A Conceptual Framework on Foreign Direct Investment in Organized Retail Sector

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Abstract

FDI in Retail sector, a stimulating support by the foreign countries in the field of organized retail business, The Indian retail industry has emerged as one of the most dynamic and fast-paced industries due to the entry of several new players. It accounts for over 10 per cent of the country's Gross Domestic Product (GDP) and around 8 per cent of the employment. FDI in retailing is going through a transition phase not only in India but the world over. For a long time, the local MoM & PoP (Kirana Stores) store was the only choice available to the consumer, particularly in the urban areas. Modernized retail formats and store segments explain the number of industries that are willing to expand their physical stores in the Indian market. Study unveils the prominence of foreign direct investment in retail sector and the impact of FDI in Retail sector.

Key words: FDI, GDP, DIPP, FIPB, LPG

Introduction

India being the developing country and the land of a billion opportunities for investment has extended their hands for many foreign countries to invest their valuable inputs and resources in the development of Indian economy. After liberalization, privatization and globalization India has received huge inflow of foreign direct investment from various countries (Refer table no.1).

Retailing today is the fastest growing sectors in the global economy and is under transition phase; not only in South Asian countries like India and China but throughout the world. The Indian retail sector is highly fragmented with 97 per cent of its business being run by the unorganized retailers. Considering these untapped market potentialities, many countries have showed interest on initiating their retail business extensions. The organized retail however is at a very budding stage. The sector is the largest source of employment after agriculture, and has deep penetration into rural India generating more than 10 per cent of India's GDP.

The increased popularity of organized retailing is mainly because of the consumers' changing behavior. This change has become possible due to double income families, breakup of joint family concept, changing lifestyles and favorable demographic patterns. Today consumers prefer to shop at places where they can get grocery, food, entertainment and others daily routine items under one roof. This has made retailing the most attractive sector of the Indian economy.

Objectives of the study

- To study the conceptual information of FDI and Retail industry
- To recognize the intrinsic worth of FDI in Retail Sector
- To analyze the impact of FDI in Retail sector

Methodology

The paper has been developed through the understandings from various sources like statistical data, research articles, published and unpublished scholarly papers, books, various international and local journals and websites.

Foreign direct investment

It is an investment made by a company in new manufacturing or marketing facilities in a foreign country is referred to as 'Foreign Direct Investment' (FDI). An investment made by a company or individual in one country in business interests in another country, in the form of either establishing business operations or acquiring business assets in the other country, such as ownership or controlling interest in a foreign company. The investment made by a company in a foreign country over a given period is called 'Flow of foreign direct investment'.

The total amount of investment made by a company in a foreign country up to a given time is called, 'The stock of foreign direct investment'. Out flow of investment to a foreign country is called, 'Outflow of foreign direct investment' and inflow of investment from foreign country is called, 'Inflow of foreign direct investment'.

Forms of FDI

Foreign direct investment takes many forms in actual practice but is generally classified as

- Vertical direct investment,
- Horizontal direct investment or
- Conglomerate direct investment.

- A vertical direct investment is one where the investor adds foreign activities to an existing business, such as in the case of an Indian auto manufacturer establishing dealerships or acquiring a parts supply business in a foreign country.
- Horizontal direct investment is perhaps the most common form. In horizontal investments, a business already existing in one country merely establishes the same business operations in a foreign country, such as in the case of a fast food franchise based in the United States opening restaurant locations in China. Horizontal direct investment is also referred to as Green-field entry into a foreign market.
- The conglomerate type of direct investment, the least common form, is where an existing company in one country adds an unrelated business operation in a foreign country. This is a particularly challenging form of direct investment, since it requires simultaneously establishing a new business and establishing it in a foreign country. An example of conglomerate direct investment might be an insurance firm opening a resort park in a foreign country.

Table No. 01 shows the inflow of foreign direct investment from various countries

Top Ten Country-wise FDI Equity Inflows to India from April, 2000 to July, 2014

S.No	Name of the Country	Amount of FDI Inflows (Rs. in crore)	%age with total FDI Inflows (+)
1	Mauritius	390691.18	35.88
2	Singapore	135784.52	11.88
3	United Kingdom	105795.83	9.46
4	Japan	85639.02	7.49
5	Netherlands	65256.29	5.57
6	U.S.A	57835.90	5.38
7	Cyprus	37349.33	3.38
8	Germany	33486.48	2.99
9	France	19398.74	1.75
10	Switzerland	13801.42	1.23

The above table opines that Mauritius has showed most favorable interest with a maximum inflow of foreign direct investment of Rs. 390691.18 crore with 35.88 % followed by Singapore with the second largest inflow of FDI of Rs.135784.52 crore. Consequently UK, Japan, Netherlands U.S.A and other countries have brought their investment to Indian potential market.

Retail Sector: An Overview and Current Position

The Retail Industry is the sector of economy which is consisted of individuals, stores, commercial complexes, agencies, companies, and organizations, etc., involved in the business of selling or merchandizing diverse finished products or goods to the end-user consumers directly and indirectly. Goods and products of the retail industry or sector are the finished final objects/products of all sectors of commerce and economy of a country.

Retail Sector in India

The Retail sector of India is vast, and has huge potential for development, as the majority of its constituents are un-organized. The retail sector of India contributes about 15% to the national GDP, and employs a massive workforce of it, after the agriculture sector.

Retail classification

Retail industry can be broadly classified into two categories namely- organized and unorganized retail.

- **Organized Retail** - Organized traders/retailers, who are licensed for trading activities and registered to pay taxes to the government.
- **Unorganized Retail** – It consists of unauthorized small shops - conventional Kirana shops, general stores, corner shops among various other small retail outlets - but remain as the radiating force of Indian retail industry.

Key drivers of the Indian Retail Industry

- Emergence of nuclear families
- An increase in the double-income households trend
- Large working population
- Reasonable Real estate prices
- Increase in disposable income and customer aspiration
- Demand as well as increase in expenditure for luxury items
- Growing preference for branded products and higher aspirations
- Growing liberalization of the FDI policy in the past decade
- Increasing urbanization,
- Rising affluence amid consumers

Reforms of FDI in Retail Sector

Until 2011, foreign direct investment (FDI) was not completely allowed in multi-brand retail, forbidding foreign companies from any ownership in supermarkets, convenience stores or any retail outlets. Even single-brand retail was limited to 51 per cent ownership.

- In January 2012, India allowed 100 per cent FDI investment in single-brand stores, but imposed the requirement that the single brand retailer would have to source 30 percent of its goods from India. On 7 December 2012, India allowed 51 per cent FDI in multi-brand retail.
- Manmohan Singh, former prime minister of India, felt that this would be beneficial for both consumers and farmers. Agricultural marketing was also expected to be benefited with the introduction of foreign investment and new technologies. Manmohan Singh was credited with bringing about this policy change aimed at making India friendlier for businessmen. With this decision, international companies, especially the supermarkets, were able to increase their presence in the multi-brand retail sector of India.
- However, they were not allowed to own more than 51 per cent stakes in these establishments. This step was regarded as the most important one in the last two decades, especially with regard to reforms in India.

Table No. 2 Shows the Sector-wise inflow of Foreign Direct investment

Sector-wise FDI Equity Inflow from April, 2000 to July, 2014

Sl. No	Sectors	FDI Inflow (Rs. In Crores)	Percentages of Total FDI Inflow
1	Service	191752.15	17.73
2	Construction	111127.49	10.40
3	Telecommunication	80608.47	7.23
4	Computer Software & Hardware	61707.07	5.76
5	Drugs & Pharmaceuticals	61340.03	5.47
6	Automobile Industry	49678.09	4.41
7	Chemicals (Other than Fertilizers)	47538.99	4.40
8	Power	44667.08	4.05
9	Metallurgical Industry	39225.17	3.60
10	Hotel & Tourism	38030.37	3.25

The above table communicates the detailed information about the sector-wise inflow of foreign direct investment to India from April- 2000 to July- 2014. Here the service sector had absorbed maximum inflow of foreign direct investment of Rs. 191752.15 crores (17.73%). It means FDI had identified maximum opportunity in service Sector. Followed by construction industries FDI inflow is at 10.40%. Consequently, Telecommunication, Computer software & Hardware, Drugs and Pharmaceuticals, Automobile industry, Chemicals, Power Metallurgical industry, Hotel and Tourism sectors had attracted FDI of 7.23%, 5.76%, 5.47%, 4.41%, 4.40%, 4.05%, 3.60% and 3.25% respectively.

Process of FDI in Retail

International companies who are willing to invest in either single or multi-brand retail can put in their applications with the Department of Industrial Policy and Promotion (DIPP). Here the applications are reviewed to determine their suitability as per the stated guidelines. Subsequently, the Foreign Investment Promotion Board (FIPB), Ministry of Finance will play very important role in these processes, and consider the applications before providing the final approval.

Benefits of FDI in retail

India's retail industry is one of the largest and potential opportunities for many investors around the world when it comes to the privately owned ones. The industry has seen some major restructuring credit to the FDI structure for becoming more liberal than before.

The benefits of FDI in retail, as per experts, carry greater weight-age than the cost related implications.

Increased Production and Reduced cost: foreign direct investment in retail, operations in distribution and production cycles are expected to become better. Owing to factors such as economic operations, the cost of production facilities will come down as well. This will mean a greater choice of products at lesser and justifiable prices for the customers.

Transfer of technology and Skills: As a result of FDI, companies will be able to bring in technology and skills from other countries and this will help in infrastructural development of India. This will also help in creating more value for money for the buyers.

Inflow of abundant Capital: Foreign direct investment in organized retail, it is possible to set up a properly organized chain of retail stores as the capital to do is readily available. The investment can be regarded as a long term one as the physical capital put into a domestic company is not liquidated easily. This is its main difference from equity capital.

Improvement in supply chain: Foreign direct investment cannot always dependent on their home country to supply the required material for its subsidiaries, most of the time it would be feasible to purchase the required materials from the local market than their home country. Hence, FDI based corporations purchase required material from the local region which encourages the local supply chain of the country's market.

Healthy Competition: When FDI inflows to every nook and corner of the retail market opportunities, would creates healthy competition among the existing and newly established retail outlets. Competition among the players ensures the adoption of innovation, strategies and changes to differentiate themselves from the competitors. The differentiable outcomes lead to benefit the consumer from the retail operations.

Boost up agricultural activities: Foreign companies by investing in host countries agricultural activities can encourage producing required necessaries for their retail operations. Introduction of advanced Technology to the agricultural activities may increase the production capacity in all agricultural streams.

Improvement in Customer Satisfaction: Foreign direct investment in retail operations ensures the production and distribution of qualitative products in the competitive market. When qualitative products were produced and sold to the market for the economical prices, a consumer can experience the usage of top qualitative products for the reasonable prices in his/her own country, this leads to better satisfaction and compel them to purchase it again and again.

Threats of FDI in Retail

The liberalization, privatization and globalization (LPG) policies of India has given wide opportunity to the foreign countries to explore their business opportunities in Indian Retail sector. The freedom of exploring the business opportunities may exploit the entire resource of the nation. The rapid growth of organized retail sector would adversely affect the small retailers, farmers and consumers and give rise to monopolies of large corporate houses which can adversely affect the pricing and availability of goods.

Domination of Organized Retailers- FDI in single-brand retail will strengthen organized retail in the country. These organized retailers will tend to dominate the entire consumer market. It would lead to unfair competition and ultimately result in large-scale exit of domestic retailers, especially the small family managed retail outlets

Create Unemployment- If the production and Purchases authority were completely centralized, a foreign retailers may directly procure the necessary resources from the main supplier of their home country will not only create unemployment on the front end retail but also the middleman who have been working in this industry will be thrown out of their jobs.

Loss of Self Competitive Strength - Indian organized retail is still underdeveloped and in a nascent stage therefore the Small companies may not be able to compete with big global giants. If the existing firms collaborate with the global biggies they might have to give up at the global front by losing their self competitive strength.

Indirectly Leads to Increase in Real Estate Cost- It is obvious that the foreign companies which enter into India to open up their malls and stores will certainly look for places in the heart of the cities. There shall be a war for place, initiated among such companies. It will result in increase in the cost of real estate in the cities that will eventually affect the interest of the ordinary people who desire to own their houses within the limit of the cities.

Distortion of Culture: Though FDI in Indian retail will indirectly or directly contribute for the enhancement of Tourism, Hospitality and few other Industries, the culture of the people in India might slowly be affected by it. The youth will easily imbibe certain negative aspects of foreign culture and lifestyles and develop inappropriate consumption pattern, not suited to our cultural environment.

Conclusion

India being the fastest developing country holds the massive opportunity to attract foreign companies to invest in commercial and economical activities of the country. Hence, government of India has removed all the barriers to the foreign investors to accumulate their capital resources to the Indian Retail sector. Considering these opportunities many countries have showed willingness to enter these potential markets. India's retail market is expected to grow to US$ 1.1 trillion by 2020 on the back of income growth, urbanization and attitudinal shifts. The organized retail sector which is estimated to reach approx. 18-20% of the total sector, by 2020, is growing at a high rate of 20%-25% p.a. Hence, the study opinions that retail business in India are still strongly dominated by unorganized retail sector. It has a huge scope for the organized retail sector to capitalize these opportunities through Foreign Direct Investment.

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