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## Foreign direct investment in India retail sector

**Dr. Sharad Ranganath Darandale**

Associate Professor, Arts, Commerce & Science College, Sonai, Taq. Newasa, Dits. Ahmednagar, Maharashtra, India

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### Abstract

Retailing is one of the world's largest private industries. Liberalizations in FDI have caused a massive restructuring in retail industry. The benefit of FDI in retail industry superimposes its cost factors. Opening the retail industry to FDI will bring forth benefits in terms of advance employment, organized retail stores, availability of quality products at a better and cheaper price. It enables a countries product or service to enter into the global market.

"There are many factors contributing to the boom in this sector. To name a few, increased consumerism with a capacity to spend on luxury items and increased spending power in the hands of Indians. More Indians are travelling abroad and are exposed to different cultures and way of life and thereby more brands. India's internal consumption is also high and the consumption pattern owing to diversity in culture, religion and the family values that encourage spending on specific occasions keeps the retail business well oiled. Marriages add a big dimension to the retail spends. Our culture expects a lot of give-and-take for marriages, festivals and other important events of life. Hence, it's imperative for people right from rural to the urban, irrespective of their caste and creed or economic status, to spend on gifts as a part and parcel of life. And that's the reason worldwide retailers eye the Indian market," says Swati Salunkhe, managing director, Growth Centre (I) Pvt Ltd.

The size of India's retail sector is currently estimated at around \$450 billion and organised retail accounts for around 5% of the total market share. Ratings agency Fitch has assigned a stable outlook to the retail sector for 2012 as factors like expected sales, growth-driven expansion and efficient working capital management are likely to benefit retail companies. It is estimated that the retail sector would continue to grow at 10-12 % per annum, which is extremely encouraging when the country's economy is only projected to grow at 6%.

**Keywords:** retailing, culture, religion and family

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### Introduction: FDI in the Retail sector

Retailing is one of the world's largest private industries. Liberalizations in FDI have caused a massive restructuring in retail industry. The benefit of FDI in retail industry superimposes its cost factors. Opening the retail industry to FDI will bring forth benefits in terms of advance employment, organized retail stores, availability of quality products at a better and cheaper price. It enables a countries product or service to enter into the global market.

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### Emerging Areas

Within retail, the emerging sectors would be food and grocery, apparel, electronics, e-commerce, fashion and lifestyle.

"The upcoming areas within retail are luxury, super specialty stores/ malls, and renewed emphasis on high streets. Unfortunately, malls have become expensive affairs for most of the retailers. Therefore, a huge investment and emphasis has been laid down on e-tailing or online stores that has wider reach and are economically viable," says Darlie Koshy, DG and CEO, Institute of Apparel Management.

Any professional who has an experience in the retail industry or a relevant qualification in the field of retail industry like visual merchandising, marketing or has pursued a retail course can get into this field.

FDI Policy in India: It will be prudent to look into Press Note 4 of 2006 issued by DIPP and consolidated FDI Policy issued in

October 2010 which provide the sector specific guidelines for FDI with regard to the conduct of trading activities.

- a. FDI up to 100% for cash and carry wholesale trading and export trading allowed under the automatic route.
- b. FDI up to 51 % with prior Government approval (i.e. FIPB) for retail trade of 'Single Brand' products, subject to Press Note 3 (2006 Series)
- c. FDI is not permitted in Multi Brand Retailing in India.

**FDI in Single Brand Retail:** The Government has not categorically defined the meaning of Single Brand anywhere neither in any of its circulars or nor any notifications.

In single-brand retail, FDI up to 51 per cent is allowed, subject to Foreign Investment Promotion Board (FIPB) approval and subject to the conditions mentioned in following

- a. Only single brand products would be sold (i.e., retail of goods of multi-brand even if produced by the same manufacturer would not be allowed)
- b. Products should be sold under the same brand internationally,
- c. single-brand product retail would only cover products which are branded during manufacturing and
- d. Any addition to product categories to be sold under "single-brand" would require fresh approval from the government.

**FDI in Multi Brand Retail:** The government has also not defined the term Multi Brand. FDI in Multi Brand retail implies that a retail store with a foreign investment can sell multiple brands under one roof.

In July 2010, Department of Industrial Policy and Promotion (DIPP), Ministry of Commerce circulated a discussion paper on allowing FDI in multi-brand retail. The paper doesn't suggest any upper limit on FDI in multi-brand retail. If implemented, it would open the doors for global retail giants to enter and establish their footprints on the retail landscape of India. Opening up 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.

Benefits of FDI in multi-brand retail soaring inflation are one of the driving motives behind this move towards multi-brand retail. Allowing international retailers such as Wal-Mart and Carrefour, which have already set up wholesale operations in the country, to set up multi-brand retail stores will assist in keeping food and commodity prices under control. Moreover, industry experts feel allowing FDI will cut waste, as big players will build backend infrastructure. FDI in multi-brand retail would also help narrow the current account deficit.

Additional benefits include moving away from an industry focus on intermediaries and job creation. Moving away from intermediary-only benefits. There is broad agreement on the need to improve efficiencies in the household trade of consumer goods. Competent management practices and economies of scale, joined with the acceptance of global best practices and modern technology, could immensely recover systemic competence.

Like their foreign counterparts, Indian customers are entitled to receive quality products, produced, processed and handled under a hygienic environment through professionally-managed outlets. Speculative apprehensions that small retailers will be adversely

affected are not reason enough to deny millions of consumers access to products that meet global standards.

Furthermore, today's intermediaries amid producers and customers add no value to the products, adding hugely to final costs instead. By the time products filter through various intermediaries and into the marketplace, they lose freshness and quality, and often go to waste. However, intermediaries garner huge profits by distributing these losses between producers and customers by buying products at low prices from producers, but selling at extremely marked-up prices to consumers. In an unbalanced system that incorporates multiple intermediaries simply for logistics, only intermediaries benefit. Safety valves there is concern about the competition presented to domestic competitors and the monopolization of the domestic market by large international retail giants. The Indian government feels that FDI in multi-brand retailing must be dealt with cautiously, given the large potential scale and social impact. As such, the government is considering safety valves for calibrating FDI in the sector. For example:

- A stipulated percentage of FDI in the sector could be required to be spent on building back-end infrastructure, logistics or agro-processing units in order to ensure that the foreign investors make a genuine contribution to the development of infrastructure and logistics.
- At least 50 percent of the jobs in the retail outlet could be reserved for rural youth and a certain amount of farm produce could be required to be procured from poor farmers.
- A minimum percentage of manufactured products could be required to be sourced from the SME sector in India.
- To ensure that the public distribution system and the Indian food security system, is not weakened, the government may reserve the right to procure a certain amount of food grains.
- To protect the interest of small retailers, an exclusive regulatory framework to ensure that the retailing giants do not resort to predatory pricing or acquire monopolistic tendencies.

#### **Impact on the sector**

- While FDI in multi-brand retail is needed in the long term, its passage (if it happens) may act as a sentiment booster the market desperately needs. The global appetite to invest in India has waned in recent months. But foreign investors may not rush in even after the proposal is passed. "Once the law is passed, the implementation in the first phase may be restricted to Congress-ruled states and a few other states. The leading foreign players will be interested if a reasonable number of states opt for it. Once some states implement it and others see the benefits, it may spread to other states despite the objections from the traders' lobby," says Shah.

#### **Impact on the listed stocks**

- So, don't jump to the conclusion that this new law will be a boon for the Indian retail sector stocks. What is good for the economy or the sector need not be good for individual companies. For example, several cash strapped companies from the retail sector may be hoping that they can divest a part of the stake to foreign players and use the money to repay their debts. Some may also want to sell out totally if 100% FDI is through. However, it will be risky to assume that the only option available to global retail players

like Wal-Mart and Tesco is to buy out existing players. In fact, the probability of that happening is remote.

- Even if it happens, existing players may not be able to get a very high price because most they are not doing well now. "FDI in multi-brand retail is going to benefit existing Indian players only if foreign players buy partial or full stake in these companies. If the foreign companies go it alone or go with other partners, it will only increase competition for the existing players," says Shah

#### Limitations of the Present Setup

- **Infrastructure:** There has been a lack of investment in the logistics of the retail chain, leading to an inefficient market mechanism. Though India is the second largest producer of fruits and vegetables (about 180 million MT), it has a very limited integrated cold-chain infrastructure, with only 5386 stand-alone cold storages, having a total capacity of 23.6 million MT. 80% of this is used only for potatoes. The chain is highly fragmented and hence, perishable horticultural commodities find it difficult to link to distant markets, including overseas markets, round the year. Storage infrastructure is necessary for carrying over the agricultural produce from production periods to the rest of the year and to prevent distress sales. Lack of adequate storage facilities cause heavy losses to farmers in terms of wastage in quality and quantity of produce in general. Though FDI is permitted in cold-chain to the extent of 100%, through the automatic route, in the absence of FDI in retailing; FDI flow to the sector has not been significant.

#### Intermediaries dominate the value chain

- Intermediaries often flout mind norms and their pricing lacks transparency. Wholesale regulated markets, governed by State APMC Acts, have developed a monopolistic and non-transparent character. According to some reports, Indian farmers realize only 1/3<sup>rd</sup> of the total price paid by the final consumer, as against 2/3<sup>rd</sup> by farmers in nations with a higher share of organized retail.

#### Improper Public Distribution System ("PDS")

- There is a big question mark on the efficacy of the public procurement and PDS set-up and the bill on food subsidies is rising. In spite of such heavy subsidies, overall food based inflation has been a matter of great concern. The absence of a 'farm-to-fork' retail supply system has led to the ultimate customers paying a premium for shortages and a charge for wastages.

#### No Global Reach

- The Micro Small & Medium Enterprises ("MSME") sector has also suffered due to lack of branding and lack of avenues to reach out to the vast world markets. While India has continued to provide emphasis on the development of MSME sector, the share of unorganised sector in overall manufacturing has declined from 34.5% in 1999-2000 to 30.3% in 2007-08. This has largely been due to the inability of this sector to access latest technology and improve its marketing interface.

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