FDI IN MULTI-BRAND RETAILING: OPPORTUNITIES AND THREATS FOR RURAL INDIA

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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. The last decade has witnessed the entry of a number of organized retailers opening stores in various modern formats in metros and other important cities. Still, the overall share of organized retailing in total retail business has remained low. The traditional grocery retail is the largest contributor to the total grocery retailing in India. But, more than that, it is a major employment provider accounting for 10% of the total employment in the country. This became a major concern for the Indian government while deciding over the opening of FDI gates for India.

This paper attempts to discuss all these aspects. The paper is organized into four main sections. While the “FDI in Indian Retail” is discussed in first part, the second part of the paper outlines the “Employment in Retailing”. The third part presents a discussion on Current Scenario of “AgriInfrastructure in the Country” and the fourth part deals with the “Opportunities and Challenges” faced by the Indian retail sector.

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1. INTRODUCTION

Foreign Direct Investment (FDI) is a method of allowing external finance into an economy. FDI facilitates international trade and transfer of knowledge, skills and technology. Foreign Investment in India constituted a small per cent of Gross fixed capital formation in 1993, which went up to 4 per cent in 1997. The Tenth Plan approach postulates a GDP growth rate of 8 per cent during 2002-2007. This implies an increase in FDI from the present levels of $3.9 billion in 2001-2002 to at least around US$ 8 billion a year during 2002-2007.

India is fast emerging as a key destination for FDI. According to the FDI Confidence Index prepared by A T Kearney, India ranks second in FDI attractiveness ranking, the first being China. Developing countries, emerging economies and countries in transition increasingly see foreign direct investment (FDI) as a source of economic development, modernization and employment generation and have liberalized their FDI regimes to attract investment.

The liberalization of Foreign Direct Investment (FDI) policy of the Indian Economy in 1991, that has made most business sectors in India eligible to receive foreign investment, has opened up front doors to many a multinational corporation. But the policy framework for the retail and the trading sector has continued to be highly restricted. Ever since, the multinational corporations have been eagerly waiting for the opening of the Indian retail sector for the FDI. Discussions pertaining to FDI in retail trade in India have always yielded a mixed bag of reactions. In the recent times FDI in retailing has been the most heard buzzword in the Indian Corporate World. And finally the big news seems to have arrived. India is ready to open up the doors for FDI in retailing.

1.1 Objectives

The objective of our study is to analyze the current retail scenario in India, investigate the controversial issues and evaluate the likely challenges and threats of FDI in retail sector in India. The specific objectives are:

(i) To study the FDI Policy of Government of India in Indian Retail,
(ii) To study the scope of employment in retailing,
(iii) To study the situation of agri-infrastructure in the Indian economy, and
(iv) To identify the opportunities and threats.

1.2 Methodology

The whole paper is based on descriptive arguments, statistical data, comparative study and analytical logic developed through the understandings from various research papers, reports, journals, books, newspapers, conference proceedings, Government reports and websites.

2. FDI in Indian Retail

2.1 Meaning of retail

Retailing encompasses those business activities involved with the sale of goods and services to the final consumer for personal, family or household use. It is the final stage in a channel of distribution. Retailing is the interface between the producer and the individual consumer buying for personal consumption. This excludes direct interface between the manufacturer and institutional
buyers such as the government and other bulk customers. A retailer is one who stocks the producer's goods and is involved in the act of selling it to the individual consumer, at a margin of profit. As such, retailing is the last link that connects the individual consumer with the manufacturing and distribution chain.

2.2 Evolution of retail in India

It is essential to highlight on the evolution of the retail sector in India. Earlier, weekly markets, village fairs and melas evolved as a source of entertainment which was within the rural reach. Later on, these were transformed Mom and Pop/ Kirana stores which are of traditional variety neighbourhood shops. After that we see government supported PDS outlets, khadi stores, cooperatives etc. Finally, with the liberalization a new large middle class with spending power had emerged and shaped this sector a new format. The vast middle class market demanded value for money products. This has fuelled the growth of supermarkets, departmental stores and shopping malls.

Fig. 1 Evolution of Retail in India

![Evolution of Retail in India](image)

Source: Technopak Research

2.3 Division of Indian Retail Industry

Retailing in India is divided into organized and unorganized retailing.

(a) Organized retailing refers to trade activities undertaken by the licensed retailers i.e., those who are registered for sales tax, income tax etc. These include the corporate backed hypermarket, retail chains and also the privately owned large retail business.

(b) Unorganized retailing, on the other hand, refers to traditional format of low cost retailing, for example the grocery shops, owner manned general stores, cigarette shops, convenience store, pavement vendor etc. It is the most prolific and visible form of retailing in India while the organized retailing constitutes only a very small percentage (3-4%). The unorganized sector is thus not a profit oriented vocation but a mere source of livelihood. Naturally, the capital investment is very low and the infrastructure is rudimentary. It is estimated that less than 4% of Indian retailers have shops larger than 500 square feet. 

2.4 Types of Retailing in India

The retail sector in India is organized into three categories, namely, ‘single-brand’, ‘multi-brand’ and ‘cash and carry’ retail.

(a) Single Brand- Single-brand retail comprises those retailers selling products “of a ‘single brand’ only, such that products should be sold under the same brand internationally and single-brand product retailing covers only products which are branded during manufacturing. FDI in ‘Single brand’ implies that a retail store with foreign investment can only sell one brand. For example, if Adidas were to obtain permission to retail its flagship brand in India, those retail outlets could only sell products under the Adidas brand and not the Reebok brand, for which separate permission is required. If granted permission, Adidas could sell products under the Reebok brand in separate outlets.

(b) Multi Brand- FDI in Multi Brand retail implies that a retail store with a foreign investment can sell multiple brands under one roof. No FDI is allowed in the multi-brand retail category. This includes all firms in organized retail that seek to stock and sell multiple brands, such as large international retailers like Wal-Mart and Carrefour. This is the sector that is most under dispute.

(c) Cash and Carry -The third segment, called ‘cash and carry’, refers to wholesale retail. The government defines this segment as the “sale of goods and merchandise to retailers, industrial, commercial, institutional or other professional business users or to other wholesalers and related subordinated service providers”. In India, FDI of 100 per cent is permitted in this segment. As per the ‘cash and carry’ structure commonly employed in India, the wholesale and retail entities are maintained as separate entities without any cross-shareholdings. The retail entity is owned and controlled by the Indian partner while the wholesale entity can be owned by the foreign partner up to 100 per cent. Wal-Mart, for example, has already established a successful presence in this category of wholesale operations by entering into a joint venture with Bharti Enterprises Ltd. of India. The new entity, Bharti-Wal-Mart, is in operation with stores opening around the country.

2.5 FDI Policy Scenario- Foreign Direct Investment under the Industrial Policy 1991 and thereafter under different Foreign Trade Policies is being allowed in different sectors of the economy in different proportion under either the Government route or Automatic Route. In Retailing, presently 51 per cent FDI is allowed in single brand retail through the Government Approval route while 100 per cent FDI is allowed in the cash-and-carry (wholesale) formats under the Automatic route.

a) Foreign Direct Investment in Multi Brand Retail Trading (MBRT) was prohibited.
b) Foreign Direct Investment (FDI) up to 51% in the Single Brand Retail Trading (SBRT) sector was permitted, under the Government/Foreign Investment Promotion Board (FIPB) route, subject to the following conditions:

i) Products to be sold should be of a ‘Single Brand’ only.

ii) Products should be sold under the same brand internationally.

iii) It would cover only products which are branded during manufacturing.

iv) The foreign investor should be the owner of the brand.

c) Government allowed 100% FDI in single brand retail with a rider that foreign brands would mandatorily have to source 30% of their requirements from Small and Medium Enterprises.

2.6 Entry Options for Foreign Players

Some of the popular entry options for foreign players have been as follows:

i) Franchising: Under this arrangement, the parent company lends its name and technology to a local partner and gets loyalty in return. In case a master franchisee is appointed at the national or regional level, the parent company gets the right to appoint local franchisees. Nike, Marks and Spencer, Pizza Hut and Mango are some of the best-known foreign players who have adopted this set up of operations. FDI (unless otherwise prohibited) is allowed with the approval of the RBI under the Foreign Exchange Management Act.

ii) Strategic Licensing Agreements: Some foreign brands offer exclusive licenses and distribution rights to Indian companies. Through these rights, Indian retailers can either sell it through their own store or enter into shop-in-shop arrangements or distribute the brands to franchisees. Mango, the Spanish apparel brand has entered India through this route with an agreement with Pyramid, Mumbai.

iii) Joint Venture: In this case, the international partner provides equity and support to the Indian investor. The Indian partner provides all the local knowledge that is typically needed in such a venture. Mc Donalds and Reebok have adopted the joint venture route in India.

iv) Manufacturing and Wholly Owned Subsidiaries: The foreign brands such as Nike, Reebok, Adidas, etc. that have wholly-owned subsidiaries in manufacturing are treated as Indian companies and are, therefore, allowed to do retail. These companies have been authorized to sell products to Indian consumers by franchising, internal distributors, Indian retailers, own outlets, etc. For instance, Nike entered through an exclusive licensing agreement with Sierra Enterprises but now has a wholly owned subsidiary, Nike India Private Limited.

2.7 Benefits of FDI in other countries: FDI was not permitted 100% at a time for most of the companies operating in different countries in retail businesses. It accrues benefits in different way in different countries. In 1992, China permitted foreign ownership up to 49% and gradually lifted the restrictions. Thailand, Russia, Indonesia, Brazil, Argentina, Singapore and Chile allowed 100% FDI in retail while Malaysia permits to a certain limit. FDI entails impressive growth in retail and wholesale trade of China.

<table>
<thead>
<tr>
<th>Country</th>
<th>FDI limits</th>
<th>Benefits</th>
<th>Remarks</th>
</tr>
</thead>
</table>
| China       | 100%       | • First permitted in 1992 with foreign ownership restricted to 49%, progressively lifted with no restrictions now.  
• Over 600 hypermarkets opened between 1996 and 2001.  
• The number of small outlets (equivalent to ‘Kiranas’) increased from 1.9 million to over 2.5 million.  
• Employment in the retail and wholesale sectors increased from 28 million people to 54 million people from 1992 to 2001. | Impressive growth in retail and wholesale trade. |
| Thailand    | 100%       | • Referred to as a country where FDI had an adverse effect on the local retailers.  
• Has limited capital requirement for retail and wholesale outlets. | Growth in agro processing industry. |
| Russia      | 100%       | • Supermarket revolution took place in 2000.  
• Heavy growth registered. |                                |
| Indonesia   | 100%       | • Modern retail took off in 1990s.  
• No limit on number of outlets.  
• Matahari is leading chain. |                                |

Brazil, Argentina, Singapore and Chile allow 100% FDI in retail sector while Malaysia permits FDI to a certain limit.

Source: YES BANK Ltd. and ASSOCHAM.
2.8 FDI in Retail and Corporate Finance:

The available theoretical and empirical research has mainly discussed and quantified the positive effects of FDI on the performance of the domestic economy, including indirect effects on domestic companies, especially in the framework of supplier-customer relations. The available evidence suggests strong direct positive effects on investment activity, employment, export performance and output growth. From the macroeconomic perspective, FDI is known to be the least volatile form of capital flows. However, foreign direct investment can also introduce certain risks into the economy. The strengthened export orientation due to FDI increases the dependence of the domestic economy on the external environment and possibly also on global developments in those sectors where the investors operate, which may lead to higher volatility in the economy’s performance. In addition, transfers of profit from foreign-owned corporations may put pressure on the current account and exchange rate of the host economy. The tendency of foreign companies to obtain funding for their operations within their group rather than from local banks may reduce the demand of large foreign-owned companies for loans on the local market. This slows the development of the domestic financial sector.4

3. Employment in Retailing

A number of issues have been raised about opening up the retail sector for FDI in India. The first concern is the potential impact of large foreign firms on employment. Following agriculture, in 2007-2008, the retail sector is the second largest employer in India.5

3.1 Employment Shares in Retail Trade

Table 1 Employment Shares in Retail Trade, 1993-2008

<table>
<thead>
<tr>
<th>Year</th>
<th>Rural</th>
<th>Urban</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007-08</td>
<td>Male</td>
<td>Female</td>
</tr>
<tr>
<td>1993-94</td>
<td>5.6</td>
<td>1.7</td>
</tr>
<tr>
<td></td>
<td>3.63</td>
<td>1.4</td>
</tr>
</tbody>
</table>

Source: DIPP Report

It transpires from the above table that the share of retail employment has risen significantly when compared to its share in 1993-1994. The pattern holds for both males and females, in rural, and in urban areas.

3.2 Share of Retailing in Employment across Different Countries: A simple glance at the employment numbers is enough to paint a good picture of the relative sizes of the two forms of trade in India – organized trade employs roughly 5 lakh people, whereas the unorganized retail trade employs nearly 3.95 crores. According to a GOI study the number of workers in retail trade in 1998 was almost 175 lakhs. Though these numbers translate to approximately 8% of the workforce in the country (half the normal share in developed countries) there are far more retailers in India than other countries in absolute numbers, because of the demographic profile and the preponderance of youth.

Table 2 Share of Retailing in Employment across Different Countries

<table>
<thead>
<tr>
<th>Country</th>
<th>Employment (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>India</td>
<td>8</td>
</tr>
<tr>
<td>USA</td>
<td>16</td>
</tr>
<tr>
<td>Poland</td>
<td>12</td>
</tr>
<tr>
<td>Brazil</td>
<td>15</td>
</tr>
<tr>
<td>China</td>
<td>7</td>
</tr>
</tbody>
</table>

Source: Presentation to FICCI by Alan Rosling (Chairman, Jardine Matheson Group): “International experience on Policy Issues.”

Table 2 shows that retail contributes 16% in employment in case of USA, 15% in case of Brazil, and Poland contributes 12%. But, India and China contribute 8% and 7% share in employment respectively.

3.3 Retail Trade in India & South East Asia: Organized retail is still in the stages of finding its feet in India even now. Though organized trade makes up over 70-80% of total trade in developed economies, India’s figure is low even in comparison with other Asian developing economies like China, Thailand, South Korea and Philippines, all of whom have figures hovering around the 20-25% mark. These figures quite accurately reveal the relative underdevelopment of the retail industry in India.

Table 3 Retail Trade in India & South East Asia

<table>
<thead>
<tr>
<th>Countries</th>
<th>Organized (%)</th>
<th>Unorganized (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>India</td>
<td>2</td>
<td>98</td>
</tr>
<tr>
<td>China</td>
<td>20</td>
<td>80</td>
</tr>
<tr>
<td>South Korea</td>
<td>15</td>
<td>85</td>
</tr>
<tr>
<td>Indonesia</td>
<td>25</td>
<td>75</td>
</tr>
<tr>
<td>Philippines</td>
<td>35</td>
<td>65</td>
</tr>
<tr>
<td>Thailand</td>
<td>40</td>
<td>60</td>
</tr>
<tr>
<td>Malaysia</td>
<td>50</td>
<td>50</td>
</tr>
</tbody>
</table>

Source: CRISIL

Table 3 shows that organized retail has ranged from 15% to 50% in South East Asian Countries except India, which is only 2%. Thus, unorganized trade makes up over 90% of the total trade in India. It is clear that India’s retail is still in the unorganized sector.

3.4 Employment Share of Retail in India from 2006-11:

The employment opportunities in the retail sector are definitely on the rise but organized retail is yet to become a preferred career option for most of India’s educated class.

Chart 3 Chart showing Employment Share of Retail in India from 2006-11

Source: YES BANK ANALYSIS

Chart 3 reveals that the overall employment share of retail in India has hovered between 9.3% to 9.4% from 2006 to 2011. In 2011, the retail sector provided employment to 41,000 people as compared to 37,000 in 2006 growing at a CARG of 2%.

4. Agri-Infrastructure in the Country

4.1 Current Scenario of Agri-Infrastructure in the Country

The warehouses in our country have been built following traditional norms and without proper specification. They lack in optimal size, adequate design, ventilation facility, inventory management and storage system. According to latest estimates, the warehousing capacity available in India, in public, co-operative and private sector is about 108.75 million MT and another 35 million MT warehousing capacity is required during the Twelfth Five Year Plan period for the storage of all major crops. Thus there exists a huge demand supply mismatch. Warehouse accounts for the largest share of infrastructure segments in the logistic industry claiming around 6-7%.
Though India is the second largest producer of fruits and vegetables (about 200 million MT), it has a very limited integrated cold-chain infrastructure, with only 5,386 stand-alone cold storages, having a total capacity of 23.6 million MT. Lack of adequate storage facilities causes heavy losses to farmers in terms of quality degradation and wastage of produce in general, and of fruits and vegetables in particular. Post-harvest losses of farm produce, especially of fruits, vegetables and other perishables, have been estimated to be over INR 1 trillion per annum, 57% of which is due to avoidable wastage and the rest due to avoidable costs of storage and commissions. vi) Since Indian agriculture is witnessing a major shift from traditional farming to horticulture, meat, poultry and dairy products and the demand for fresh and processed fruits and vegetables is increasing due to rising urban population and transforming consumption habits, the role of cold storages becomes critical.

5. Opportunities and Threats

5.1 Opportunities: The following may be regarded as major perceived benefits of allowing FDI in retail in India:

i) Capital Inflow: This would provide an opportunity for domestic retailers to bridge the gap between capital required and raised. In fact FDI is one of the major sources of investments for a developing country like India wherein it expects investments from Multinational companies to improve its economy by creating job opportunities, imparting expertise, developing infrastructure and opportunities for research and development in the host country.

ii) Impact on Food Inflation: FDI in retail will give impetus to the backward linkages which is essential for controlling food inflation. Players in the organized retail sector will create adequate infrastructure facilities, thereby reducing wastages and increasing the supply of commodities, bringing down their prices considerably. Due to the Direct Procurement model followed by organized retailers, there would be substantial cost savings through disintermediation which would ultimately benefit the consumer.

iii) Improvement in Supply Chain: Improvement of distribution efficiencies along with capacity building and introduction of modern technology will help to avoid wastages.

iv) Impact on Consumers: The strongest impact of organized retailing would be seen on the consumers. Along with the increase in disposable income and increased discretionary expenditure, the consumers will get better choice of formats. Due to the Direct Procurement model followed by organized retailers, there would be substantial cost savings through disintermediation which would ultimately benefit the consumer.

v) Benefits for the Farmers- Lack of adequate storage facilities causes heavy losses to farmers, in terms of wastage in quality and quantity of produce in general, and of fruits and vegetables in particular. Farmers would be better off with the “farm-to fork” ventures with retailers which helps (i) to cut down intermediaries ; (ii) give better prices to farmers, and (iii) provide stability and economics of scale which will benefit, in the ultimate analysis, both the farmers and consumers.

vi) Creation of More and Better Employment Opportunities- Huge investments in the retail sector will see gainful employment opportunities in agro-processing, sorting, marketing, logistic management and the front-end retail business. Industry estimates suggest employment of one person per 350-400 sq.ft of retail space, which means nearly 1.5 million jobs will be created in the front-end alone in the next 5 years. Assuming that 10% extra people are required for the back end, the direct employment generated by the organized retail sector in India over the coming 5 years will be close to 1.7 million jobs. Indirect employment generated on the supply chain to feed this retail business will add millions of jobs.
5.2 Threats: In a survey, conducted by The Confederation of Indian Industry (CII) during December 2011 to January 2012 on the impact of FDI on Small and Medium Enterprises (SMEs) showed that 52 percent of respondents hope for early implementation of 51% FDI in multi-brand retail. On the question how the SME industry consider entry of MNC retailers as a threat or opportunity, majority of respondents (66.7%) see it as an opportunity for their sector while around 21 % of respondents perceive it as a threat. About 12.5 percent of respondents are of the opinion that the decision would have little or no impact on their company.13

1. Effect on Traditional Mom and Pop Stores- Traditional retailing has been established in India for many centuries, and is characterized by small, family-owned operations. Because of this, such businesses are usually very low-margin, are owner-operated, and have mostly negligible real estate and labour costs. Getting customers to switch their purchasing away from small neighbourhood shops and towards large-scale retailers may be a major challenge. The oppositions, on the other hand, believe that local kirana shops will not be affected. The kirana stores operate in a different environment catering to a certain set of customers and they will continue to find new ways to retain them.

2. Effect on Farmers- It is being claimed by the advocates of FDI in retail that the elimination of intermediaries and direct procurement by the MNCs would secure better prices for the farmers. The fact is that the giant retailers would have far greater buyer power vis-à-vis the farmers compared to the existing intermediaries. The entry of giant MNCs into agricultural procurement would make the problems worse for the farmers. On the contrary, the advocates of FDI believe that FDI in retail in the agriculture will help in improving supply chain, infrastructure and ensure economic security for farmers through the elimination of middlemen in the country.14

3. Effect on Consumers- Those who purchase at modern outlets have reported better product quality, lower prices, one-stop shopping, choice of more brands and products, better shopping experiences with family and fresh stocks as some of the reasons for their choice of outlet. On the other hand, proximity to residence, goodwill, credit availability, possibility of bargaining, choice of loose items, convenient timings, home delivery, etc, are some of the benefits of traditional outlets.15

4. Effect on Existing Indian Organized Retail Firms- The existing Indian organized retail firms support retail reforms. They expect a flurry of joint ventures with global majors for expansion of capital and opportunity to gain expertise in supply chain management.

FINDINGS AND CONCLUSION

We have made an attempt to ascertain the scenario of Agri-infrastructure in India. Provision of adequate infrastructure, in terms of both quantity and quality, is very essential for rapid achievement of sustainable economic growth. Additional 35 MT warehousing capacity is required during the Twelfth Five Year Plan period for the storage of the all major crops. So, the entry of modern retail formats will bring with it an intensive infrastructure.

The major perceived benefits of allowing FDI in Indian retail are: (i) Capital Inflow,(ii) Control of food inflation, (iii) Improved supply chain, (iv) Consumer benefit,(v) Farmer benefit and(vi) Creation of more and better employment opportunities.

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