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Foreign Direct Investment in Indian Retail: An Overview

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FDI has become a very sensitive issue looking into its consequences on the Indian economy. The Indian government is trying to keep certain checks on the foreign investors while allowing them to invest in India. FDI in India may lead to heavy displacement of workforce in the country. Also, if proper rules and regulations are not followed, it may cause some big retailers to own a large chunk of money, leading to the financial imbalance in the country. FDI may also lead to the closure of small retail shops and manufacturers. For instance, a retailer like Walmart has the power to dictate the terms to suppliers and manufactures. Also it has the policy of pushing the prices paid to the farmers and manufacturers down to the level that most of them are not able to sustain and as such they go out of the business. In contrast, there are also some favourable results of FDI provided proper policies are followed. Retail sector will become highly organized resulting in more jobs and resulting growth of the economy. Higer competition in the market will lead to the drastic reduction in overall prices, finally benefitting the consumers. There will also be more transperancy in the Mandi system which will prevent exploitation of the farmers. Infrastrucure will also improve as a result of heavy investments from the foreign players.

It is a matter of how FDI is approached, which will decide the eventual consequences on the Indian economy. The government should frame the policies very thoughtfully and carefully. Small retailers should also be encouraged get themselves organized to avoid getting wiped out due to

FDI in India

The definition of FDI has been originally provided by international monetary fund and was subsequently endorsed by the organization for economic & Cooperative Development.

" FDI Reflects the objective of obtaining a lasting interest by a resident entity in one economy ("Direct investor") in an entity resident in an economy other than that of the investor ("Direct investment enterprise"). The lasting interest implies the existence of a long term relationship between the direct investor and the enterprise and a significant degree of influence on the management of the enterprise. Direct investments involve both the initial transaction between the two entities and all subsequent capital transactions between them and among affiliated enterprises, both incorporated and unincorporated."

FDI Policy in respect of Retail Sector in India

FDI in India has become a serious point of debate looking into its impact on the Indian retail sector. The Indian government has restricted the foreign investors to enter the Indian retail sector to protect the business interests of small and medium retail shops and store owners. The following guidelines have to be followed by the foreign investors:

1. FDI upto 100% is allowed under the automatic route for Cash and Carry wholesale and export trading
2. FDI upto 51% is allowed for retail trade of 'Single Brand' products; with prior government approval
3. FDI is not yet allowed for 'Multi Brand' retailing

Recent Changes in FDI Policy for Retail Sector in India

The Indian Government has declared the following prospective reforms in the Indian retail sector:

1. FDI upto 51% will be allowed in 'Multi-Brand' sector
2. Single brand retailers will be allowed to own 100% of their Indian stores.

The above announcement by the government is based on the following:

1. The foreign retailers will be required to procure atleast 30% of their supply from small and medium sized Indian suppliers
2. The foreign retailers can open their retail stores and operations only in cities having population of more than 1 million. Only 55 cities satisfy such criteria out of approx 7950 towns and cities in India.

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3. In case of investment of over US $100 million by multibrand retailers, 50% of such amount should be invested back-end infrastructure facilities such as transportation, warehousing and storage, packaging etc.
4. State laws and regulations must be followed prior to any investment

Impact of FDI in Indian Retail

Foreign Direct Investment in Retail has become a very sensitive issue. Experts have been debating on the pros and cons of the same. According to the supporters, FDI, in the long run, can lead to greater efficiency and improvement in the living standards while also helping to reap the benefits of the global economy. The consumers will be benefited by reduction in overall prices and improvement in quality brought about by the advanced technology and knowhow of the foreign investors, also leading to greater output and increased consumption.

Some points in favor of FDI policy are as below:-

1. The retail sector will become highly organized which will require more and more workers, thereby increasing the employment. For instance, in USA 80% of the retail sector is organized and it employs 13-16% of the total workforce of the country.
2. FDI will lead to a healthy competition in the market and as such will eventually lead to the reduction or control in prices of goods. Big retailers such as Walmart, Target and others already have been operating in many countries for over 30 years; but they have not yet monopolized the market; rather they have been successful in keeping a check on the food inflation by following healthy competitive practices.
3. The intermediaries operating in Mandis do not have clear pricing structure and there is no transparency. According to a survey, out of the price the final consumer pays, an average farmer gets only one third of the total price; rest all go to the intermediaries. FDI will evict the mandi system and the intermediaries, thereby benefiting the farmers and the producers. This will also keep a check on the prices of commodities. For example, according to the Business Standard, Wal-Mart has introduced 'Direct Farm Project' at Haider Nagar near Malekotla in Punjab, where 110 farmers have been with Bharti Wal-Mart for sourcing fresh vegetables directly.
4. Heavy inflow of foreign capital will help in building the infrastructure of the nation.
5. Apart from sustainable development, many economic issues will also be taken care as a result of FDI. Shop workers in India are exploited by making them work for longer hours. Also many shop owners employ under age workers, giving rise to child labour practices. Non-registration of shops and absence of worker contracts also boosts corruption at grass-root level and generates black money.
6. The organized retail chains will invest heavily on supply chain and logistics systems which will help in reducing wastage, especially of perishable items.
7. Better competition generated will benefit both the producers and consumers.

In contrast to the above favorable points for FDI, there is a huge risk for small retailers being running out of the business by big foreign retail chains. For instance, Walmart, the largest retailer in the world, had a turnover of $446 billion in 2012 with net income of $15 billion. It is operating in more than 8970 locations worldwide employing more than 2.2 mn people. Out of these locations, more than 30% are outside USA. An average Walmart store if about 85000 sq ft with an average turnover of about $51 mn. Whereas an average Indian store has a turnover of only Rs. 200000. Only about 4% of the total retail outlets are more than 500 sq ft in size. The total turnover of the unorganized retail sector was only Rs. 725000 Crores while employing 39.5 mn persons.

The average Indian retailer is in the unorganized sector. No organized Indian retailer will be able to stand against a retailer like Walmart who has the capacity to sustain losses for years until its competitors are completely wiped off. This strategy is normally used by large players to drive out small players and disperse the competition. The small independent stores will be compelled to close which will lead to huge job losses since operations in big stores like Walmart are highly automated and require very less work force.

India has 35 Cities & Towns each with a population over 1 million. If Walmart opens an average store in each of these cities and towns and if each such store achieves the average Walmart performance per store, we are looking at a turnover of over Rs. 80330 mn with only 10195 employees. Multiplying this as per the average trend in India, it would mean displacing about 432000 persons. The major factor against FDI driven "modern retailing" is the fact that it leads to labour displacement to the extent that it can only expand by destroying the traditional retail sector.

If Walmart sets operations at prime locations in these 35 large cities and towns and starts offering everything from vegetables to the latest electronics gadgets at extremely low prices, it will most likely undercut those in nearly local stores selling similar goods.

Walmart is more likely to source its raw materials from abroad, and procure vegetables and fruits directly from Indian Farmers at predetermined quantities and specifications. This would mean that a foreign company will buy in bulk from India and abroad and will be able to sell at low prices – severely undercutting the small retailers. Once a monopoly situation will be created, this will then turn into buying at low prices and selling at high margins. It is just an example of one store only. 350 other global retail companies are also in line. East India Company also entered India as a trader and then took over politically.

It is a surprising fact that out of total agricultural producers of the whole country, only 40% is available for sale in urban markets. 60% of the total produce is stored by farmers for distribution; it is consumed in the villages itself. Farmers mainly store the produce for self consumption, to pay as wages to agriculture labours for their work, to use for next year farming and to feed their domestic animals. In this case, if Wal-Mart brings these produce in the market through its supply chain, the medium and small farmers and the agriculture labours will never be able to buy these at the market prices for their self consumption. If this happens, it will be the same case as it is with Alphanso mangoes in Konkan and fish in Kerala. Konkan people don't eat mangoes as they export these for higher prices. They use the money earned from exports in buying goods from urban areas. Kerala people spend their export earnings in buying expensive whisky. Undoubtedly, FDI in agriculture puts small and medium farmers, who account for two third of India's population and labours at high risk.

According to the national sample survey data, a very sad fact is that out of 10 farmers, 7 do not even have heard about the 'Minimum Selling Price' set by the government. Out of those aware of it, 81% does not know how to use it. The reason being, the Minimum Selling Price is applicable only in wholesale Mandis and not in haats.

Conclusion

Retailing is one of the fastest growing sectors of the economy. Since the agriculture sector has already become overcrowded and the manufacturing sector has started stagnating; and also due to the tough nature of work and low wages in both the sectors, many million Indians are getting attracted or are virtually forced into the services sector. Here also due to the lack of opportunities, many individuals are inclined towards starting a small retail shop or store depending on their means of capital. Since retailing is one of the easiest businesses to enter due to low capital and infrastructure requirement, it plays a vital function in the economy providing a social security net for the unemployed. Indian economy and policies supports its citizens to make their own living through self-employment. A typical retailer works at a small scale level and follows a low cost and size format, which makes them rarely eligible for tax. Owing to the importance of the retail sector in the Indian economy, the government must pay due attention to it.

Looking into the sensitiveness of the FDI issue, it needs to be considered very carefully and thoughtfully. A recent survey by UNCTAD projected India as the second most important FDI destination after China for transnational corporations during 2010 – 2012. According to Ernst & Young, FDI in India in 2010 was $44.8 billion and in 2011 it increased to $50.8 billion. India has seen an eightfold increase in its FDI in March 2012.

The government should put suitable checks in place before permitting any foreign players in the Indian market. Not doing this may lead to heavy displacement of the workers in the country, subsequently leading to other negative consequences.

For example, Walmart alone has the power to dictate the terms of suppliers' contracts including turnaround time, quality, quantity and price. Wal-Mart has the policy of pushing the prices paid to the farmers and the manufacturers down to the level that some of them are not able to sustain and they simply go out of business.

If the government allows big foreign retailers to take over the retail segment without any proper rules and regulations, and fair competition, then the larger amount of money will be concentrated with few business houses leading to financial imbalance in the industry. To avoid exploitation of the farmers, the concept of Minimum Selling Price must be promoted and efforts should be made to make farmers aware of the same.

Based on the above discussion, some recommendations are given below:

1. Lending policies should be relaxed by the Government and the RBI which will enable retailers in both the organized and the unorganized sectors to expand and improve overall efficiency. Government should also form policies to encourage unorganized retailers to move to the organized retailing by motivating them to invest in space and equipments.
2. The foreign players should be allowed to enter gradually while keeping a check on the social issues relating to the labour dislocation. The policy should be fine-tuned accordingly.
3. A National Committee should be developed to analyse the problems of the retail sector and also to develop the policies which will enable it to deal with FDI as and when it comes.
4. Such National Committee should develop a clear set of policies for giant retailers, providing strict guidelines on the purchase and procurement of agriculture produce, domestically manufactured and imported goods.
5. Setting up of cooperative stores should be encouraged by the government for procuring their consumer goods from small and medium producers.
6. A committee for agriculture products should be formed to ensure that the farmers get fair prices for perishable commodities; prices should not be distorted as compared to the market prices.

7. The dislocation issue can be addressed by developing and improving the manufacturing sector in India. If proper attention is given to this sector, it will act as a backup for the displaced workforce from the retail sector.

8. According to IndiaInfoline.com agro products and food processing sector in India is responsible for $69.4 billion out of the total $180 billion retail sector (2001 Figure). This is a significant portion of the total figure. What makes it more important is the fact that the returns in this segment are likely to get much higher for any retailer. The consumers will also benefit in form of lower prices achieved due to the economies of scale in vegetables, fruits etc. segment. However, interest of the producer should also be taken care of as it is often the produces who loses out. Normally the goods are procured at very low rates from the producer as compared to the drastically high rate they are sold at to the final consumer. The government should increase their involvement in this sector and reap the benefits itself while ensuring the welfare of the producers and the interest of the consumers.

The government should keep a strict check on its policies pertaining to the FDI. Even the foreign retailers are evaluating the FDI policies before making a move in India. For instance, Walmart is not hurrying up to open retail stores in the country. Even though it is interested to enter the front end retailing in India, it is taking its time to study and evaluate the FDI policy before finalizing its future course of action. Another big retailer IKEA will also open stores in India after the government approves its proposal fully. This is inspite of the fact that the sourcing norms for FDI in single brand retail have been relaxed. Previously it was required to source atleast 30% of requirements from micro small and medium enterprises (MSMEs); however it has now changed to preferably MSMEs instead of atleast 30%.

In view of the above discussion, Government need to give time to small retailers so that they can understand organized retail and should encourage them to progress from unorganized to the organized format. They should be given opportunity to provide more personalized services so that, inspite of their higher costs; they are not wiped out of the market by the big retail stores.

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