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**FDI in Retail Sector: Problems and
Prospects**

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FDI in Retail Sector: Problems and Prospects

Introduction

Retailing is the interface between the producer and the individual consumer, buying for personal consumption. This excludes direct interface between the manufacturer and the institutional buyers, such as the Government and other bulk customers.

Retail industry comprises both the organised and the unorganised sectors. Organised 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. Unorganised retailing, on the other hand, refers to the traditional formats of low-cost retailing, for example, the local kirana shops, owner operated general stores, paan/beedi shops, convenience stores, hand cart, pavement vendors, etc. In India around 95% of the retail industry is unorganized. Among the organized ones, the already established retailers in India are Pantaloon Retail, Shoppers' Stop, Marks & Spencer, Hyper City, Lifestyle, Subhiksha, Trent, Reliance Retail etc., which is 5% of the total retail market. Retail sector in India is estimated to account for about 10 per cent share in GDP, as compared to 8 per cent in China, 6 per cent in Brazil and 10 per cent in USA. India is estimated to have around 15 million retails outlets¹.

India is now the last major frontier for globalized retail. In twenty years since the economic liberalisation of 1991, India's middle class has greatly expanded, and so has its purchasing power. But over the years, unlike other major emerging economies, India has been slow to open its retail sector to foreign investment. Recent signals from the government however suggest that this may be about to change: global supermarket chain store such as Wal-Mart (United States), Carrefour (France), Marks and Spencer

¹ India, Lok Sabha Secretariat, Department Related Standing Committee on Commerce, 90th Report on Foreign and Domestic Investment in Retail Sector, presented on 8 June, 2009

and Tesco (United Kingdom), and Shoprite (South Africa) may finally be allowed to setup shops in India².

Background of Policy on FDI in Trading

- As per the Statement on Industrial Policy dated 24th July, 1991, FDI in the Trading sector was permitted up to 51 % only in the trading companies, primarily engaged in export activities.

In 1997

- FDI in trading companies was permitted vide Press Note 3 (1997) as part of the guidelines for Foreign Investment Promotion Board (FIPB) for considering proposals for FDI. As per this policy, FDI up to 100% was permitted under the FIPB route in case of trading companies, for the following activities:
 - (a) exports
 - (b) bulk imports with ex-port/ex-bonded warehouse sales
 - (c) cash and carry wholesale trading
 - (d) other import of goods or services provided at least 75% is for procurement and sale of goods and services among the companies of the same group and not for third party use or onward transfer/distribution/sales.

As part of liberalisation process in the year 2000, in addition to FDI in export trading, bulk imports with ex-port/ex-bonded warehouse sales, and wholesale cash and carry trading, other permissible modes of trading as per the Export-Import Policy were opened up for FDI viz. in companies for providing after-sales service; domestic trading of products of joint ventures; trading of high-tech items; items for social sector; hi-tech medical and diagnostic items; items sourced from Small Scale Industries (SSI) sector; domestic sourcing of products for exports; test marketing of such items for which a company has an approval for manufacture provided such test marketing facility is for a

² Foreign Direct Investment in India's Retail Bazar: Opportunities and Challenges, March 2011, by Anusha Chari, University of North California and T.C.A. Madhav Raghavan, Indian Statistical Institute, New Delhi

period of two years and investment in setting up manufacturing facilities commences simultaneously with test marketing.

Current Regulation on FDI in Trading Sector

FDI up to 51% is permitted, with prior Government approval in single brand retail and 100% is permitted under the automatic route in wholesale/cash and carry trading, including business-to-business sales, and export trading. FDI up to 100% is permitted with prior Government approval in trading of items sourced from small scale sector and test marketing. Also, FDI is permitted under the automatic route for Storage and Warehousing services, including warehousing of agricultural products with refrigeration (cold storage). The FDI limit of 74% was increased to 100%.

FDI up to 51%, with prior Government approval, is allowed in retail trade of single brand products, subject to the following conditions:

- (i) FDI up to 51% would be allowed, with prior Government approval, for retail trade of Single Brand Products;
- (ii) Products to be sold should be of a 'Single Brand' only.
- (iii) Products should be sold under the same brand internationally.
- (iv) 'Single Brand' product-retailing would cover only products which are branded during manufacturing³.

Provisions of other Countries

FDI in retail trade is allowed in most Asian countries. China has, from December, 2004, lifted all restrictions on the number or location of retail outlets and FDI up to 100% is permitted. Malaysia permits FDI up to 70% in the retail trade sector and proposals for FDI beyond 70% are considered on a case-to-case basis. Thailand, Indonesia and Brazil also permit 100% FDI in retail sector⁴.

³ India, Lok Sabha Secretariat, Department Related Standing Committee on Commerce, 90th Report on Foreign and Domestic Investment in Retail Sector, presented on 8 June, 2009

Multi-Brand Retail FDI Policy in Other Countries⁵

S. No.	Country	FDI Limits	Benefits	Remarks
1.	China	100%	<ul style="list-style-type: none"> • First permitted in 1992 with foreign ownership restricted to 49%, progressively lifted and now no restrictions. • Over 600 hypermarkets opened between 1996 and 2001 • The number of small outlets (equivalent to 'kiranas') increased from 1.9 million to over 2.5 million • Employment in the retail and wholesale sectors increased from 28 million people to 54 million people from 1992 to 2001. 	Impressive growth in retail and wholesale trade.
2.	Thailand	100%	<ul style="list-style-type: none"> • Referred to a country where FDI had an adverse effect on the local retailers. • Has a limited capital requirement for retail and wholesale outlets. 	Growth in agro processing industry.
3.	Russia	100%	<ul style="list-style-type: none"> • Supermarket revolution took place in 2000s. • Heavy growth registered. 	
4.	Indonesia	100%	<ul style="list-style-type: none"> • Modern retail took off in 1990s. • No limit on number of outlets 	
5.	Malasia	70%	Matahari is leading chain.	
6.	Brazil, Argentina, Singapore & Chile also allow 100% FDI in retail sector.			

Concern about Opening up Indian Retail to FDI

A number of concerns have been raised about opening up the retail sector with restrictions for FDI in India. The first concern is the potential impact of large foreign firms on employment. Following agriculture, in 2007-2008, the retail sector is the second largest employer in India (National Sample Survey Organization, 64th round). Retail trade employed 7.2% of the total workforce which translates to 33.1 million jobs (Department of Industrial Policy and Promotion (DIPP) Report, 2010). Moreover, the

⁴ Ibid

⁵ India, Ministry of Commerce and Industry, PIB Release *Background material on Cabinet Decision on FDI in Retail*, dated 25.11.2011 (<http://pib.nic.in/newsite/printrelease.aspx>)

share of retail employment has risen significantly when compared to its share in 1~993-1994. The pattern holds for both males and females, in rural, and in urban areas.

Employment Shares in Retail Trade, 1993-2008

	Rural		Urban	
	Male	Female	Male	Female
2007-08	5.6	1.7	18.8	8.6
1993-94	3.63	1.4	14.6	6.66

Source: Authors' calculations based on data from DIPP report. Each cell has the average percent of the retail sector in total employment over the given time period.

The second concern is that FDI may lead to unfair competition and ultimately result in large-scale exit of incumbent domestic retailers, especially the small family-owned business because a large unorganized component of the retail sector is a major issue.

Following are the some main issues relating to FDI in retail which could be taken into consideration:—

- FDI driven modern retailing would be labour displacing. Any policy that results in elimination of jobs in the unorganized retail must be put on hold, till jobs on a large scale can be created in the manufacturing sector. The growth rate of labour in manufacturing and industry is insufficient to absorb the labour that may be displaced.
- The global retail chains, with their deep pockets, would be able to sustain losses for many years, till their immediate competitors were wiped off. The predatory pricing strategy of large retailers would drive out small retailers, resulting in job losses.
- Once monopoly of global retail chains was established, they were more likely to buy cheap and sell dear, disintegrate established supply chains by controlling both ends of the chain.
- Retailing cannot boost GDP by itself. It is only an intermediate value added process. Only after the tardy growth in manufacturing is addressed properly, dislocating some of the retailing workforce into this space could be thought of.

- Allowing FDI in retail would disrupt the current balance of the economy by rendering millions of small retailers jobless⁶.

Steps taken by the Government to analyze the Impact of FDI on retail sector

Government is in the process of studying the impact of FDI in the retail sector. The retail sector is growing at the rate of 8-9% per annum and a number of big Indian business houses are entering in the retail sector. Food constitutes 70% of the retail sector and is also directly linked to the rural economy. Food worth Rs. 50,000 crore rots in India. There is no organized system for storage, for processing, for trading and for grading of food items. Any move that would avoid loss of food and benefit the farmers through better procurement prices would need to be considered.

Government is looking at different models with specific focus on augmenting manufacturing activity; upgradation of technology and generation of employment. These are essential ingredients of FDI in any sector⁷.

Impact on unorganized retailers

- Unorganized retailers in the vicinity of organized retailers experienced a decline in their volume of business and profit in the initial years after the entry of large, organized retailers.
- The adverse impact on sales and profit weakens over the time.
- There was no evidence of a decline in overall employment in the unorganized sector as a result of the entry of organized retailers.
- There is competitive response from traditional retailers through improved business practices and technology upgradation.

⁶ Foreign Direct Investment in India's Retail Bazar: Opportunities and Challenges, March 2011, by Anusha Chari, University of North California and T.C.A. Madhav Raghavan, Indian Statistical Institute, New Delhi

⁷ India, Lok Sabha Secretariat, Department Related Standing Committee on Commerce, 90th Report on Foreign and Domestic Investment in Retail Sector, presented on 8 June, 2009

Impact on consumers

- Consumers have definitely gained from organized retail on multiple counts.
- Overall consumer spending has increased with the entry of the organized retail.
- While all income groups saved through organized retail purchases, the survey revealed that lower income consumers saved more. Thus, organized retail is relatively more beneficial to the less well-off consumers.
- Unorganized retailers have significant competitive strengths that include consumer goodwill, credit sales, amenability to bargaining, ability to sell loose items, convenient timings and home delivery.

Impact on farmers

- Farmers benefit significantly from the option of direct sales to organized retailers.
- Average price realization for cauliflower farmers selling directly to organized retail is about 25 per cent higher than their proceeds from sale to regulated Government mandi.
- Profit realization for farmers selling directly to organized retailers is about 60 per cent higher than that received from selling in the mandi.
- The difference is even larger when the amount charged by the commission agent (usually 10 per cent of sale price) in the mandi is taken into account⁸.

Recommendations in the Mid Term Appraisal of Tenth Plan

- Mid Term Appraisal of the tenth Five Year Plan made a strong case for FDI in modern retailing as entry of modern foreign retailers through joint ventures in India would help develop backward linkages to sources of supply and thus develop a domestic supply chain capable of meeting international standards.
- Review of the existing policy as part of general strategy of promoting labour intensive manufacturing by the same retailers has been suggested.
- Fears of large adverse effects on existing retailers are grossly exaggerated especially since modern domestic retailing has begun in any case.

⁸ *Ibid*

- Allowing FDI in joint ventures is likely to provide access for domestic suppliers to international retailing which purely domestic modern retailers may not be able to offer.

Committee on Foreign and Domestic Investment in Retail Sector-90th Report of Department Related Parliamentary Standing Committee on Commerce

The Hon'ble Department Related Parliamentary Standing Committee on Commerce, in its 90th Report, on 'Foreign and Domestic Investment in Retail Sector', laid in the Lok Sabha and the Rajya Sabha on 8 June, 2009, had made an in-depth study on the subject and identified a number of issues related to FDI in the retail sector. These included:

- Labour displacing effects of FDI driven modern retailing
- Job losses due to predatory pricing strategies of large retailers
- Disintegration of established supply chains by establishment of monopolies of global retail chains, leading to their control of both ends of the supply chain
- Inability of retail to boost GDP by itself, it being only an intermediate value added process
- Disruption of current balance of the economy by rendering millions of small retailers jobless⁹.

Rationale for FDI in Retail Trading

In the light of above mentioned various studies on impact the rationale for allowing the FDI in retail is that the Agriculture sector needs well-functioning markets to drive growth, employment and economic prosperity in rural areas of the country. Further, in order to provide dynamism and efficiency in the marketing system, large investments are required for the development of post-harvest and cold-chain infrastructure nearer to the farmers' field. FDI in front end retailing is imperative to fund

⁹ India, Ministry of Commerce and Industry, Department of Industrial Policy and Promotion, Discussion Paper on FDI in Multi-brand Retail (http://dipp.nic.in/english/discuss_p)

this investment. Allowing FDI in front end retail operations will enable organized retailers to generate sufficient cash to fund this investment.

International retailers should be mandated to bring with them technology and management know-how which will ensure that investment in organized retail works to India's advantage. In order to provide dynamism and efficiency in the marketing system, large investments are required for organized retailing, linked with the back end of the value chain. FDI in front-end retailing is imperative to derive full advantage of the value chain for the producer and the consumer.

FDI in retail, may, therefore, be an efficient means of addressing the concerns of farmers and consumers, as referred to above. The private sector, especially organized retail, is best suited to make investments of this magnitude. Permitting foreign investment in food-based retailing is likely to ensure adequate flow of capital into the country & its productive use, in a manner likely to promote the welfare of all sections of society, particularly farmers and consumers.

It is therefore clear that organized retail cannot have a cake walk and will face a growing challenge from the unorganized retail sector. It is possible that the unorganized retail sector may be re-inventing itself, through new and improved practices, to meet the challenges posed by organized retail. It is also evident that without addressing the gaps in the value chain, organized retail will neither be profitable nor make any great difference to the economy¹⁰.

'FDI in India's Retail Sector: More Bad than Good?'

- i) The retail sector is severely constrained by limited availability of bank finance. The Government and the RBI need to evolve suitable policies to enable retailers in the organized and unorganized sector to expand and improve efficiencies.
- ii) A National Commission should be set up to study the problems of the retail sector which should also evolve a clear set of conditionalities on foreign retailers on procurement of farm produce, domestically manufactured merchandise and

¹⁰ *Ibid*

imported goods. These conditionalities must state minimum space, size and other details like construction and storage standards.

- iii) Entry of foreign players must be gradual with social safeguards so that the effects of labour dislocation can be analyzed and policy fine tuned. Foreign players should initially be allowed only in metros.
- iv) Manufacturing sector in India must be developed to address the dislocation of existing retailers¹¹.

FDI in Multi Brand Retail

The Government on 20 September 2012 notified 51 per cent foreign direct investment in multi-brand retail, paving way for players such as Carrefour and Walmart to enter India.

The notification will allow major retail chains like Walmart to hold majority stake in a local partner and also sell directly to consumers. India's retail business is estimated between \$450 and \$600 billion and is growing at over 20 per cent on Compound Annual Growth Rate (CAGR) basis. Previously, 100 per cent FDI was allowed in cash and carry. According to Government Policy, opening up of the retail sector will improve the farm-to-fork efficiency, besides building backend infrastructure like cold chain. The move will eliminate middlemen and also help in taming inflation. However, opening up of the retail sector will come with strict riders.

According to current policy on FDI in retail, foreign retailers will only be allowed to set up shop in cities with a population of more than 1 million, and must source at least 30 per cent of the goods from local and small industries. The State Governments will have the freedom to decide whether to allow the supermarkets on their patch and the minimum investment will be \$100 million in the near future¹².

¹¹ *Ibid*, p. 27

¹² *Government's Stands Firm, Notifies 51% FDI in Multi-brand Retail (News Item)*, Hindu Business Line, New Delhi, Dated 21.9.2012

The government's decision to open up foreign direct investment (FDI) in multi-brand retail and relax rules for single-brand stores, is a useful reform in itself and, more importantly, allowing foreign retailers management control in multi-brand retail would ensure a well-capitalised industry and induce foreign retailers to invest in back-end operations and infrastructure. Nine states have already backed the reform that is expected to create millions of jobs and help tame inflation by reducing wastage. However, merely opening up multi-brand retail will not suffice. Other complementary state-level reforms are needed. States should scrap the Agricultural Produce Marketing Committee (APMC) Act that denies farmers the freedom to buy and sell freely and only empowers middlemen. Alternatively, the Act can be amended to exclude perishables from its fold. Organised structures are needed for farmers to enhance their bargaining power vis-a-vis big retail chains.

Amul is a successful example of how farmers have enhanced their capacity to negotiate prices with big buyers. Its organised supply chain links farmers with consumers, raises income for producers and lowers retail prices. Political parties should get into the act and organise farmers into larger collectives, companies or producer cooperatives. This, in turn, will ensure a vibrant and functional futures market for commodities.

For single-brand retail stores, the government has diluted a rule that requires them to source 30% of what they sell from Indian vendors whose investment in plant and machinery is less than \$1 million.

This initiative is welcome as the old rule was irrational. It has also scrapped a rule that mandated that the foreign investor should also be the owner of the brand. This makes eminent sense, given that single-brand stores adopt various business models. It will attract more foreign investment¹³.

¹³ *Beneficial Retail (Editorial)*, Economic Times, New Delhi, dated 17.9.2012

Forecasts for Retail Sector Growth in India

The data from private consulting company reports suggest that growth in the retail market has been rapid despite major restrictions on FDI. In the third-quarter report of 2010, the Brand Marketing India (BMI) India Retail Report forecasts that the total retail sales will grow from US\$ 353 billion in 2010 to US\$ 543.2 billion by 2014. An important consideration, the report suggests that there is the fast-growing middle and upper class consumer base. The analysis also suggests that in the next few years there will be major opportunities in India's smaller cities¹⁴.

Conclusion

Despite encouraging signs, India's retail market remains largely off-limits to large international retailers like Wal-Mart and Carrefour. Opposition to liberalizing FDI in this sector raises concerns about employment losses, unfair competition resulting in large-scale exit of incumbent domestic retailers and infant industry arguments to protect the organized domestic retail sector that is at a nascent stage. Based on international evidence, allowing entry by large international retailers into the Indian market may help tackle inflation especially in food prices. Moreover, technical know-how from foreign firms, such as warehousing technologies and distribution systems can improve supply chain efficiency in India, in particular for agricultural produce. Better linkages between demand and supply have the potential to improve the price signals that farmers receive and also serve to enhance agricultural and other exports¹⁵.

¹⁴ Foreign Direct Investment in India's Retail Bazar: Opportunities and Challenges, March 2011, by Anusha Chari, University of North California and T.C.A. Madhav Raghavan, Indian Statistical Institute, New Delhi, p. 4

¹⁵ *Ibid*, p. 1