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Problems and Prospects of FDI in Indian Retail Sector

[1]S. Pattu Meenakshi, [2]Venkata Subrahmanyam C. V., [3]Dr. K. Ravichandran
[1]Research Scholar, Department of Management Studies, Madurai Kamaraj University, Madurai – 625 021
[2]Research Scholar, Department of Entrepreneurship Studies, Madurai Kamaraj University, Madurai – 625 021
[3]Professor & Head, Department of Entrepreneurship Studies, Madurai Kamaraj University, Madurai – 625 021

ABSTRACT: *Today India was being looked up by many foreign nations as the scope of investment is seen to be high in our country for the availability of huge resources. Retail Industry has spotted India for stamping its development which had led to the origin of many retail stores. Though it's been argued that it may affect the local players, many organized retail stores were brought in and they are running successfully covering standard customers for them. FDI as an important means to reorganize the production facilities globally is regarded as an important vehicle for economic development particularly for developing economies. Indian government promotes FDI in retail sector by providing up to 51% for single brand segment and 100% in wholesale segment. It gives an opportunity for the global retail giants to enter India. This paper focuses on the problems and prospects of FDI in Indian retail sector in multibrand segment which aims to give a brief idea about the implications of foreign investments in retail sectors.*

I. INTRODUCTION

Though foreign direct investments (FDIs) in India were significant in the 1950s and 1960s, FDI inflows were meager in the 1970s and 1980s. By the mid-1980s, the stagnation and technological obsolescence in Indian industry led to a push for economic reform and deregulation of exchange controls. As a result of the reforms agreed with the IMF, FDI boomed in post reform India and FDIs in India are considered to be a major stimulus in our economic growth as it has the ability to curtail the shortage of financial resources and the shortage of technology and skill consequently. But the researchers are also of the opinion that FDI may exert a negative impact on economic growth of the recipient countries by extracting their labor and other resources.

II. RETAILING IN INDIA

Trade or retailing is the single largest component of the services sector in terms of contribution to GDP. Its massive share of 10-11% is double the figure of the next largest broad economic activity in the services sector. Retailing is the largest private sector in India and second to agriculture in employment. After farming, retailing is India's major occupation (8% of total population). It employs 40 million people. The retail industry is divided into organized and unorganized sectors.

- **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. Modern format retailers which include Supermarkets like Foodworld, Hypermarkets like Big Bazaar, HyperCity; Departmental Stores like, Shoppers Stop, Lifestyle, Pantaloons, Piramyds, Westside and Trent, Specialty chains like Ikea the retail furnishing house and entertainment chains like Fun Republic, Fame Adlabs, Inox and PVR. Some of the biggest Indian corporate houses like the Future Group, Raheja Group, Reliance, TATA's, Aditya Birla Group, Bharti etc. have made massive investments in India's organized retail business.
- **Unorganized retailing**, on the other hand, refers to the traditional formats of low-cost retailing, for example, the local kirana shops, owner manned general stores, paan/beedi shops, convenience stores, hand cart and pavement vendors, etc. Unorganized retailing is by far the prevalent form of trade in India – constituting 95% of total trade, while organized trade accounts only for the remaining 5%. Organized retail trade employs roughly 0.5 million people and unorganized 39.5 million.

With India's growing per capita income and a rising middle class, the retail sector has the potential to be the real growth engine of the country's economy. While demand for a superior shopping experience is evident in the metropolitan cities, the Tier II and Tier III towns are also rapidly acclimatizing to the changing landscape of the Indian retail market. Growing consumerism, changes in consumers' tastes and preferences, and heightened brand consciousness has been fast replacing traditional mom and pop stores with organized retail malls that house lifestyle and luxury brands from national and international retailers.

As part of its retail transformation, India has seen substantial increase in mall space in recent years. Over the past decade, such cities as NCR-Delhi, Mumbai and Bangalore have shown prominent growth in retail stock, while Hyderabad, Pune, Chennai, Kolkata and many other Tier III towns are rapidly emerging as the retail growth corridors of the next decade

III. CHANGING INDIAN CONSUMER BEHAVIOUR

There has been an increase in the disposable income of the middle class households in India. Between 1993 and 2003 there was a 20.9% growth in the real disposable income of the Indians. Besides that, there has been a 10% growth in the middle and high income populations in the last decade. Add to that, the falling interest rates, easier consumer credit and a greater variety and quality of goods available at all price points has increased the momentum of consumerism in India. Consumers in particular, the urban consumers are getting exposed to international lifestyles. They are inclined to own more assets and thus there is an increased tendency to spend. Therefore, contrary to the olden times, shopping is no longer need based. The greater education levels have increased the awareness levels of consumers and they are becoming more demanding and discerning. The age segments of 17- 21 year olds, (which number more than a 100 million in India) tend to spend freely and are highly influenced by international lifestyles. As the contemporary retail sector in India is reflected in sprawling shopping centers, multiplex- malls and huge complexes offer shopping, entertainment and food all under one roof, the concept of shopping has altered in terms of format and consumer buying behavior, ushering in a revolution in shopping in India. This has also contributed to large scale investments in the real estate sector with major national and global players investing in developing the infrastructure and construction of the retailing business. The trends that are driving the growth of the retail sector in India are

- Low share of organized retailing
- Competitive real estate prices
- Increase in disposable income and customer aspirations
- Increase in expenditure for luxury items

Another credible factor in the prospects of the retail sector in India is the increase in the young working population. Hefty pay-packets, nuclear families in urban areas, along with increasing working-women population have also contributed to the growth of retailing in India. These key factors have been the growth drivers of the organized retail sector in India which now boast of retailing almost all the preferences of life - Apparel and Accessories, Appliances, Electronics, Cosmetics and Toiletries, Home and Office Products, Travel and Leisure and many more. With this the retail sector in India is witnessing a rejuvenation as traditional markets make way for new formats such as departmental stores, hypermarkets, supermarkets and specialty stores. The retailing configuration in India is fast developing as shopping malls are increasingly becoming familiar in large cities. When it comes to development of retail space specially the malls, the Tier II cities are no longer behind in the race. If development plans till 2007 are studied it shows the projection of 220 shopping malls, with 139 malls in metros and the remaining 81 in the Tier II cities.

IV. WHAT IS FDI?

Foreign direct investment (FDI) or foreign investment refers to the net inflows of investment to acquire a lasting management interest in an enterprise operating in an economy other than that of the investor. It usually involves participation in management, joint-venture, transfer of technology and expertise. There are two types of FDI: inward foreign direct investment and outward foreign direct investment, resulting in a net FDI inflow (positive or negative) and "stock of foreign direct investment", which is the cumulative number for a given period. Direct investment excludes investment through purchase of shares. Foreign direct investment, in its classic definition, is defined as a company from one country making a physical investment into building a factory in another country. The direct investment in buildings, machinery and equipment is in contrast with making a portfolio investment, which is considered an indirect investment. In recent years, given rapid growth and change in global investment patterns, the definition has been broadened to include the acquisition of a lasting management interest in a company or enterprise outside the investing firm's home country. As such, it may take many forms, such as a direct acquisition of a foreign firm, construction of a facility, or investment in a joint venture or strategic alliance with a local firm with attendant input of technology, licensing of intellectual property.

V. FDI – AN OVERVIEW

Domestic firms that are contemplating to enter the international market require information and knowledge that may be costly to obtain. Foreign firms are an obvious source of such information to enable the host country's access to the world market. Moreover, Foreign Direct Investment implies an element of risk sharing between the capital owners and the capital importing countries that make this type of capital flow more desirable than loans.

Unlike borrowings from foreign sources which involve contractual obligations from day one, direct foreign investment does not involve any fixed charges. Moreover, dividends would have to be paid only when the firms earn profit. FDI can also stimulate employment generation in the host country because everything else being equal, the establishment of foreign firms increases the demand for labor and the demand for intermediate goods and services from local suppliers.

FDI flows are usually preferred over other forms of capital flows because they are non-debt creating and non-volatile. In a world of increased competition and rapid technological changes, their complimentary and catalytic role can be very valuable. FDI can contribute directly and indirectly to building national capabilities. FDI as an important means to reorganize the production facilities globally, it is regarded as an important vehicle for economic development particularly for developing economies. Thus foreign direct investment is considered a desirable route amongst various forms of capital inflows for bridging this gap, as it is not prone to quick reversal unlike portfolio investment. The importance of FDI also lies in the fact that assistance from multilateral and bilateral sources is either stagnant or declining in comparison with FDI inflows. Further, apart from the long-term additional capital that it brings in, FDI also facilitates technology up-gradation and introduction of modern production and management practices.

VI. DETERMINANTS OF FDI INFLOWS

The volume and the quality of FDI in a country depend on the following factors:

a) **Natural Resources:** Availability of natural resources in the host country is a major determinant of FDI. Most foreign investors seek an adequate, reliable and economical source of minerals and other materials. FDI tends to flow in countries which are rich in resources but lack capital, technical skills and infrastructure required for the exploitation of natural resources.

b) **National Markets:** The market size of a host country in absolute terms as well as in relation to the size and income of its population and market growth isanother major determinant. Large markets can accommodate more firms and can help firms to achieve economies of large scale operations.

c) **Availability of Cheap Labor:** The availability of low cost and skilled labor has been a major cause of FDI in countries like China and India. Low cost labortogether with availability of cheap raw materials enables foreign investors to minimize costs of production and thereby increase profits.

d) **Socio-Economic Conditions:** The size of the population of the host country, its infrastructural facilities and income level of the country also influence direct foreign investment.

e) **Political Situation:** Political stability, legal framework, judicial system, relations with other countries and other political factors prevailing in the country also influence movements of FDI from one country to another.

f) **Rate of interest:** Differences in the rate of interest prevailing in different countries stimulate foreign investment. Capital tends to move from a country with a low rate of interest to a country where it is higher. FDI is also inspired by foreign exchange rates. Foreign capital is attracted to countries where the return on investment is higher.

g) **Government Policies:** Policy towards foreign investment, foreign collaborations, foreign exchange control, remittances, and incentives – both monetary and fiscal offered to foreign investors exercise a significant influence on FDI in a country. For example, Export Processing Zones (EPZs) have been developed in India

VII. PROBLEMS OF FDI IN INDIAN RETAIL SECTOR

(1) Adverse Impact on the Employment

In the absence of any substantial improvement in the employment generating capacity of the manufacturing industries in our country, entry of foreign capital in the retail sector is likely to play havoc with the livelihood of millions. Let alone the average Indian retailer in the unorganized sector, no Indian retailer in the organized sector will be able to meet the onslaught from a firm such as Wal-Mart when it comes in full swing. With it's incredibly deep pockets Wal-Mart will be able to sustain losses for many years till its immediate competition is wiped out. This is a normal predatory strategy used by large players to drive out small and dispersed competition. This entails job losses by the millions. A back-of-the-envelope calculation can substantiate the point. If we take the case of India, it has 35 towns each with a population over 1 million. If Wal-Mart were to open an average Wal-Mart store in each of these cities and they reached the average Wal-Mart performance per store-we are looking at a turnover of over Rs.80, 330mn with only 10,195 employees. Extrapolating this with average trend in India, it would mean displacing about 4,32,000 persons and if we suppose that the large FDI driven retailers take up 20% of the retail trade in India, it would mean a turnover of Rs. 800 billion and displacement of eight million persons employed in the unorganized retail sector.

(2) Threat on Organized Retail Players

Entry of global players would increase internal rivalry among the players than promoting business of overall industry. Their economies of scale will allow them to reduce their margin to provide value for money products in the beginning to grab the market share which is not possible for domestic players to reduce in comparison to global players because of huge investment. Majority of the Indian players have not attained even break-even point as organized retail is still at the nascent stage in India.

(3) Huge Spread of Retail Chain Stores

Financially strong giants will spread their function at multiple location to cater to maximum markets with full fledge infrastructure which is not possible for domestic player to cater.

(4) Predatory Practices of the Multinational Retail Chains

FDI in retail is often supported on the basis of the need to develop modern supply chains in India, in terms of the development of storage and warehousing, transportation, logistic and support services, especially in order to meet the requirements of agriculture and food processing industries. While the infrastructure and technology needs are undeniable, the belief that the entry of multinational food retailers is the only way to build such infrastructure is unfounded.

It is often argued that the Indian farmers and manufacturers are going to enjoy access to international markets by supplying commodities to these multinational retailers. However, the experience of the producers, especially those producing primary commodities in the developing world, is not encouraging in this regard. The International market access available to the global retailers do not benefit the producers from the developing countries since they are unable to secure a fair price for their produce in the face of enormous monopsony power wielded by these multinational giants.

(5) Monopoly In The Customer Market And Creation Of Cartels By The Global Players

Foreign players may create monopoly by providing products at discounted rates in the beginning to grab the market share by displacing domestic giants and after getting good market or monopoly in the market may create a cartel of global giants to exploit the customers by inducing price hike and customers would not get any option than to purchase at the available prices.

(6) Setback To The Trade Balance

FDI in retailing can upset the import balance, as large international retailers may prefer to source majority of their products globally rather than investing in the local markets.

(7) Towering Effect On Real Estate Prices

The entry of global players may have towering impact on the real estate prices. With intensified fight for space in cities, the race may result in steep rise in real estate prices which could be counterproductive for the domestic players.

(8) Distortion Of Urban Development And Culture

The promotion of large retail stores with huge retail space also fosters a different kind of urban development than what we have followed in India till date. Large shopping malls with all known retail chains with their showrooms as a part of urban development is familiar in the US where the consumers live in suburbs, drives long distances for his/her shopping and lives in a community that hardly knows each other. The problem with this model is that it neglects the simple Indian reality where most households do not have cars and need local markets. The myth of a huge and fast growing affluent middle class is counter to the reality that this section is still too small to support the remodeling of the urban landscape as is being planned with malls, large retail chains and branded products.

VIII. PROSPECTS OF FDI IN INDIAN RETAIL SECTOR

(1) It Will Improve Competition And Bring Prices Down

Retail trade in India is fragmented, unorganized, un-networked, inefficient and individually small. An all too visible manifestation of the inefficiencies is the huge disparity between the price which he producer gets and the price which the consumer pays— sometimes as high as 10-20 times! Clearly, what is needed is an efficient supply chain backed by improved infrastructure, cold storages, packing and transportation. The traditional system of distribution, ending with the mom and pop or the street-side vegetable seller, is just not capable of creating it.

(2) Investing In Technology and Better Supply Chain Management

The cold storage chains set up by international retailers will solve the perennial problem of wastages. As much as 40 % of India's fruits and vegetables rot due to lack of processing facilities. The foreign retail giant houses like Wal-Mart and Carrefour can bring better managerial practices and IT- friendly techniques to cut wastages and set up integrated supply chains to gradually replace the present disorganized and fragmented retail market. According to McKinsey, India wastes nearly Rs. 50,000 crore in the food chain itself. With IT application, the modern retail store can cut transaction costs such as due to inventory, delivery and handling. That is precisely how the US based Wal-Mart grew to be a giant because it reduced its distribution costs to 3% of sales compared to 4.5% of others.These international retail outlets can help develop the food processing industry which requires $28 billion of modern technology and infrastructure. Also a more advanced and efficient production and distribution cycle shall evolve. An improved distribution system and better supply chain management shall make an improvement in the product basket from India for exports.

(3) Controlling Inflation

Industry trends for retail sector indicate that organized retailing has major impact in controlling inflation because large organized retailers are able to buy directly from producers at most competitive prices.

(4) Increase In Exports

There are likely to be greater levels of exports due to increased sourcing by major players. Sourcing by Wal-Mart from China improved multifold after FDI was permitted in China.

(5) Manpower and Skill Development

By allowing market-savvy, market-intelligent and best management practices of corporations such as Wal-Mart, Carrefour, Ahold, JC Penny, etc to enter India the know-how and professionalism of Indian employees shall increase. Also there shall be a greater managerial talent inflow from other countries which add to transfer of knowledge and technical know-how.

(6) Better Enforcement of Tax Laws

While there will be increased tax revenue on the one hand, on the other hand there will be better enforcement of tax laws on the organized sector and international players. Tax evasion by players of the organized sector will not be possible like those of the unorganized sector. Thus, the exchequer of the Govt. shall increase.

(7) Increase In Employment Levels

Employment shall be generated at various levels and across the entire value chain. Retailing industry doesn't need very high level skill sets. Graduates and school pass outs shall be suitable for the jobs and this is a major unemployed demographic group. It is projected that job generation will be similar to that of the ITES industry. More employment generation shall lead to an increase in the tax paying population.

(8) Better Lifestyle

Greater levels of wages are paid by most international players. The increasing purchasing capacity of consumers shall lead to better lifestyle. International retailers shall offer a better product variety with many new product categories emerging. Also the quality of products shall improve. The newer supermarkets in urban/metropolitan India offer a produce which is cleaner, fresher, well-packed and often cheaper than the vegetable seller on the street.Modern retailing is designed not only to provide consumers with a wide variety of products under one roof, but also of assured home delivery and information feedback between consumers and producers. A modern retail outlet will also make it easy to buy on credit and provide for servicing and repair of products sold.

(9) Tourism Development

The Singapore and Dubai shopping festivals were examples of the possibilities for improving tourism thanks to the retail industry.

(10) Overall Growth and Expansion

FDI would result in market growth and expansion. A greater consumer spending shall lead to greater GDP growth.

IX. CONCLUSION

Given the WTO regime India is a party to, the entry of FDI in the retail sector is inevitable. But with the instruments of public policy in its hands, the government can create conditions that slow down their entry. Japan has done this quite effectively. In this fashion, the Government can try to ensure that the domestic and foreign players are approximately on an equal footing and that the domestic traders are not at an especial disadvantage. While it is true that some dislocation of traditional retailers will be felt, the government must ensure that retail does not remain concentrated in a few foreign hands.

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