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FOREIGN DIRECT INVESTMENT IN INDIAN RETAIL SECTOR: STRATEGIC ISSUES AND IMPLICATIONS

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Abstract: **Indian retail industry is one of the sunrise sectors with huge growth potential. According to the Investment Commission of India, the retail sector is expected to grow almost three times its current levels to $660 billion by 2015. However, in spite of the recent developments in retailing and its immense contribution to the economy, retailing continues to be the least evolved industries and the growth of organized retailing in India has been much slower as compared to rest of the world. Undoubtedly, this dismal situation of the retail sector, despite the ongoing wave of incessant liberalization and globalization, stems from the absence of an FDI encouraging policy in the Indian retail sector. In this context, the present paper attempts to analyses the strategic issues concerning the influx of foreign direct investment in the Indian retail industry. Moreover, with the latest move of the government to allow FDI in the multi-brand retailing sector, the paper analyzes the reason why foreign retailers are interested in India, the strategies they are adopting to enter India and their prospects in India.**

The findings of the study point out that FDI in retail would undoubtedly enable India Inc to integrate its economy with that of the global economy. Thus, as a matter of fact FDI in the buzzing Indian retail sector should not just be freely allowed but should be significantly encouraged.

Keywords: **Organized retail, sunrise sector, globalization, foreign direct investment, strategic issues and prospects.**

I. INTRODUCTION

The Indian retail industry is the fifth largest in the world. Comprising of organized and unorganized sectors, retail industry is one of the fastest growing industries in India, especially over the last few years. With growing market demand, the industry is expected to grow at a pace of 25-30% annually. The Indian retail industry is expected to grow from Rs. 35,000 crore in 2004 -05 to Rs. 109, 000 crore by the year 2010. The Indian retail industry is the most promising emerging market for investment. In 2007, the retail trade in India had a share of 8-10% in the GDP (Gross Domestic Product) of the country. In 2009, it rose to 12%. It is also expected to reach 22% by 2010 (Kearney, A.T).

According to the Investment Commission of India, the retail sector is expected to grow almost there times its current levels to $ 660 billion by 2015. It is expected that India will be among the top 5 retail markets then. The organized sector is expected to grow to $100 bn and account for 12-15% of retail sales by 2015 (Singhal 1999). However, in late 1990's the retail sector has witnessed a level of transformation. Though initially, the retail industry in India was mostly unorganized, however with the change of testes and preferences of the consumers, the industry is getting more popular these days and getting organized as well. According to a report by **North bride Capita,** the India retail industry is expected to grow to US$ 700 billion by 2010. By the same time, the organized sector will be 20% of the total market share.

Table: 1 Share of Organised Retail

Year	2010	2011	2012	2013
Total Retail (in billion INR)	7000	8250	10000	13080
Organized Retail (in billion INR)	50	150	350	540
% Share of Organized Retail	0.70%	1.80%	3.5%	5.5%

Source: Confederation of Indian Industries

It can be mentioned here that, the share of organized sector in 2007 was 7.5% of the total retail market. Organized retails business in India is very small but has tremendous scope. The total in 2005 stood at $225 billion, accounting for about 11% of GDP. In this total market, the organized retail accounts for only $8 billion of total revenue. According to A T Kearney, the organized retailing is expected to be more than $23 billion revenue by 2010 (http://www.articlebase.com).

As the retail market place changes shape and competition increases, the potential for improving retail productivity and cutting costs is likely to decrease. Therefore it is important for retailers to secure a distinctive position in the market place based on values relationships or experience. Also, as the organized retails space in India continues to grow, it is likely to see a number of initiatives in the near future. Companies are likely to combine expansion with innovative measures as they look to ensure profitability in difficult times. One such initiative includes assessing the prospects of foreign players in this sector through foreign direct investment.

II. STRATEGIC ISSUES CONCERNING RETAIL SECTOR IN INDIA

Retailing is the largest private industry in India and second largest employer after agriculture. The sector contributes to around 10 percent of GDP. With over 12 million retail outlets, India has the highest retail outlets density in the world. This sector witnessed significant development in the past 10 years from small unorganized family owned retail formats to organized retailing. Liberalization of the economy, rise in per capita income and growing consumerism has encouraged large business and venture capitalist in investing in retail infrastructure.

The importance of retail sector in India can be judged from following facts (a) Retail sector is the largest contributor to the Indian GDP (b) The retail sector provides 15% employment (c) India has world largest retail network with 12 million outlets (d) Total market size of retailing in India is U.S$ 180 billion (e) Current share of organized retailing is just 2% which comes around to $3.6 trillion (f) organized retail sector is growing @ 28% per annum.

The Indian retail sector is very different from that of the developed countries. In the developed countries, products and services normally reach consumers from the manufacturer / producers through two different channels: (a) via independent retailers ('vertical separation') and (b) directly from the producer ('vertical integration'). In the latter case, the producers establish their own chains of retail outlets, or develop franchisees.

Growth Drivers in India for Retail Sector:

The retail industry in India is currently growing at a great pace and is expected to reach US$ 1.3 trillion by the year 2018 at a CAGR of 10%. As the country has got a high growth rate, the consumer spending has also gone up and is also expected to go up further in the future. In the last four years, the consumer spending in India climbed up to 75%. As a result, the Indian retail industry is expected to grow further in the future days. By the year 2013, the organized sector is also expected to grow at a CAGR of 40%.

Challenges of Retailing in India:

In India the retailing industry has a long way to go and to become a truly flourishing industry, retailing needs to cross various hurdles. The first challenge facing the organized retail sector is the competition from unorganized sector. Needless to say, the India retail sector is overwhelmingly swarmed by the unorganized retailing with the dominance of small and medium enterprises in contradiction to the presence of few giant corporate retailing outlets. The trading sector is also highly fragmented, with a large number of intermediaries who operate at a strictly local level and there is not 'barrier to entry', given the structure and scale of these operations (Singhal 1999)

The tax structure in India favours small retail business. Organized retail sector has to pay huge taxes, which is negligible for small retail business. Thus, the cost of business operations is very high in India. Developed supply chain and integrated IT management is absent in retail sector. This lack of adequate infrastructure facilities, lack of trained work force and low skill level for retailing management further makes the sector quite complex. Also, the intrinsic complexity of retailing – rapid price changes, threat of product obsolescence, low margins, high cost of real estate and dissimilarity in consumer groups are the other challenges that the retail sector in India is facing.

The status of the retail industry will depend mostly on external factors like Government regulations and policies and real estate prices, besides the activities of retailers and demand of the customers also show impact on retail industry. Even though economy across the globe of the customers also show impact on retail industry. Even though economy across the globe is slowly emerging from recession, tough times lie ahead for the retail industry as consumer spending still has not seen a consistent increase. In fact, consumer spending could contract further as banks have been overcautious in lending. thus, retailers are witnessing an uphill further as banks have been overcautious in lending. Thus, retailers are witnessing an uphill task in terms of wooing consumers, despite offering big discounts. Additionally, organized retailers have been facing a difficult time in attracting customers from traditional kirana stores, especially in the food and grocery segment.

III. STRATEGIC IMPLICATIONS OF FDI IN RETAIL

In spite of the recent developments in retailing and its immense contribution to the economy, it still continues to be the least evolved industries and the growth of organized retailing in India has been much slower as compared to rest of the world. Over a period of 10 years, the share of organized retailing in total retailing has grown from 10 per cent to 40 percent in Brazil and 20 percent in China, while in India it is only 2 per cent (between 1995 – 2005). One important reason for this is that retailing is one of the few sectors where foreign direct investment is not allowed. Within the country, there have been protests by trading associations and other stakeholders against allowing FDI in retailing. On the other hand, the growing market has attracted foreign investors and India has been portrayed as an important investment destination for the global retail chains (http://www.articlesbase.com).

The need for larger FDI is because India is at a stage where it needs US investments, technology, and management policies to sustain and enhance its economic growth. In 2006, Foreign Direct Investment (FDI) in India amounted to US $37 billion, out of which only $5 billion was from the US. This was not a very encouraging figure in view of the goal of increasing the GDP by 34-36%. India still requires an FDI component equal to 4% of the GDP. The US needs to invest more in various sectors of the Indian economy. As such, India is rated as the 2nd best economy to invest in after china. India is looking forward to a high growth rated as the 2nd best economy to invest in after China. India is looking forward to a high growth rate of almost 16% - double that of the current 8%. Hence, there is a distinct need for larger FDI. There are other necessities which a larger FDI will cater to viz., employment generation, income generation, technology transfer, and economic stability. Hence, the need for larger FDI is a pressing situation these days in India. Foreign countries are well aware of this, and many of them are taking extra initiative to invest in the Indian economy.

Major Attractions for Global Retailers in India:

Retailing is being perceived as a beginner and as an attractive commercial business for organized business i.e. the pure retailer is starting to emerge now. India organized retail industry is one of the sunrise sectors with huge growth potential. Total retail market in India stood at USD 350 billion in 2007 -08 and is estimated to attain USD 573 billion by 2012-13. Organised retail industry accounts for only 5.5% of total retail industry and is expected to reach 10% by 2012 (http:// business. rediff.com). AT Kearney, the well –known international management consultancy, recently identified India as the 'second most attractive retail destination' globally from among thirty emergent markets. It has made India the cause of a good deal of excitement and the cynosure of many foreign investors; eyes. With a contribution of an overwhelming 14% to the national GDP and employing 7% of the total workforce (only agriculture employs more) in the country, the retail industry is definitely one of the pillars of the Indian economy (http:/www. indiaretaibliz.com/blog/2009/07/02).

Foreign companies' attraction to India is the billion-plus population. Also, there are huge employment opportunities in retail sector in India. India's retail industry is the second largest sector, after agriculture, which provides employment. According to Associated Chambers of Commerce and Industry of India (ASSOCHAM), the retail sector will create 50,000 jobs in the next few years. As per the US Census Bureau, the young population in India is likely to constitute 53 per cent of the total population by 2020 and 46.5 percent of the population by 2050 – much higher than countries like the US, the UK, Germany, China etc. India's demographic scenario is likely to change favourably, and therefore, will most certainly drive retail sales growth, especially in the organized retail segment. Even though organized retailers have a far lesser reach in India than in other developed countries, the first –mover advantage of some retail players will contribute to the sector's growth.

Challenges for Global Retailers in Indian Retail Sector:

History has witnessed that the concern of allowing unrestrained FDI flows in the retail sector has never been free from controversies and simultaneously has been an issue for unsuccessful deliberation ever since the advent of FDI in India. Where on one hand there has been a strong outcry for the unrestricted flow of FDI in the retail trading by an overwhelming number of both domestic as well as foreign corporate retail giants; to the contrary, the critics of unrestrained FDI have always fiercely retorted by highlighting the adverse impact, the FDI in the retail trading will have on the unorganized retail trade, which is the source of employment to an enormous amount of the population of India.

The antagonists of FDI in retail sector oppose the same on various grounds, like, that the entry of large global retailers such as Wal –Mart would kill local shops and millions of jobs, since the unorganized retail sector employs an enormous percentage of Indian population after the agriculture sector; secondly that the global retailers would conspire and exercise monopolistic power to raise prices and monopolistic (big buying) power to reduce the prices received by the suppliers; thirdly, it would lead to asymmetrical growth in cities, causing discontent and social tension elsewhere. Hence, both the consumers and the suppliers would lose, while the profit margins of such retail chains would go up.

Many trading associations, political parties and industrial associations have argued against FDI in retailing due to various reasons. It is generally argued that the Indian retailers have yet to consolidate their position. The existing retailing scenario is characterized by the presence of a large number of fragmented family owned businesses, who would not be able to survive the competition from global players. The examples of south east Asian countries show that after allowing FDI, the domestic retailers were marginalized and this led to unemployment. Another apprehension is that 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 local products. The global retailers might resort to predatory pricing. Due to their financial clout, they often sell below cost in the new markets. Once the domestic players are wiped out of the market foreign players enjoy a monopoly position which allows them to increase prices and earn profits.

Indian retailers have argued that since lending rates are much higher in India, Indian retailers, especially small retailers, are at a disadvantageous position compared to foreign retailers who have access to International funds at lower interest rates. High cost of borrowing forces the domestic players to charge higher prices for the products. Another arguments against FDI is that FDI in retail trade would not attract large inflows of foreign investment since very little investment is required to conduct retail business. Goods are bought on credit and sales are made on cash basis. Hence, the working capital requirement is negligible. On the contrary; after making initial investment on basic infrastructure, the multinational retailers may remit the higher amount of profits earned in India to their own country.

IV. IMPACT AND ROLE OF FDI IN INDIAN RETAIL SECTOR

In the fierce battle between the advocators and antagonist of unrestrained FDI flows in the Indian retail sector, the interests of the consumers have been blatantly and utterly disregarded. Therefore, one of the arguments which inevitably needs to be considered and addressed while deliberating upon the captioned issue is the interests of consumers at large in relation to the interests of retailers.

Interestingly, in contradiction to the recommendations of the Parliamentary Committee's report, the Economic Survey 2008 -09 raised hopes of all those looking for a favourable response of the government on the subject. While, the Economic Survey has made a strong case for opening up the FID for multi – brand retail, it has recommended a gradual opening of the sector. Improving the investment environment would require FDI in multi-format retail, starting with food retailing. Initially the FDI could be allowed subject to the setting up a modern logistics system, perhaps jointly with other organized retailers. A condition could also be put that it must have, for five years say, wholesale outlets where small, unorganized retailers can also purchase items to facilitate transition (http:// www. indiaretailiz. com/blog /2009/07/02).

Most modern organized retailers, who have been asking for removal of ban on FDI in retail, were excited with the recommendation made by the Survey in its report. In wake of relentless protests for the opening up of the Indian retail market for the reception of unrestrained FDI, the Investment Commission in July, 2006, suggested that 49% FDI be allowed in the Indian retail sector without any restrictions on the number of outlets or location of stores. The Commission opined that foreign investment would help in improving the retail and supply chain infrastructure, and generate large-scale employment in the country. In addition, the Indian retailers could absorb some of the best operational practices of these international retailers and gain in experience. Ultimately, the consumers would benefit due to the availability of more product offerings, lower prices, and efficient service. The recommendations of the Investment Commission proved to be very promising an paved the way for a positive feedback to the global retailers towards the Indian retail sector (Business Insights International 2009).

V. CONCLUSIONS AND RECOMMENDATIONS

Amidst today's time of fierce competition and a quest to achieved and enhance a substantial level of economic and social development; each and every nation is trying to liberalize its economic policies in order to attract investments from not only, domestic players, but also from magnates all across the globe. Consequently, people with generous reserves of funds, all around the globe, are expending their wings and seeking opportunities of investing in different spheres of this lucrative market. India too is not oblivious to the rapid developments taking place in the global market and has emerged as one of the prime destinations for the investment of funds from an impressive number of foreign investors. Current FDI policy allows 100% FDI in Cash – and carry wholesale formats and 51% FDI is allowed in single brand retailing. However, the regulations have been interpreted as guiding to a blanket ban on foreign investments in the sector. Thus, even investments by financial investors like FIIs and PE funds are prohibited, limiting the flow of capital required for the growth of the sector.

A clarification of issues will enable investments by financial investors in the retail sector. This can be done by allowing investments by investors such as FIIs, Venture Capital Funds and other financial investors in the sector.

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