

FDI in Indian Retail Sector - Perspectives and Prospects

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Abstract

With the advent of globalization, developing countries, particularly those in Asia, have been witnessing a massive surge of FDI inflows during the past two decades. Even though India has been a latecomer to the FDI scene compared to other East Asian countries, its significant market potential and a liberalized policy regime has sustained its attraction as a favourable destination for foreign investors. This article aims to examine the impact of inward FDI on the Indian economy, particularly after a decade of economic reforms, and analyzes the challenges to position itself favourably in the retail market. In this context, the article further investigates the likely impact of FDI inflows to Indian retail sector especially on Employment, Organized and unorganized sectors, Exports, Hyper marketing and shopping malls, Farmers and small manufacturers and Infrastructure.

Key Words: Retailing, Hyper marketing shopping malls, Foreign Direct Investment

Introduction

Economic development has become an urgent need globally, for developing countries in particular. "Globalization" which made its beginning in the last quarter of 20th century links countries closer than ever before with each other, reinforces this need. Although many countries have achieved substantial increase in per capita income, even now more than a billion people in over one hundred countries still live in dire poverty.

Starting from mid 1980's with Rajiv Gandhi's outward oriented industrialization policy, India started liberalizing the economy to the rest of the world at a rapid pace. Since the early 1990's the FDI flows have been playing increasingly prominent role in the economy.

The Department of Industrial Policy and Promotion has marked out – sports goods, stationery, electronics and building equipment as some of the sectors that may be opened up with an FDI capital of 51%, since there are hardly any small manufacturers and

retailers that will be affected in these areas. The government is also thinking of permitting multi – brand retail in such areas. (So far the government permits 51% FDI in single brand retail through the FIPB) The main players of the world in retail sector are Wal-mart, Carrefour, Tesco and Metro. The international players currently in India include McDonald's, Pizza Hut, Dominos, Levis, Lee, Nike, Adidas, TGIF, Benetton, Swarovski, Sony, Sharp, Kodak, and the Medicine Shoppe.

There is an enormous theoretical & empirical literature dealing with the relationship between FDI & growth. Although there are numerous factors determining the inflow of FDI in developing countries, recent empirical studies discussed in De Mello Luiz. R (1999) suggests that one of the most important factors determining the surge of FDI inflows in the developing countries in recent years have been the privatization and globalization of production, In addition several factors including the degree of political stability, the

nature of Government policy, trade and investment regime, the openness of the host country and the size of the market are possible determinants of FDI flows, With the advent of liberalization FDI is assuming prominent role in developing countries all over the world and India in particular in recent years.

Review of Literature

Attracting foreign direct investment (FDI) has become a key part of national development strategies for many countries. They see such investments as bolstering domestic capital, productivity, and employment, all of which are crucial to jump-starting economic growth. While many highlight FDI's positive effects, others blame FDI for "crowding out" domestic investment and lowering certain regulatory standards. The effects of FDI can sometimes barely be perceived, while other times they can be absolutely transformative. While FDI's impact depends on many conditions, well-developed and implemented policies can help maximize its gains.

A study by Saritha Chauhan (Confederation of Indian Industry) developed an insight as to what are the trends in Indian Retail Industry, benefits and drawbacks of FDI in Retail, whether it will be beneficial for economy and finally the challenges in Indian Retailing.

A paper by Nagesh Kumar and Jaya Prakash Pradhan examines the relationships between foreign direct investment (FDI), domestic investment and growth. The authors suggest a positive correlation between FDI and growth. However, the direction of causality between the two is ambiguous, since positive growth also leads to increased FDI. The authors also found a dynamic relationship between FDI and domestic investment. FDI at first 'crowds out' domestic investment but later results in increased domestic investment as the country's business climate improves.

A study by Asian Development Bank discussed the impacts of foreign direct investment (FDI) on Asian economies and concluded that FDI accompanied by proper development strategies can play an essential role in a country's economic growth and development.

A later study by Balasubramanyam et al. (1999) tested four hypotheses of FDI's contribution to growth: (i) FDI can promote growth in the presence of a liberal trade regime; (ii) a threshold level of human endowment is necessary for the promotion of growth through FDI; (iii) effective utilization of human capital in conjunction with FDI requires an adequate domestic market for the goods produced; and (iv) technology and skill spillovers from FDI do not materialize from the mere presence of FDI, but form a competitive environment.

Rashmi Banga (liberalization and wage inequality in India - Indian council for research on international economic relations - ICRIER) reviewed various literatures on the relationship between foreign direct investment (FDI) and exports. She then examined the effects of FDI on India's exports and found that FDI has had a significant effect on the export-intensity of industries in India

The current debate on allowing foreign direct investment (FDI) in India's retail trade primarily focuses on two issues – employment and consumer welfare. The supporters of the move have developed consumer centric arguments while the opponents are more concerned with its adverse impact on employment. In the process, some key areas of concern remain untouched

Present Scenario

Existence of a Large Middle Income Group

A 250 million-population base in the middle-income group is an envy of a consumer

products division of any multinational company. India's middle-income group (popularly called middle-class) is about 25% of the total population base. Of this segment about 4% are extremely rich and about 10% have just graduated into the middle class and are feeling their way through the material world. In addition about 1% of the poor in the country are graduating into this middle-income group every year for the last ten years. (Source: India market demographics report 2002, NCAER and UNWorld Population Prospects).

Large Domestic Market

Indian economy is evolving as a service exporting economy of the world. It has evolved as a domestic consumption economy which accounts for 65% of the total GDP. Compared to that, 42% of Chinese economy is for domestic consumption. (www.researchandmarkets.com) These two statistics account for reasons of high disparity between two nations export performance. Indians consume more than they export; hence focus is on domestic markets. The reverse is true in case of China, where the focus is to grab FDI, build factories and export goods. (Source: UN World Population Prospects)

Emerging New High Income Groups

The large segment of population less than 30 years age in India is about half the total population base. It is active, educated, progressive and vibrant. Narrow down this segment into the most active group i.e. IT and BPO workers. Their numbers are about a million and half in Delhi, Bangalore, Mumbai, Pune and Kolkota. Each of them earns an average of \$600 to \$700 a month (about Rupees 25,000). This is a fairly high income in India. Each has fewer responsibilities as their family life has just begun. Hence, with this much money in their pocket, they scour store

shelves for designer jeans, good restaurants and quality housing. They get these and get ready for more, every month. A million and half of these young men and women have more than a billion to spend every month.

Indian Retail Market

Retailing to a large extent is in private hands. Mom & pop stores dominate the landscape. Rough estimate is that there are 5 million retail outlets in India. Shopping during festival seasons of Baisakhi, Diwali, Durga Puja or Onam is a nerve racking experience. Major players are having difficulty entering the market place. Reliance took the initiative recently to enter the retail market. A pan-India network of retail outlets is in Reliance's mind. Already they are facing a talent shortage. Foreign retail vendors like Wal-Mart or Metro are not having smooth sailing, while trying to enter the Indian retail market. One of the many reasons for lack of their success is that India fears that these chains will become outlets for Chinese made goods stores in India. Instead, India wishes for them to source most products in India. In addition India want them to source merchandise from India for sale in US and Europe. This will require FDI to encourage local producers and set up foreign brand names for manufacture in India. Somehow offers and counter offers for the above deal have not seen the light of the day.

Overall Indian consumer goods market is about \$450 billion. According to a survey by AT Kearney It is expected to double to about \$800 billion in about 5 years, if the country maintains its 8% growth trajectory. Of this amount only 4% is in the organized sector, remaining bulk of consumer sales are handled by the unorganized sector. Shopping Centres, as we know them in the West are of recent origin. India's first fully integrated shopping mall (Crossroads) complete with food court

and conveniences, opened in Mumbai in 1999. Surprisingly there is only 8% of the total population base, which is involved in the retail trade. They run 5 million plus retail stores, of which 90% are small stores of less than 500 square feet. Hence these stores carry a very limited variety and still smaller inventory.

Retailing and Rural Market

727 million of Indians live in villages. This is two third of the population. They are largely untouched by the consumer revolution sweeping the cities. Product marketers have not paid enough attention to the rural areas. Hence, there are lesser number of TV sets, refrigerators, cable TV outlets, cell phones, PCs, cars etc. in the rural areas. Indian villages depend upon agriculture for sustenance. Per capita income in rural areas is about \$450 per annum range compared to \$700 in the cities. A small percentage of landowner's class or cash crop farmers are prosperous and can truly be classified as rich and middle-income earner. But they are 8% of the total rural population. Whereas cities could boast of a third of its population as middle-income earners, the village India can only boast of about 15% of its population base in that category. That does not mean that the village folks are perpetually worst off. On the contrary their lot is similar to the city folks. Reasons: village folks pay no taxes and pay very little in lease costs, transportation expenses are minimal and are better off in food and clothing, which they mostly barter. Hence, both urban and rural residents are just about the same. Only on paper the rural India appears worst off. It is to be reasonably assumed that although the marketing gimmicks of the companies both in organized as well as in the unorganized sector tend to inundate cities, they have not penetrated the villages. Additionally, the village folks pay no attention to fashion, fragrance, motor vehicles, PCs and video recorders. But this is likely to change.

Future Prospects

Based on the present scenario the following are projected as the future prospects of Indian retail industry –

Retail sector will create 50,000 jobs a year directly and indirectly

The retail sector is the second largest source of employment and the job market is hugely receptive to this. All the major Indian cities have major commercial projects under construction for retail purposes. In fact, the retail sector has provided the primary boost to the commercial property market all over India. Presently, there are over 55 large shopping malls under development all over India. The retail sector is also getting acceptance in the job market with more and more business schools focusing on the sector and large retailers setting up retail academies. This sector is estimated to create 50,000 jobs per year in the next five years.

Organized retail will form 10% of total retailing by the end of this decade. In the meantime, the organized sector will grow at the rate of around 30% per annum

Initiatives of the Central and State Governments like allocation of land at concessional rates, grants of loans at liberalized interest rates to promoters of shopping malls and also rationalization of state levies are prime factors that will aggressively inspire entry of organized sector into retailing in the next few years.

India to have nearly 500 shopping malls by 2010

The near future would see intense competition among players, in similar product categories and eventually, but inevitably, retail format sizes would become larger. Hypermarket is emerging as the most favorable format for the time being in India.

The arrival of multinationals will further push the growth of this format. Wal-Mart already operates a procurement center in Bangalore and exports products worth close to \$2 billion to Wal-Mart stores worldwide, mainly leather apparel, textiles, home furnishings and jewelry.

The Indian retail Industry is expected to grow at about 36 percent by 2008 and with the increase in foreign investment the industry is expected to do a business of Rs. 1.60 trillion by the year 2008. The country is believed to have an average age of 24 years for its population as against 36 years for the USA and 30 years for China. A younger population tends to have higher aspirations and spends more as it enters the earning phase.

The international players currently in India include McDonald's, Pizza Hut, Dominos, Levis, Lee, Nike, Adidas, TGIF, Benetton, Swarovski, Sony, Sharp, Kodak, and the Medicine Shoppe. Global players are entering India indirectly, via the licensee/franchisee route, since Foreign Direct Investment (FDI) is not allowed in the sector.

It sought to invest "significantly" in India both for opening stores and outsourcing from the market. Even the Tata Sons has set up a wholly owned subsidiary, Infiniti Retail Ltd, to run Croma — its national, multi-brand retail chain. And Infiniti has entered into a sourcing agreement with Australian retail company, Woolworths Ltd.

More Indian households are getting added to the consuming class with the growth in income levels. The number of households with income of over Rs 45,000 per annum is expected to grow from 81 million in 2005-06 to 106 million by 2010.

This large base of households with growing disposable income is expected to drive demand for organized retail. Of this, 56 per

cent (44.8 million households) are expected to be concentrated in urban India.

Exports will increase by \$2 billion per year and by 2010 it will reach \$ 40 billion

When markets open up to modern retail, export volume tends to surge. As an example, we can look at how the governments of China and India have dealt with foreign investors. China's policy of being open to foreign investment directly led to a surge of exports of more than \$60 billion per year. Wal-Mart alone exports approximately \$20 billion in products from China—a significant rise in exports occurred after the company developed operations in China. By comparison, India's policy of being more closed to foreign investments means exports are hovering under \$5 – 10 billion per year.

Indian retail sector is the second largest employer after agriculture in the country and the entry of foreign companies will not only increase the number of employment opportunities but also exports.

Organized retailing holds the promise of lowering the prices of foreign goods sold through these large stores. This also means that some of these retail chains will eventually have to start manufacturing locally or outsource from domestic manufacturers in order to be in the competition.

There will be 83% increase in the turnover of the farming sector

40% of Fruit and vegetables and 10% of food grains gets wasted due to inefficient supply chains resulting from inadequate infrastructure, poor logistic management, improper handling, etc. The farmers get only 25 per cent of the consumer prices in the case of unprocessed vegetable.

Organized retailers (including the existing foreign players) are trying to set up supply

networks by sourcing directly from farmers. They are in the process of implementing agriculture practices such as contract farming which enables farmers to produce for the international markets. Some retailers, for example McDonald's for lettuce, have been very successful with contract farming.

Reliance has proposed to set up 1,600 odd rural business hubs throughout India between 2007 – 2010. These RBH will be used as procurement centres as well as retail outlets for manufacturing consumer goods, agricultural inputs and various types of financial products and services.

India will attract \$150 billion of foreign direct investment by 2010 in infrastructure sectors alone

Transport, Roads, Power and Water availability continue to remain a cause for

concern amongst the investor community. 43% of the port and airport facilities in India are much below international standards.

Against the overall flow of just \$3.2 billion during first half of the current fiscal, India has potential to absorb \$150 billion of foreign direct investment by 2010 in infrastructure sectors alone, while opening up of branded retail

The Survey for 2005-06 tabled in Parliament emphasized on evolving a well defined regulatory architecture to increase the comfort level of players to tap the huge potential. Upbeat about the procedural simplifications and opening up of more sectors like single brand retail, up to 49 per cent in airports, will lead to evolution of a holistic strategy to attract investments.

Retail Consumer Market – Some facts and figures

	2005	2010
Expected Retail Volume Growth	6%	10%
- Salary rise above inflation (Urban areas)	7.3%	7%
Electronic Goods: (000)		
Television Sets Volume ('000)	9,413	11,667
Refrigerators sales volumes ('000)	4,271	5,848
Video Recorders sales volumes ('000)	1250	2000
PC Computers sales volumes ('000)	7000	18,000
Cell Phone subscribers (millions - year end)	120	400
Motor Vehicles Production:		
Cars (millions)	1.3	2.0
Motor Cycles, Scooters (million units)	8.5	17
Housing Construction:		
Cement production (million tons)	130	200
- Percent of Cement used to build housing	42%	Same
- Effective Mortgage rate after government incentives on home loans	5.3%	5%
Other Luxury Items:		
Perfumes & Fragrance (US \$m)	392	542

Source: Economists Intelligence Unit

Conclusion

India is in the midst of a retail boom. The sector witnessed significant transformation in the past decade—from small unorganized family-owned retail formats to organized retailing. With the growth in organized retailing, unorganized retailers are fast changing their business models. However, retailing is one of the few sectors where foreign direct investment (FDI) is not allowed at present.

By permitting foreign retailers to India the pop and mom stores will not lose their share of profits. More over the consumers will have a wider variety of choices. The greater advantage is that FDI increases exports and ensures better quality inputs to our farmers and small manufacturers.

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