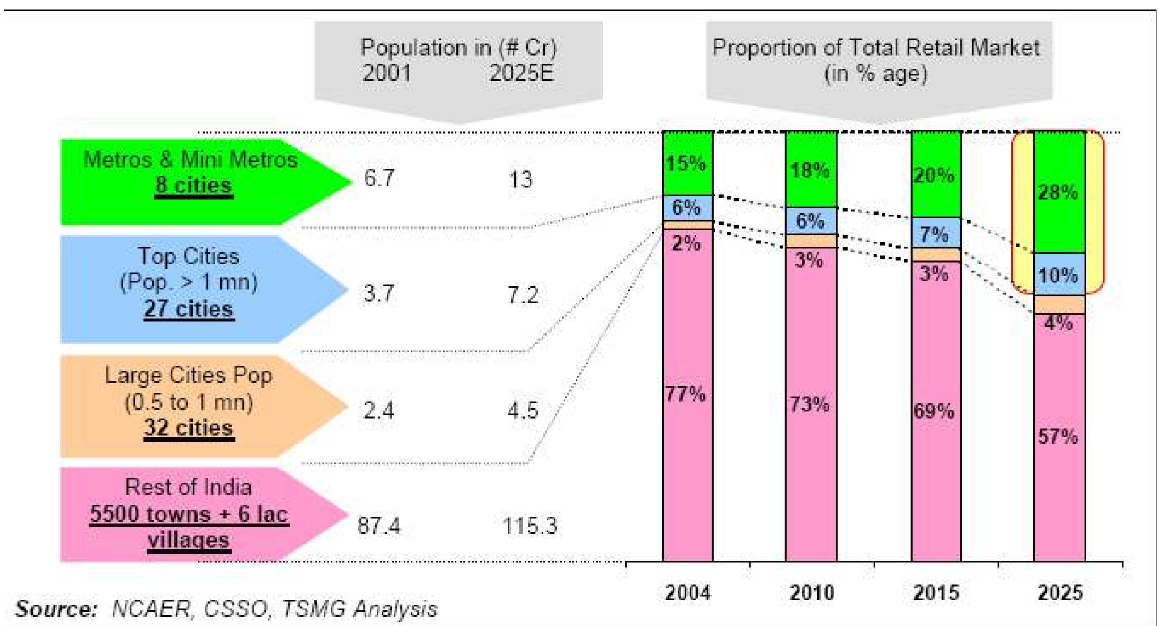
- FDI should be allowed in stages
  - Initial stages: 26% FDI
  - Establishment Phase: 49% FDI
  - Mature Phase: 100% FDI
- FDI policy
  - No incentives needed to attract FDI
  - Market size and potential are sufficient inducers
  - No need for costly tax breaks, import duty exemptions, land and power subsidies, and other enticements



Current FDI Regime in India:

- FDI is not permitted in retail trade sector, except in : Private labels Hi-Tech items/ items requiring specialized after sales services. Medical & diagnostic items.
- Items sourced from the Indian small sector (manufactured with technology provided by the foreign collaborator).
- For 2 Years test marketing (simultaneous commencement of investment in manufacturing facility required).
- 51% FDI is permitted in single brand retailing.





RECOMMENDATIONS:

- A **National Commission** must be established to study the problems of the retail sector and to evolve policies that will enable it to cope with FDI – as and when it comes.
- The proposed National Commission should evolve a clear set of **conditionalities on giant foreign retailers** on the procurement of farm produce, domestically manufactured merchandise and imported goods.
- Entry of foreign players must be **gradual and with social safeguards** so that the effects of the labour dislocation can be analysed & policy fine tuned.

- The government must actively encourage setting up of **co-operative stores** to procure and stock their consumer goods and commodities from small producers.

There is no doubt that the sector is growing on its own. However, one cannot deny the fact that the growth has been much slower as compared to the rest of the world. Over a 10 year period the share of organized retailing in total retailing has grown 40% in Brazil and 20% in China. In India it is only 2%. Government, as a facilitator, plays a significant role in the growth of this sector. Positive interventions are needed since the sector has huge employment potential and substantial backward linkages. At present there is no clear policy on retailing. Rather than a piecemeal effort, the government should come up with a comprehensive policy for opening up the sector with clear timelines. This would make it easier for domestic players to plan their future growth. Many laws relating to retailing, such as the Agriculture Produce Marketing Committee act (1976) and Essential Commodities Act (1955), are outdated & should be amended. Although Franchising is an important mode of conducting business, unlike countries such as US, India does not have a comprehensive legislation governing franchising. Such legislations should be implemented for protecting franchising rights. Appropriate Urban planning & supporting infrastructure is needed for the sector's healthy development. A retailer requires 12 to 15 clearances at the central/state/local levels to conduct business. A single-window clearance process would immensely reduce uncertainty, delays & red-tapism. There are various restrictions on inter-state movement of goods, especially food-grains. This forces retailers to source locally and they are not able to reap the benefits of economies of scale.

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