

# FDI in Retail: Future Expectation for Indian Economy

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## Abstract:

*This paper deals with issues related to FDI in retail sector in India. India is the third largest emerging market economy in the world. The retail sector contributes to more than 10% of India's GDP and gives employment to around 40 million people in India. Thus, flow of Foreign Direct Investment will have a huge impact on the economic performance of the country. The whole paper is divided into six parts. First part deals with the FDI and the types of FDI. Second part deals with the retail in India in which we have focused on different type of retail sector present in India. In the third and fourth section we have discussed FDI in retail in India and its impact with the help of SWOT analysis. In the fifth and sixth section we have discussed impact of FDI on real estate and unorganized sector.*

**Keywords:** FDI, Retail, Unorganized sector, Real estate, Impact, Employment

## I. Introduction

Investment made by a company based in one country into the company based in another country is called Foreign Direct Investment (FDI). FDI is different from Foreign institutional investment (FII) as in FII the overseas invest in the equities listed on a stock exchange. FDI is made in number of ways- either by setting up a subsidiary company in the host country by acquiring shares of the host country or through merger or joint venture. There are various factors which affects the inflow of FDI in a country like market size, differential rate of return,, resource location etc.

Types of FDI are as follows:

- 1) Horizontal FDI
- 2) Vertical FDI

## II. Retail in India

With the relaxation of the FDI policy, the government has ended a waiting period of more than seven years for multinational retailers to enter the market. The impact is likely to be a mixed initially as small retailers and middlemen/agents will face increased pressure on their business with the entry of the international retail-chain operators. Retailing is the sale of goods and services from individual or businesses to the end user. It is the last link that connects the individual consumer with the manufacturing and distribution chain. The Associated Chambers of Commerce and Industry of India (ASSOCHAM) predicts that the Indian retail sector is poised for 15% year-over-year growth over the next five years through 2018. This robust growth picture also is painted by AT Kearney, whose 2012 Global Retail Development Index (GRDI) puts India as the fifth most favorable destination for global retailers. In 2011, India's retail industry which is one of the fastest growing retail markets in the world accounted for 22% of India's GDP and employed close to 9.4% of the labor force. Organized retail in India currently constitutes only 6-7% of overall retail trade in India, although by 2016-17 this share is projected to grow to 10%. In the last few years retail sector in India have flourished, drivers being urbanization, increase in income of Indian middle class, increasing investment in technology, improvement in infrastructure, and change in the consumer profile due to increasing young population in India. This gives huge incentive to the foreign investors to invest in retail sector of India. The Indian retail sector can be divided into two parts:

- 1) *Organized sector:* It refers to trading activities undertaken by licensed retailers that is, those who are registered for sales tax, income tax. These include privately owned retail business and retail chains. The organized sector in India is at very nascent stage with very small share
- 2) *Unorganized sector:* It refers to traditional formats of low cost retailing for example, beedi shops, owner manned general stores, pavement vendors etc. Traditionally, small stores which we call kirana stores has been one of the easiest way to generate self employment as they require limited investment in land, capital and labor

## III. FDI in Retail

As it happened India's decision to allow foreign direct investment (FDI) in multi-brand retail towards the end of 2012 and its FDI policy modified in April 2013 put the country back on the retailing map of the world. However, this is not the first time that India has invited global retailers to set up their shops. In 1997, the government approved 100 percent FDI in "cash and carry" wholesale stores under the automatic route and, in 2006, 51 percent FDI was allowed in single-brand retailing, although with prior approval from the government. In December 2011, the government fully opened up FDI in single-brand retail stores. A number of international retail brands such as IKEA and Carrefour were excited to enter the Indian market and announced their plans to start talks on investment proposals with the concerned ministries. In the

much-debated and politically-sensitive multi-brand retail space, however, partial 51 percent FDI was proposed only in September 2012, with parliamentary approval in December 2012.

A development that is perceived to be a game changer for retail business in India will depend on retailers adaptation to local tastes and preferences. According to the Government of India's notification, 51% of FDI is permitted, subject to certain conditions.

1. *State Acceptance*: Stores may be set up in those states which allow FDI in multi brand retail under this policy. Such stores will be subject to compliance with applicable state laws and regulations.

2. *Minimum Investment*: The minimum amount that the foreign investors have to invest is US\$ 100 billion.

3. *Backend Investment*: Atleast 50% of total FDI brought in shall be invested in backend infrastructure with in three years of first tranche of FDI. Backend infrastructure includes capital expenditure on all activities, excluding that on front –end units , for instance, it includes investment made towards processing , manufacturing, distribution , quality control, design improvement, packaging, logistics, storage, ware house and agriculture market produce. Expenditure on land cost and rentals will not be counted for the purpose of backend infrastructure.

4. *Procurement*: Atleast 30% of the procurement of manufactured and processed product purchased shall be sourced from small industry globally with investment in plant and machinery not exceeding USD 1 million

5. *Location*: Retail sales outlet may be set up in cities with population of more than I million according to 2011 census and may also cover area of 10 km around municipal/ urban agglomeration limits of such cities. Only 53 cities in India qualify under this criterion

6. *Agriculture produce*: First right of procurement lies with the government.

#### **IV. Swot Analysis of FDI in Retail**

##### **A. Strength**

1. A large young working population with median age of 25 years, nuclear families in urban areas, along with increasing working women population and emerging opportunities in the service sector are going to be the key growth drivers of the organized retail sector in India,

2. Customers will have access to greater variety of international quality branded goods,

3. Employment opportunities both direct and indirect have been increased. Farmers get better prices for their products through improvement of value added food chain,

4. Increase in disposal income and customer aspirations are important factors; increase too in expenditure for luxury items,

5. It has also contributed to large scale investments in the real estate sector,

6. Large domestic market with an increasing middle class and potential customers with purchasing power,

7. The country will flourish in terms of quality standards and consumer expectations, since the inflow of FDI into the retail sector is bound to pull up the quality standards and cost-competitiveness of Indian producers in all the segments

8. The consumer get a better product at cheaper price, so consumers get value for their money.

##### **B. Weakness:**

1. Will mainly cater to high-end consumers placed in metros and will not deliver mass consumption goods for customers in villages and small towns,

2. Retail chain are yet to settled down with proper merchandise mix for the mall outlets,

3. Small size outlets are also one of the weaknesses in the Indian retailing, 96% of the outlets are le Small size outlets are also one of the weaknesses in the Indian retailing, 96% of the outlets are lesser than 500 sq. ft.

4. The rapid development of retail sector is the sharp improvement in the availability of retail space. But the current rally

in property prices, retail real estate rentals have increased remarkably, which may render a few retailing business houses unavailable. Retail companies have to pay high rentals which are blockage in the turn of profits. Rents in India easily account for 9-15% of retailers' revenue, which is significantly higher than the global average of 4-10%.

5. The volume of sales in Indian retailing is also very low.

C. Opportunities:

1. once the concept picks up, due to demonstration effect, there will be an overall up-gradation of domestic retail trade, Global retail giant takes India as key market. It's rated fifth most attractive retail market. The organized retail sector is expected to grow stronger than GDP growth in the next five years driven by changing lifestyle, increase in income and favorable demographic outline. Food and apparel retailing are key drivers of growth,

2. It can become one of the largest industries in terms of numbers of employees and establishments,

3. Rural retailing is still unexploited Indian market.

4. It will work positively for farmers and small-scale manufacturing hubs as they will find large-scale buyers for their products.

5. It will also be beneficial for customers as this will increase one-stop shopping options with access to international brands.

D. Threats:

1. one of the greatest barriers to the growth of modern retail formats are the supply chain management issues. For perishables, the system is complex. Government regulations, lack of adequate infrastructure and inadequate investment are the bottlenecks for retail companies,

2. Difficult to target all segments of society,

3. Emerge of hyper and super markets trying to provide customer with value, variety ad volume,

4. Heavy initial investment is required to break even with other companies and compete with them,

5. Labor rules and regulation are also not followed in the organized retails,

6. Lack of uniform tax system for organized retailing is also one of the obstacles

7. Problem of car parking in urban areas is serious concern,

8. Sector is unable to employ retail staff on contract basis,

9. The unorganized sector has dominance over the organized sector because of low investment needs.

10. Another hurdle is the role that Indian state governments can play in allowing FDI in the states they rule. Though the central government has allowed FDI in multi-brand retail at the Centre level, the state governments are at liberty to make their own decisions about the implementation of the policy

**V. Impact of FDI in Retail on Real Estate**

The recent decision of the government to allow foreign direct investment (FDI) in the multi-brand retail sector will also help the real estate sector in the country immensely due to increase in demand and increased investor confidence. The new international entrants will be willing to take longer term bets and invest in stores which will be sustainable over the long haul. Competition will increase as Indian retailers shape up and intensify their expansion plans - which had been fairly low over the past few years.

At the same time, as the demand for office space will continue to be strong, fresh jobs creation in the country will also see a strong growth. Normally, when a company takes 1,000 sq feet of office space on rent, it employs around seven people to fully utilize that space. That means, at least seven new people will enter the job market and, on average, five out them will buy residential apartments. Therefore, the requirement of residential space increases five times that of the commercial space use. Thus, if the demand for the commercial space remains strong, it will also continue to give a fillip to the residential real estate.

Currently, some retailers are cash-strapped and this will provide a sort of bail-out option to them. Overall, the investment by local and new international retailers that are likely to flow into the sector will definitely also take the form of

investments into real estate at the front end in terms of retail store spaces and of the back end in terms of better quality warehouses. Therefore, FDI in retailing expected to increase transparency in the retail real estate sector.

Also, it will increase the interest and confidence level of real estate developers to set up quality shopping centres. They now have reason to set behind them their experiences post-2008, and can once again consider investing in this asset class with a clear vision on long-term profit.

The main ingredient of real estate costs is land, which continues to remain stable and in fact is appreciating in most markets. This needs to be coupled with the cost of construction and cost of capital. There is also a challenge by alternative and much more lucrative investment opportunities in the form of residential projects, supported by stronger-than-expected demand for retail brought on by the opening up of FDI norms, this may actually accelerate land prices and the cost of space in shopping centres.

This will not happen immediately upon introduction of FDI in multi-brand retail. The reason is that there are a lot of non-performing retail assets on the market that will be absorbed in the first phase.

#### **VI. Impact of FDI on Unorganized Sector**

The unorganized retail sector is not a homogeneous category, it comprises of peddlers, street vendors, kiosks, push-cart vendors, weekly traders. It is not unknown that the majority of those engaged in retailing at the lower end of the economy depend on the small and medium enterprises for their supplies. It has been reiterated time and again, by many economists, how and under what conditions the unorganized sector has risen to such heights in India and other developing countries via the route of the neo-liberal regime. Indian retail market is quite diverse in terms of scale, culture and structure. Some reasons for this diversity can be attributed to the divide that exists between rural and urban India. Traditional forms of marketing (neighborhood markets, mandis, and periodic/weekly markets) coexist with modern day markets (supermarkets, hypermarkets, Single brand outlets etc.). Decline of the rural economy coupled with lack of employment in the manufacturing sector (organized sector) created a vast pool of surplus labour in the country in the post reform period. This multitude of labour started migrating to urban centres in search of employment and many of them landed up with self employment in the service sector of which retailing forms a huge part. Annihilation of small scale and self employed lower middle class will lead to large scale poverty and destitution because the unorganized sector is absorbing the shocks of migration and rural distress. It manages by catering to middle classes in the metropolis. If this market is gone, they will all be unemployed. With the entry of the multi-brand retail giants in the market two possibilities emerge (a) these retail giants are expected to procure 30 percent of goods from medium scale enterprises (but it is not necessary that these enterprises should be from the host country) thus, in case it decides to capture the domestic market it would create direct contact with small and medium enterprises and get commodities at the lowest possible cost and take benefit of the economies of scale. In case this happens, then the retail giants would slowly gain hands and monopolize the market and dictate the prices of essential commodities in the domestic market. This would slowly displace small vendors who don't have enough working capital to compete with retail giants. These vendors who till now were able to purchase goods from the wholesale market by proving their credit worthiness would no longer be able to give cash and carry goods to the retail market.

(b) Since multi brand retail stores have the liberty to buy products from anywhere in the world and they have enough resources to conduct market research, it would explore the world market and invest wherever they would be able to maximize their profits through final sale. In this scenario, small vendors and traders would continue to have access to the products which are produced by the small scale industries but at the same time these enterprises would face severe competition from cheap commodities imported from elsewhere. In the long run it is speculated that the prices of their commodities would fall in the markets and sooner or later these domestic small enterprises would be forced to quit.

#### **VII. Conclusion**

Consumers are always hungry for modern ways of shopping. Indian retail sector is growing fast and its employment potential is growing fast too. The retail scene is evolving very quickly. Retailers are rethinking their approaches towards the suppliers so that they can get the best pricing strategies for them. In the light of above, it would be prudent to encourage FDI in retail further. Of course, sufficient consideration should be given to the interests of SMEs, farmers and consumers while finalizing this decision.

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