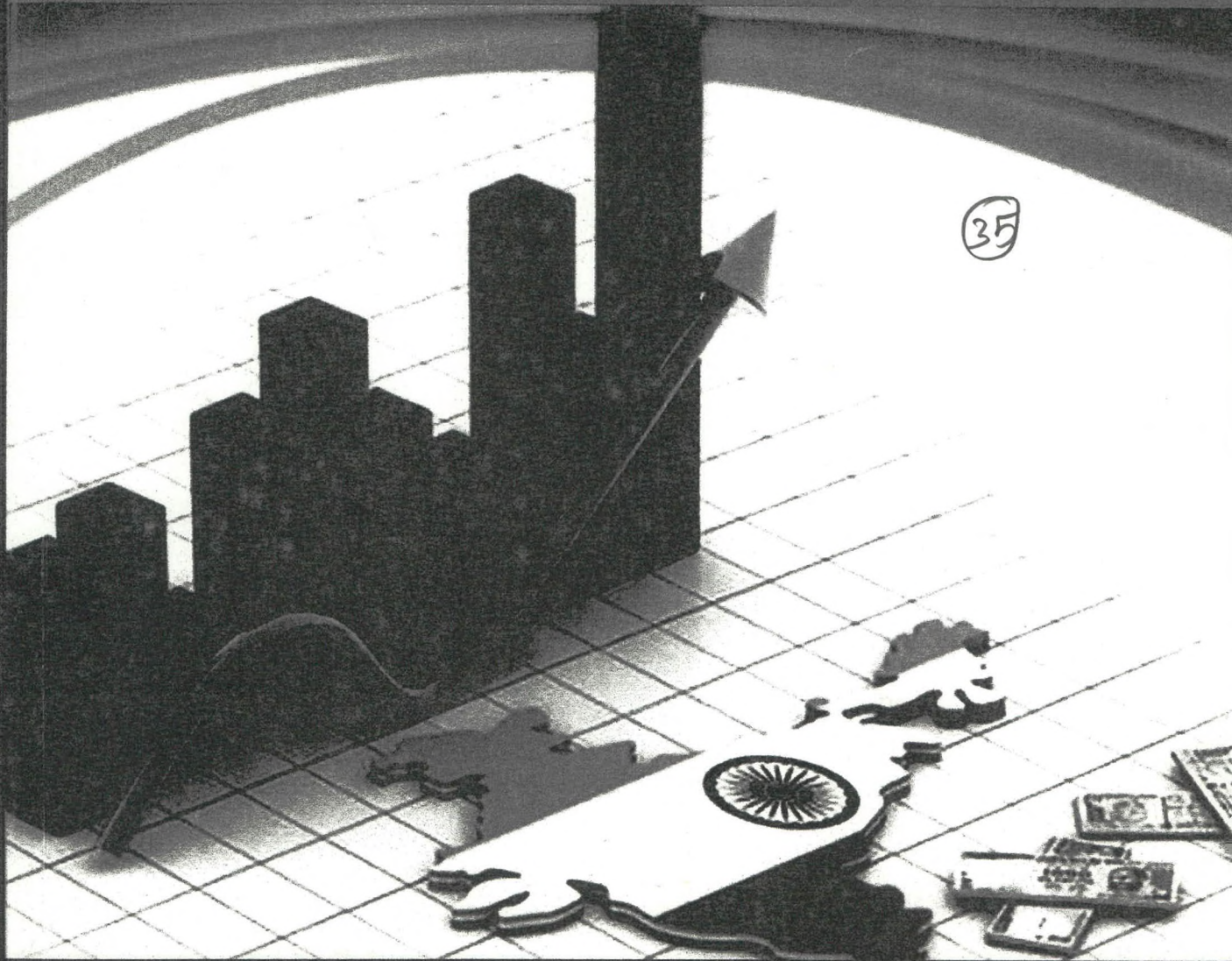


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# **Foreign Direct Investment in Retail Sector: Opportunities and Challenges**

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## **Introduction**

The Foreign Direct Investment means cross border investment made by a resident in one economy in an enterprise in another economy, with the objective of establishing a lasting interest in the investee economy. India is the 3rd largest economy of the world in terms of purchasing power parity and thus looks attractive to the world for FDI. Foreign direct investment, commonly known as FDI, refers to an investment made to acquire lasting or long-term interest in enterprises operating outside of the economy of the investor. The investment is direct because the investor, which could be a foreign person, company or group of entities, is seeking to control, manage, or have significant influence over the foreign enterprise. The purchase or establishment of income-generating assets in a foreign country that entails the control of the operation or organisation. FDI is not just a transfer of ownership as it usually involves the transfer of factors complementary to capital, including management, technology and organisational skills. Even Government of India, has been trying hard to do away with the FDI caps for majority of the sectors, but there are still critical areas like retailing and insurance where there is lot of opposition from local Indians and Indian companies. Some of the major economic sectors where India can attract investment are Telecommunications, Apparels, Information Technology, Pharma, Auto parts, Jewelry, Chemicals.

In last few years, certainly foreign investments have shown upward trends but the strict FDI policies have put hurdles in the growth in this sector. India is however set to become one of the major recipients of FDI in the Asia-Pacific region because of the economic reforms for increasing foreign investment and the deregulation of this important sector. India has technical expertise and skilled managers and a growing middle class market of more than 300 million and this represents an attractive market.

It plays an important role in the long-term development of a country not only as a source of capital but also for enhancing competitiveness of the domestic economy through transfer of technology, strengthening infrastructure, raising productivity and generating new employment opportunities. FDI in retail sector can expand markets by reducing transaction and transformation costs of business through adoption of advanced supply chain and benefit consumers and suppliers. FDI in multi-brand retail will support the government's role of achieving remunerative prices for farmers and will also increase quality and choice for India's increasingly sophisticated consumer base

### **Types of FDI**

FDI comes in three types they are – Horizontal, Vertical and Conglomerate

*Horizontal:* where the company carries out the same activities abroad as at home (for example, Toyota assembling cars in both Japan and the UK.

*Vertical:* when different stages of activities are added abroad. Forward vertical FDI is where the FDI takes the firm nearer to the market (for example, Toyota acquiring a car distributorship in America) and Backward Vertical FDI is where international integration moves back towards raw materials (for example, Toyota acquiring a tyre manufacturer or a rubber plantation).

*Conglomerate:* where an unrelated business is added abroad. This is the most unusual form of FDI as it involves attempting to overcome two barriers simultaneously - entering a foreign country and a new industry. This leads to the analytical solution that internationalisation and diversification are often alternative strategies, not complements.

### **FDI in Multi-Brand Retail**

FDI in Multi Brand retail implies that a retail store with a foreign investment can sell multiple brands under one roof. FDI in multi-brand retail will mean that global retailers including Wal-Mart, Carrefour and Tesco can open stores offering a range of household items and grocery directly to consumers in the same way as the ubiquitous 'kirana' store.

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.

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. However, it will work positively for farmers and small-scale manufacturing hubs as they will find large-scale buyers for their products. It will also be beneficial for customers as this will increase one-stop shopping options with access to international brands. It could require an additional 6-10 years for the market to mature.

#### **Opportunities/Benefits of FDI**

- (1) **Growth in Economy:** Due to foreign companies entering into retail sector, new infrastructure will be built thereby bolstering the jaggging real estate sector. In turn, banking sector will also grow as the funds needed to build infrastructure will be provided by banks.
- (2) **Job Opportunities:** It has been estimated according to government, that approximately ten million jobs will be created mostly in retail and real estate sectors.
- (3) **Benefits to Farmers:** In the retailing business, the intermediaries have dominated the interface between the manufacturers or producers and the consumers. Hence the farmers and manufacturers lose their actual share of profit margin, as the lion's share is eaten up by the middlemen. This issue can be resolved by FDI, as farmers might get contract farming, where they will be able to supply an organised retailer based upon demand and will get paid handsomely for that and they need not run in search of buyers.
- (4) **Benefits to consumers:** Consumers will get variety of good quality products at low prices compared to market rates and will be able to choose from various international brands at one place.

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- (5) **Lack of Infrastructure:** This has been one of the common issues in the retailing chain in India for years, which has led to the process of an incompetent market mechanism. To cite an example, inspite of India being one of the largest producers of fruits and vegetables, lack of proper cold storage facility significantly affects the selling of these perishable items and also in huge losses. Allowing FDI might help India have better logistics and storage technologies resulting in avoiding wastage. Due to FDI foreign companies will invest around \$ 100 million in India. Thereby, infrastructure facilities, refrigeration technology, transportation sector will get a boost.
  - (6) **Cheaper Production facilities:** FDI will assure operations in production cycle and distribution. Due to economies of operation, production facilities will be available at a cheaper rate and thus resulting in availability of variety products to the ultimate consumers at a reasonable and cheaper price.
  - (7) **Availability of new technology:** FDI allows transfer of skills and technology from abroad and develops the infrastructure of the domestic country. Greater managerial talent will flow in from other countries. Domestic consumer will get the benefit of getting great variety and quality products at all price points.
  - (8) **Long term cash liquidity:** FDI will render necessary capital for establishing organised retail chain stores. It is a long term investment because the physical capital in the domestic company is not easily liquidated.
  - (9) **Conducive for the country's economic growth :** FDI will create a competition among the global investors, which will ultimately guarantee better and lower prices, thereby benefiting people in all sections of the society. The market growth and expansion will increase. It will step-up retail employment. It will ensure better managerial techniques and success. Higher wages will be paid by the international companies. Urban consumers will be exposed to international lifestyles.
  - (10) **FDI opens up a new avenue for Franchising:** Restrictions on FDI are regarded as trade barriers as they traverse direct market access to foreign firms. Retail giants who are very keen in looking for entry into foreign markets look for other available alternatives. These restrictions on the global retailers regarding the inflow of FDI, leads them towards getting the market entry through franchises. Thus, countries which offer promising market potentialities for retail growth offer substantial growth in the franchising sector also.

According to the Indian Government's condition, foreign companies have to source a minimum of 30% of their goods from Indian micro and small industries. This will encourage the domestic manufacturing by creating a big effect for employment and technology

upgradation and income generation. Countries like China, Indonesia and Thailand have 100% FDI in retail. Reports show that these countries have experienced high growth in agro processing industry, refrigeration technology and infrastructure. Foreign countries will also create a supply chain management in the Indian market. This will result in avoidance of food wastage and perishables.

### **Challenges of FDI**

The industry is facing a severe shortage of talent, especially at the middle management level. Most Indian retail players are under serious pressure to make their supply chain more efficient in order to deliver the level of quality and service that consumers are demanding. Long intermediation chain would increase the cost by 15 per cent. The retailer does not have industry status yet making it difficult for retailers to raise finance from Bank to fund his expansion plan; governments restrictions on the FDI are leading to an absence of foreign players resulting in limited exposure to best practice. India's retail sector remains off-limits to large international chains especially in multi-brand retailing.

The first concern is the potential impact of large foreign firms on employment in the retail sector. A second related concern raised in the DIPP's report is that opening up FDI would lead to unfair competition and ultimately result in large-scale exit of incumbent domestic retailers, especially the small family-owned business. A third concern raised by domestic incumbent firms in the organized retail sector is that this sector is under-developed and in a nascent stage. Here we argue that the potential benefits from allowing large retailers to enter the Indian retail market may outweigh the costs. Evidence from the United States suggests that FDI in organized retail could help tackle inflation, particularly with wholesale prices. It is also expected that technical know-how from foreign firms, such as warehousing technologies and distribution systems, will lend itself to improving the supply chain in India and added benefit of improved distribution and warehousing channels may also come from enhanced exports. 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.

India is focusing on maximizing political and social stability along with a regulatory environment. In spite of the obvious advantages of FDIs, there are quite a few challenges facing larger FDIs in India, such as:

1. **Resource challenge:** India is known to have huge amounts of resources. There is manpower and significant availability of fixed and working capital. At the same time, there are some underexploited or unexploited resources. The resources are well

available in the rural as well as the urban areas. The focus is to increase infrastructure 10 years down the line, for which the requirement will be an amount of about US\$ 150 billion. This is the first step to overcome challenges facing larger FDI.

2. **Equity challenge:** India is definitely developing in a much faster pace now than before but in spite of that it can be identified that developments have taken place unevenly. This means that while the more urban areas have been tapped, the poorer sections are inadequately exploited. To get the complete picture of growth, it is essential to make sure that the rural section has more or less the same amount of development as the urbanized ones. Thus, fostering social equality and at the same time, a balanced economic growth.
3. **Political Challenge:** The support of the political structure has to be there towards the investing countries abroad. This can be worked out when foreign investors put forward their persuasion for increasing FDI capital in various sectors like banking, and insurance. So, there has to be a common ground between the Parliament and the Foreign countries investing in India. This would increase the reforms in the FDI area of the country.
4. **Federal Challenge:** Very important among the major challenges facing larger FDI, is the need to speed up the implementation of policies, rules, and regulations. The vital part is to keep the implementation of policies in all the states of India at par. Thus, asking for equal speed in policy implementation among the states in India is important. India must also focus on areas of poverty reduction, trade liberalization, and banking and insurance liberalization. Challenges facing larger FDI are not just restricted to the ones mentioned above, because trade relations with foreign investors will always bring in new challenges in investments.

## Conclusion

FDI in the retail sector would not only lead to a substantial surge in the country's GDP and overall economic development, but would also help in integrating the Indian retail market with that of the global retail market in addition to providing not just employment but a better paying employment, which the unorganized sector (kirana and other small time retailing shops) have undoubtedly failed to provide to the masses employed in them. Thus, as a matter of fact FDI in the buzzing Indian retail sector should not just be freely allowed but should be significantly encouraged. Allowing FDI in multi brand retail can bring about Supply Chain Improvement, Investment in Technology, Manpower and Skill Development, Tourism Development, Greater Sourcing from India, Up-gradation in Agriculture, Efficient Small

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and Medium Scale Industries, Growth in market size and Benefits to Government through greater GDP, tax income and employment generation. FDI provides job opportunities and benefits farmers and consumers.

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