Critical study of Foreign Direct Investment in Indian Retail with special reference to Multi Brand Retail Sector

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ABSTRACT

FDI is an important tool in the economic development of the nation. Contribution of FDI through financial resources, technology and innovative techniques raise the overall productivity of diverse sectors of economy. If properly navigated, FDI truly acts as a catalyst for development of sectors such as agriculture, manufacturing, service, SME and many more.

Indian retail sector is one of the most sought after sectors that carry great potential for attracting FDI. The issue of opening of retail sector for FDI is most controversial and debated issue in recent times. An attempt is made in this paper to cover present regulatory framework for FDI in retail sector and various entry options for FDI in retail. The paper also offers critical analyses of recent decision of Government of India to open retail sector for FDI in single brand and multi brand category and its likely impact on various components of Indian economy.

Keywords: Retail sector, FDI

INTRODUCTION

FDI is an important tool in the economic development of the nation. Contribution of FDI through financial resources, technology and innovative techniques raises overall productivity of diverse sectors of economy. If properly navigated, it also acts as a catalyst for development of sectors such as agriculture, manufacturing, service, SME and many more.

Indian retail sector is one of the most sought after sectors that carry great potential for attracting FDI. The sector is rightly projected as sunrise sector of India. The growth of retail, especially in 21st century is mind boggling and attracting the attention of retailers world over. With steady entry of top global retailers such as Wal Mart, Tesco, Carrefour and many more in last couple of years despite conservative approach of the government, the sector has become more fascinating for research study. The recent decision of Indian government of opening up the sector for FDI in single and multi brand retail has stirred up the heat with intense agitational activities witnessed all over India. The whole issue needs dispassionate review from all - intellegensia, corporate world as well as from government so that Indian retail sector benefits in its onward march of progress.

OBJECTIVES OF THE STUDY

1. To study present regulatory framework for FDI in general and in retail sector.
2. To study various entry options available to global retailers in India.
3. To study and analyze likely impact of FDI in single as well as multi brand retail on different components of Indian economy.

FOREIGN DIRECT INVESTMENT

'Foreign investment' is investment in an enterprise by a Non-Resident irrespective of whether this involves new equity capital or re-investment of earnings. Foreign investment is of two kinds – (i) Foreign Direct Investment (FDI) and (ii) Foreign Portfolio Investment.

FDI is defined under Dictionary of Economics as "Investment in a foreign country through the acquisition of a local company or the establishment thereof an operation on a new site." It refers to capital inflow from abroad. It is a form of long term international capital movement, made for the purpose of productive activity and accompanied by the intention of managerial control or participation in the management of foreign firm.

International Monetary Fund (IMF) and Organization for Economic Cooperation and Development(OECD) define FDI similarly as a category of cross border investment made by a resident in one economy (the direct investor) with the objective of establishing a 'lasting interest' in an enterprise (the direct investment enterprise) that is resident in an economy other than that of the direct investor.

Regulatory Framework for FDI in India

Indian companies can receive FDI under two routes-

1. **Automatic Route** – It does not require prior approval either of Reserve Bank of India (RBI) or government. It is allowed in all activities / sectors except where the provisions of consolidated FDI policy paragraph as "Entry route for investment" issued by government of India from time to time is attracted.
2. **Government Route** –'Government route' means that investment in the capital of resident entities by non-resident entities can be made only with the prior approval from FIPB, Ministry of Finance or SIA, DIPP as the case may be. FDI in sectors, not covered under automatic route requires prior approval of the government which is considered by Foreign Investment Promotion Board (FIPB), Department of Economic Affairs, and Ministry of Finance. Following sectors require prior approval of Government of India.
    a. Sectors prohibited for FDI - retail trading, lottery business, atomic energy, gambling and betting, business of chit fund, agriculture and plantation, nidhi companies, housing and real estate business.
    b. Activities that require industrial license
    c. Proposals in which the foreign collaborator has existing financial / technical collaboration in India in the same field.

d. Proposals for acquisition of shares in an existing Indian company in financial services and where Securities Exchange Board of India (SEBI) regulation, 1977 is attracted.

e. All proposal falling outside notified sectoral policy in which FDI is not permitted.

The Legal basis

Foreign Direct Investment by non-resident in resident entities through transfer or issue of security to person resident outside India is a 'Capital account transaction' and Government of India and Reserve Bank of India regulate this under the FEMA, 1999 and its various regulations. Keeping in view the current requirements, the Government from time to time comes up with new regulations and amendments/changes in the existing ones through order/allied rules, Press The Department of Industrial Policy and Promotion (DIPP), Ministry of Commerce & Industry, Government of India makes policy pronouncements on FDI through Press Notes/ Press Releases which are notified by the Reserve Bank of India as amendment to notification No. FEMA 20/2000-RB dated May 3, 2000. These notifications take effect from the date of issue of Press Notes/ Press Releases. The procedural instructions are issued by the Reserve Bank of India vide Circulars. The regulatory framework over a period of time thus consists of Acts, Regulations, Press Notes, Press Releases, Clarifications, etc. This circular consolidates into one document all the prior policies/regulations on FDI which are contained in FEMA, 1999, RBI Regulations under FEMA, 1999 and Press Notes/Press Releases/Clarifications issued by DIPP and reflects the current 'policy framework' on FDI. It deals comprehensively with all aspects of FDI Policy which are covered under the various Press Notes/Press Releases/ Clarifications issued by DIPP.

Table 1. Sector wise Division for FDI

FDI --- AUTOMATIC ROUTE	FDI -- GOVERNMENT ROUTE
Floriculture, Horticulture, Animal Husbandry	Tree Plantation
Mining, Exploration of Metal and Nonmetal ores	Manufacturing items reserved for SME (24%)
Coal and lignite mining and processing	Cigars and cigarette manufacturing
Alcohol distillation and brewing	Defence (26%)
Coffee and Rubber processing	Private Banking sector (74%)
Drugs and Pharmaceuticals	Commodity Exchange (49%)
Power	Print Media (26%)
Advertising and films	
Green field projects in aviation sector	
Data processing, software development and Computer consultancy services	
Health and Medical Services	
Hotel and Tourism	
Petroleum and natural gas	

Source: D/o IPP. F. No.5 (14)/2009 FC dated 31/3/2010 issued by Ministry of Commerce & Industry, GOI

FDI monitoring and reviewing agencies

1. Ministry of Commerce and Industry, GOI

The Ministry of Commerce and Industry, GOI is the nodal agency monitoring and reviewing FDI policy on continuous basis. This body makes policy pronouncement on FDI through press note / press releases which are notified by RBI as amendments to notifications. The regulatory framework consists of FEMA, regulations, press notes, press releases, circulars, clarification etc.

2. RBI (Reserve Bank of India)

RBI administers FEMA along with Directorate of Enforcement under the Ministry of Finance. Its main objective is to facilitate external trade and payment and promote orderly development and maintenance of foreign exchange market in India. Procedural instructions are issued by RBI through series of circulars. FEMA has been introduced in 1999 as a replacement to earlier FERA. It came into effect in the year 2000. The main objective was to consolidate and amend the laws relating to foreign exchange under the objective of facilitating external trade payment. RBI monitors the process. FDI is a capital account transaction and any violation of FDI regulations are covered by penal provisions of FEMA.

3. FIPB (Foreign Exchange Promotion Board)

FIPB is a board, set up under Dept. of Economic Affairs, Ministry of Finance, GOI. It is a government body that offers single window clearance for proposals on FDI in India that are not allowed an access through automatic routes. FIPB comprises of secretaries drawn from different ministries. This interministerial body examines and discusses proposals for FDI in country. FIPB has powers to consider recommendations up to Rs. 1200 crores. Proposals more than Rs. 1200 crores require the approval of cabinet committee on economic affairs (CCEA). It is mandated to play important role in the administration and implementation of governments FDI policy.

4. DIPP (Dept of Industrial Policy and Promotion)

Established in 1995, reconstituted in 2000, this board mainly looks after the formulation and implementation of industrial policies and strategies for industrial development of the country in conformity with developmental needs and national objectives. It also plays key role in the formulation of FDI policy, approval and facilitation of FDI. It also plays a role in resolving problems faced by foreign investors in implementation of their projects through Foreign Investment Implementation Authority(FIIA), which interacts directly with ministries/state governments concerned.

Consolidated circular which consolidates all prior policies/regulations on FDI which are contained under FEMA, 1999 and press notes/releases/clarifications/circulars issued by DIPP is released by DIPP in April, 2000. The document reflects current policy framework on FDI. Ministry has also assured of releasing a consolidated circular on update FDI policy every six months. The circular consolidates FDI policy framework, the legal edifice is built by RBI under FEMA. SIA is the Secretariat of Industrial Assistance in DIPP, under Ministry of Commerce and Industry, is another facilitation body as regards to FDI in India.

Table 2. Ranking of Sector wise FDI inflow in India (April 2000- Dec 2010)

Rank	Sector	% of FDI inflow
1	Service Sector	32
2	Computer Hardware and Software	14
3	Telecommunication	12
4	Housing and Real Estate	11
5	Construction Activities	11
6	Power	6
7	Automobile Industry	6
8	Metallurgical Industry	4
9	Petroleum and Natural Gas	3
10	Chemicals	1

Source: Fact Sheet of FDI- DIPP (2010)

Regulation for FDI in Retail

FDI in retail is the most controversial and debated issue attracting cross sections of opinion from government, Political Parties, Industry experts and Academia. Since retail yet does not enjoy independent industry status, there are no exclusive figures available on FDI in retail sector. Prior to 1997, FDI was allowed in retailing to end users, but all applications were considered on case to case basis. This enabled "Nanz" supermarket of Germany and "Dairy Farm" of Hongkong to enter food retailing in India in 1991, by linking up with domestic retailers. Nanz was folded after opening up of eight stores in New Delhi. In late nineties, the domestic retailers agitated against FDI in retailing and since 1997-98 FDI in retail was disallowed.

As per current laws except under single brand retail where FDI upto 100% is allowed directly, FDI in retail is prohibited in India. India being a signatory to WTO is required to open up retail trade sector to FDI. In 1997 FDI in Cash and Carry with 100% ownership was allowed under the government approval route. It was brought under automatic route in 2006. 51% investment in single brand retail outlet was also permitted in 2006. FDI in multi brand retail is still prohibited in India.

Press note of 2006 by DIPP and consolidated FDI policy issued in October 2010 provide sector specific guidelines and regulatory framework for FDI with regard to conduct of trading activities which also includes retail operations.

Approved entry options to foreign players in retail sector

1. **Franchise agreement -** In Franchise and commission agent services FDI is allowed with approval of RBI under FEMA. Players such as MacDonald, Pizza Hut, Nike, Mango, Marks and Spencers have entered Indian market through this route.

2. **Wholesale Cash and Carry Trade (B2B) -** 100% FDI is allowed in wholesale trading which involves building of a large distribution infrastructure to assist local manufacturers. Metro A.G., Shoprite, Amway followed this route to enter into India.

3. **Strategic licensing agreement -** Regulated by DIPP. Some foreign brands gave exclusive licenses and distribution rights to Indian companies, by which Indian

companies can sell foreign brand in their own stores. E.g. Mango, Adidas, Hugo Boss etc.

4. **Manufacturing and wholly owned subsidiaries -** Multinationals having wholly owned subsidiaries in manufacturing in India are treated as Indian companies and are allowed to sell products to Indian customers .e.g. Sony, LG, Samsung, HUL etc.
5. **Test marketing -** FIPB allows foreign companies to test market their product in India for two years period, by the end of which they are required to set up manufacturing unit in India. E.g. Amway, Oriflame
6. **Joint venture -** Foreign retailers can enter into joint venture with Indian company and undertake business operations. E.g. Bharati-Walmart, Dairy Farm-RPG
7. **Special cases -** With special permission of RBI some international retailers from Sri Lanka have independently Indian retail market. Such cases are treated as exclusive. E.g Hammedia from Sri Lanka
8. **Single Brand Retailing -** FDI in single brand implies that a retail store with foreign investment can sell only one brand Government has defined single brand retailing as under –

Tracking the FDI reforms in Single brand retailing:

In single brand retail, FDI up to 51% is allowed, subject to FIPB approval and subject to the conditions mentioned in press note 3 of DIPP as stated herewith—

a. Only single brand products would be sold. Retail of goods of multi brand, even if produced by the same manufacturer is not allowed.
b. Single brand product retail would cover the products which are branded during manufacturing stage only.
c. Any addition to product categories to be sold under the single brand requires fresh approval from the government
d. Product should be sold under the same brand name internationally.
e. Retailers may be able to sell multiple products under the same brand name. E.g. product range under the same brand name.
f. International retailer can not source the products and thereafter brand them under their product label. Since the regulation requires product to be branded at manufacturing stage only, the regulatory provisions as of now, discourage private labels and promote manufacturer's own brands only.
g. Existing policy does not clearly clarify whether retailing of goods under sub brands, grouped under major parent brand can be considered as single brand retailing and eligible for 51% FDI.

In January 2012, Indian Government finally came out with the notification of allowing 100% FDI in single brand retailing. RBI notified exchange in single brand retail policy and operationalised the change by removing FDI cap in SBR.

Tracking the FDI reforms in Multi brand retailing:

Multi brand retailing implies that a retail store with foreign investment can sell multiple brands, under one roof. In July, 2010, DIPP, Ministry of Commerce, circulated a discussion paper on allowing FDI in MBR. Opening up of retail sector to MBR means that global retailer can open the store offering multiple items including grocery, household, electronics and all other under one roof. FDI can be a powerful tool to improve productivity of Indian retail sector. FDI in single brand retail was permitted in 2006. Between 2006 and 2010 a total of 94 proposals were received, of these 57 proposals have been approved. FDI inflow of $ 196.46 million under the category of single brand retailing was received between April 2006 – Sept. 2010, comprising 0.16% of total FDI inflow. During that period, it had also positive effect on Indian retailers' stocks.

ICRIER and Crisil, leading Indian research agencies have projected the worth of Indian retail sector to reach $ 496 billion by 2011-12. They have concluded that FDI in retail sector in the long run will not harm interests of small retailers.

In July, 2011, the committee of secretaries has principally cleared the proposal to allow 51% FDI in Multi brand retail with some riders. It requires the global retailer to invest minimum of US$ 100 million, with minimum investment of 51% in backend supply chain. Also 35% sourcing compulsory from domestic small and medium scale units..

Number of concerns have been expressed on opening of retail sector to MBR. Standing committee of Parliament in its 90th report on 'Foreign and Domestic Investment in retail sector' tabled in parliament on 8th June, 2009, had made in depth study of the issue and its major findings are as follows:

a. There is a risk of creating unfair competition and large scale exit of small scale retailers
b. Fear of creation of large scale unemployment in unorganized retail sector
c. No scope of absorption of displaced workers in manufacturing sector
d. Indian organized retail sector still in fledgling stage and requires protection in order to settle down

The Central government, on 24th November, 2011 finally announced its decision to allow foreign retailers to own 51 % stake in multi brand retail sector , thus clearing the way for global retailers to open supermarkets in India. It also allowed 100 % FDI in single brand retail, a decision that carries the potential to push the economic reforms further. Conditions that were laid down are as under:

1. Minimum investment of $100 million, 50% in back end operations
2. Back end can not include the investment in land and rentals and front end stores
3. At least 30 % sourcing must be from SME's (Small and Medium Scale IEnterprises)
4. Stores can only be in the cities with at least one million population (about 40+ cities)
5. Government shall have first right of procurement of farm produce

However, after aggressive opposition from nearly all quarters, with stalling of parliament by opposition parties and nationwide agitations, the decision is deferred till assembly elections likely to take place in five states in the year 2012. Efforts of the government are on, hectic parleys with farmers bodies, parliamentarians as well as business leaders to build consensus over the issue.

Analysis of FDI regulations in Single Brand and Multi Brand retail:

1. Farmers – prime beneficiaries……

Investment in back end infrastructure will help reduce wastage of farm produce, improve livelihood of farmers, lower the prices of products and ease supply side inflation, food safety, hygiene and quality. Direct farm initiatives shall also provide better remuneration to farmers. More investment is likely in farming sector. Since each retailer is expected to bring $ 100 million, it will have notable investment in back end and logistics and likely to push employment further. Farmers have chances to gain greater market access, higher profits, better technology and linkages with consumers due to direct back end linkages. Key farmer issues can be addressed which would help agricultural productivity. Intermediaries often flout *mandi* 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 1/3rd of the total price paid by final consumer, against 2/3rd by farmers in nations with a higher share of modern retail.

2. Real Estate sector likely to upscale their operations…….

The decision to allow 51% in Multi brand retail is expected to prompt realtors to revive their plans to build malls and shopping complexes, which were shelved down in the past few years due to economic slowdown. As per Jones Lang Lasalle India Consultant, Rs. 22,000 crores retail real estate market shall grow at CAGR of 25 % a year for the next five years, growing at 50- 100 %. With this, much needed capital too is expected to come into the country for retail which means more job creation in future.

3. Consumers and Common man to become real kings and queens now……..

The oft quoted term- consumer as a king and queen - is finally wearing a garb of reality. Entry of global retailers is expected to have direct impact on consumers as well as common man. It is expected to bring down commodity prices for the common man. Large scale and high volume sourcing and technology edge of global retailers help in realizing greater operational efficiency and wide assortment of goods at lower prices may be made available to consumers. Food safety, hygiene and quality are value additions. More than 60% of the wastage can be prevented if specialized cold storage chains are built up on mass scales, which eventually shall help common man.

4. Other fringe benefits......

- **Long term cash liquidity:**

  FDI will provide necessary capital for setting up organized retail chain stores. It is a long term investment because unlike equity capital, the physical capital invested in the domestic company is not easily liquidated.

- **Lead driver for the country's economic growth:**

  FDI in MBR would create a competition among the global investors, which would ultimately ensure better and lower prices thus benefiting people in all sections of the society. There would be an increase in the market growth and expansion. It will increase retail employment and suppress untrained manpower and lack of experience. It will ensure better managerial techniques and success. Higher wages will be paid by the international companies. Urban consumers will be exposed to international lifestyles.

- **FDI opens new doors for Franchising:**

  Retail giants who are at their wings, seeking entry into foreign market look for other available alternatives. These restrictions on the global retailers regarding the inflow of Foreign Direct Investment, leads them towards acquiring the market entry through franchises. Thus, countries which offer promising market potentialities for retail growth offers substantial growth in the franchising sector as well.

5. Adverse impact feared on supply chain intermediaries……….

It is feared that foreign retailers will directly impact existing supply chain intermediaries that are being fed by SME's. Since sourcing from domestic SME's Is not mandatory, foreign retailers may source the products from countries like China which is known as manufacturing hub of the world and it may put Indian SME sector in great danger. There may be a possibility of large scale unemployment if not checked. The current provision of 30% sourcing from Indian SME's should be made mandatory and should be strictly monitored. Due to predatory pricing strategies, vast class of India's merchants may get affected directly.

6. Fear of survival of Small and unorganized retailers in the environment of intense competition……….

The local kiranas, small shopkeepers, hawkers, peddlers still form major section of Indian economy. Retail sector acts as a shock absorbing sector, providing opportunities for self employment in case of economic slowdown. The local shopkeepers in the vicinity of big retailers might find it difficult to compete. The prices will be determined by modern retailers and small shopkeepers may have to loose their profit margin due to predatory pricing strategy. 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.

7. Will consumers be exploited in the long run??

It is argued that consumers shall benefit due to variety, quality and availability of wide merchandise. However, it is feared that in the long run, consumers may have to face the risk of higher prices, substandard quality and limited options once these big retailers settle down comfortably in Indian market.

8. Prospects of Indigenous modern retail sector at stake........

Another concern is that the Indian retail sector, particularly organized retail, is still under-developed and in a growing stage and that, therefore, it is important that the domestic retail sector is allowed to grow and consolidate first, before FDI in MBR is allowed.

CONCLUSION

FDI in retail is very much debatable issue which needs to be resolved by taking into consideration the interest of the stakeholders. The decision to allow entry to foreign players in MBR is clearly a game changer for Indian retail sector. A fresh wave of consolidation may come, ending the era of multiple players in modern retail. Big retail bosses across the world shall come to India either independently or by partnering with Indian counterparts for a successful head start.

The policy of allowing 100% FDI in single-brand retail was adopted to allow Indian consumers access to foreign brands. It shall benefit both the foreign retailer and the Indian partner – foreign players get local market knowledge, while Indian companies can access global best management practices, designs and technological knowhow. By completely opening this sector, the government has strongly conveyed its willingness in retail sector reforms.

By allowing FDI in retail trade, India will significantly benefit in terms of quality standards since the inflow of FDI in retail sector is bound to pull up the quality standards and cost-competitiveness of Indian producers and marketers in all the segments. It will also help in integrating the modern Indian retail market with that of the global retail market. More chances of respectful status and better pay packets for retail staff, which the unorganized sector has failed to provide to the masses employed.

On the other hand, FDI in multi-brand retailing must be dealt cautiously as it has direct impact on a large chunk of population. Foreign capital, if unchecked, may widen the gap between the rich and the poor. Thus, the entry of foreign capital into multi-brand retailing needs to be anchored in such a way that it results in a win-win situation both for India and global players. For example FDI in multi –brand retailing can be allowed in a calibrated manner with social safeguards so that the effect of possible labor dislocation can be analyzed at regular intervals and policy fine tuned accordingly. To ensure that the foreign investors make a genuine contribution to the development of India's infrastructure and logistics, it can be stipulated that a percentage of FDI should be spent towards building up of back end infrastructure, logistics or agro processing units and the claims must be critically evaluated. It can also be stipulated that at least 50% of the jobs in the retail outlet should be reserved for rural youth.

On regulatory front, more clarity is required and the same is possible only when retail is recognized as a separate and independent sector of Indian economy. Thus, the priority step would be accordance of industry status to retail sector. Secondly, uniform regulatory structure need to be set up with respect to taxes and duties as regards modern retail sector. Exclusive national policy pertaining to this sector should be formulated. Enactment of national shopping mall regulation act would help to regulate fiscal and social aspects of modern retail sector and create investor friendly environment in India that as regards FDI in retail sector.

Along with existing legal and regulatory framework, strong enforcement mechanism is necessary to ensure that big retailers do not dislocate small retailers by unfair means and there is peaceful coexistence of both the arms of retail sector.

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