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# Foreign direct investment in Indian retail sector: Opportunities and Threats

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**Abstract**
FDI plays an important role in the long term development of a country by enhancing the competitiveness of domestic economy through transfer of capital, up gradation of technology, developing managerial skills and capabilities in various sectors, strengthening infrastructure, raising productivity and generating new employment opportunities. India is being looked up by many foreign nations as the scope of investment due to rise in purchasing power, growing consumerism and brand proliferation. Allowing FDI in the retail sector proves good as it leads to improvements in supply chain technologies, elimination of the exploitative system of middlemen and informational externalities to local players that could benefit consumers and suppliers. Competition is best for consumers as it gives them variety and better quality at reduced prices. Opposition have raised concerns about employment losses, promotion of unhealthy competition among organized domestic retailers from the market and distortion of urban cultural development. However, the Indian government must take timely and prudent actions to safeguard the health of the Indian retail sector and to stabilize themselves against competition from the giant players of the global economy.

**Keywords:** FDI, Indian retail sector, Indian economy

## Introduction
Though foreign direct investments (FDIs) in India were significant in the 1950s and 1960s, FDI inflows were meager in the 1970s and 1980s. By the mid-1980s, the stagnation and technological obsolescence in Indian industry led to a push for economic reform and deregulation of exchange controls. As a result of the reforms agreed with the IMF, FDI boomed in post reform India and FDIs in India are considered to be a major stimulus in our economic growth as it has the ability to curtail the shortage of financial resources and the shortage of technology and skill consequently. But the researchers are also of the opinion that FDI may exert a negative impact on economic growth of the recipient countries by extracting their labor and other resources.

Foreign direct investment (FDI) or foreign investment refers to the net inflows of investment to acquire a lasting management interest in an enterprise operating in an economy other than that of the investor. It usually involves participation in management, joint-venture, transfer of technology and expertise. There are two types of FDI: inward foreign direct investment and outward foreign direct investment, resulting in a net FDI inflow (positive or negative) and "stock of foreign direct investment", which is the cumulative number for a given period. Direct investment excludes investment through purchase of shares. Foreign direct investment, in its classic definition, is defined as a company from one country making a physical investment into building a factory in another country. The direct investment in buildings, machinery and equipment is in contrast with making a portfolio investment, which is considered an indirect investment. In recent years, given rapid growth and change in global investment patterns, the definition has been broadened to include the acquisition of a lasting management interest in a company or enterprise outside the investing firm's home country. As such, it may take many forms, such as a direct acquisition of a foreign firm, construction of a facility, or investment in a joint venture or strategic alliance with a local firm with attendant input of technology, licensing of intellectual property.

FDI flows are usually preferred over other forms of capital flows because they are non-debt creating and non-volatile. In a world of increased competition and rapid technological changes, their complimentary and catalytic role can be very valuable. FDI can contribute directly and indirectly to building national capabilities. FDI as an important means to reorganize the production facilities globally, it is regarded as an important vehicle for economic development particularly for developing economies. Thus foreign direct investment is considered a desirable route amongst various forms of capital inflows for bridging this gap, as it is not prone to quick reversal unlike portfolio investment. The importance of FDI also lies in the fact that assistance from multilateral and bilateral sources is either stagnant or declining in comparison with FDI inflows. Further, apart from the long-term additional capital that it brings in, FDI also facilitates technology up-gradation and introduction of modern production and management practices.

## Review of literature
A study conducted by Mukherjee and Patel (2005) found that foreign retailers are working with small manufacturers and are providing them technologies like packaging technologies and bar coding. Sourcing from India has increased with the advent of foreign retailers and they also bring in an efficient supply-chain management system. Joint ventures with foreign retailers are helping the Indian industry to get access to finance and global best practices. Prof. Kore Chandrakant

(2011) examines the changing habits of Indian consumers, impact of FDI on consumers, suppliers and present retailers. It raises the concern regarding the employment opportunities citing the example of Wal-Mart, the world's largest retailer which has the capability of wiping out immediate competition and sustaining losses for few years, an estimated eight million people in the unorganized sector will be displaced. Moghe (2012) [14] critically analyzed the decision of Indian government to open retail sector for FDI in single-brand and multi-brand category and it's likely to have an adverse impact on various components of Indian economy. Vaidehi and Alekhya (2012) [25] studied the positive and negative effects of FDI on Indian economy. It can be concluded that to keep pace with the forecast of Indian GDP, government should encourage foreign investment. Jain and Sukhlecha (2012) studied FDI in multi-brand retail and tried to establish the need of the retail community to invite FDI in multi-brand retailing. Kumar (2013) examined the decision of government to allow 51 percent FDI in multi brand retail. India came under serious flake due to many reasons, loss of employment being one of them. Mahadevaswamy and Nalini (2013) analyzed the perceptions of the common man about foreign direct investment (FDI) in multi-brand retailing (MBR). Jain (2013) examined that retailing is the interface between the producer and the individual consumer buying for personal consumption. As such, retailing is the last link that connects the individual consumer with the manufacturing and distribution chain. Indian retail industry is one of the sunrise sectors with huge growth potential.

**Overview of retails sector in India**

Retailing is one of the prime movers of an Indian economy. In India, retailing is the second largest industry accounting for about 14 to 15% of its GDP and around 8 % of the employment. Nearly 40 million people earn their livelihood from retailing business and majority of them are small traders, kirana shop owners etc. In 2010, the Indian retail market was valued at $435 billion and attracted the largest number of new retailers. According to study conducted by Indian Council for Research on International Economic Relations (ICRIER), total retail business in India will grow at 13% annually, from $ 322 billion in 2006-2007 to $ 590 billion in 2011- 2012 and further to $ 1 trillion by 2016-2017.

Retailing in India is gradually becoming the next boom industry. The whole concept of shopping has changed in terms of format and consumer buying behavior, bringing a revolution in shopping. Contrary to traditional retailing, modern retail has entered Indian markets as sprawling shopping centers, multi-storied malls offering shopping, entertainment and food all under one roof. India has a large proportion of young population that provides a conducive environment for this sector. The per capita income in India has doubled between 2000-01 and 2009-10 resulting in improved purchasing power. The customer mind set is gradually shifting from low price to better convenience, high value and a better shopping experience. Quick and easy loans, EMIs, loan through credit cards, have made purchasing very easy for Indian consumers. There is high brand consciousness among the youth. All these factors are contributing to the growth of retail sector in India. The retail trade sector of India occupies important place in the socio-economic growth of the country. As a consequence, the opening up of the retail sector to foreign direct investment (FDI) is inevitable. International experience also shows that there has been impressive growth in retail and wholesale trade after China approved 100% FDI in retail. Thailand has experienced tremendous growth in the agro-processing industry.

**Determinants of FDI inflows**

The volume and the quality of FDI in a country depend on the following factors:

a. **Natural Resources:** Availability of natural resources in the host country is a major determinant of FDI. Most foreign investors seek an adequate, reliable and economical source of minerals and other materials. FDI tends to flow in countries which are rich in resources but lack capital, technical skills and infrastructure required for the exploitation of natural resources.
b. **National Markets:** The market size of a host country in absolute terms as well as in relation to the size and income of its population and market growth is another major determinant. Large markets can accommodate more firms and can help firms to achieve economies of large scale operations.
c. **Availability of cheap labor:** The availability of low cost and skilled labor has been a major cause of FDI in countries like China and India. Low cost labor together with availability of cheap raw materials enables foreign investors to minimize costs of production and thereby increase profits.
d. **Socio-Economic Conditions:** The size of the population of the host country, its infrastructural facilities and income level of the country also influence direct foreign investment.
e. **Political Situation:** Political stability, legal framework, judicial system, relations with other countries and other political factors prevailing in the country also influence movements of FDI from one country to another.
f. **Rate of interest:** Differences in the rate of interest prevailing in different countries stimulate foreign investment. Capital tends to move from a country with a low rate of interest to a country where it is higher. FDI is also inspired by foreign exchange rates. Foreign capital is attracted to countries where the return on investment is higher.
g. **Government Policies:** Policy towards foreign investment, foreign collaborations, foreign exchange control, remittances, and incentives – both monetary and fiscal offered to foreign investors exercise a significant influence on FDI in a country. For example, Export Processing Zones (EPZs) have been developed in India.

**Advantages of FDI in retail**

- **Overall growth of the country:** FDI is one of the major sources of investments for a developing country like India wherein it expects huge investments from multinational companies to improve the countries growth rate, create jobs, share their expertise, back-end infrastructure and research & development in the country.
- **Availability of Large Varieties at Reduced Prices:** Entry

of the multi-national corporations will promise intensive competition between the different companies offering their brands in a particular product market. When the manufacturing companies will take efforts to increase their market share, competition among them will be activated. Such a competition will result in the availability of many varieties, reduced prices, and convenient distribution of the marketing offers.

- **Improvement in supply chain systems:** Improvement of supply chain and distribution efficiencies, coupled with capacity building and introduction of modern technology will help to reduce the wastages. As much as 40% of India's fruits and vegetables rot due to lack of processing facilities. The foreign retail houses like Wal-Mart and Carrefour can bring better managerial practices and IT-Friendly techniques to cut wastages and set up integrated supply chains to gradually replace present disorganized retail market.
- **Improved standard of living:** Consumers in the organized retail will have the opportunity to choose between a numbers of internationally famous brands with pleasant shopping environment, huge space for product display, maintenance of hygiene and better customer care. FDI can account for a higher standard of living by bringing in high-quality foreign items of luxury that were previously banned in India. As a result, the high class of India won’t have to import these goods and generate a cash outflow.
- **Improved technology and logistics:** Improved technology in the sphere of processing, grading, handling and packaging of goods and further technical developments in areas like electronic weighing, billing, barcode scanning etc. could be a direct consequence of foreign companies opening retail shops in India,. Further, transportation facilities can get a boost, in the form of increased number of refrigerated vans which can help to bring down wastage of goods.
- **Benefits for the farmers:** Though India is the second largest producer of fruits and vegetables, it has a very limited integrated cold-chain infrastructure. Lack of adequate storage facilities causes heavy losses to farmers, in terms of wastage in quality and quantity of produce. With liberalization, there could be a complete overhaul of the supply chain infrastructure. Extensive backward integration by multinational retailers, coupled with their technical and operational expertise, can hopefully remedy such structural flaws. Also, farmers can benefit with the ‘farm-to fork’ ventures with retailers which helps- (i) to cut down intermediaries (ii) to give better prices to farmers, and (iii) provide stability and economics of scale.
- **Better employment opportunities:** Huge investments in the retail sector will see gainful employment opportunities in agro processing, sorting, marketing, logistics, and front end retail. At least 10 million jobs are likely to be created in the next three years in the retail sector.
- **Impact on real-estate development:** Retail is closely dependent on real estate as any retailer will require substantial spaces for setting up business. Real estate in India has gone through a revamp due to the demand of high-end retail malls and people’s changing perception towards an enjoyable shopping experience. Thus real estate can get a further facelift in India and receive more investment with the opening up of FDI in multi-brand retail.

**Disadvantages of FDI in Retail**

- **Displacement of traditional retailers:** FDI in retail will have an adverse impact on the traditional unorganized retail which is currently more dominant. India has 1.2 crore shops employing over 4 crore people and 95% of these are small shops run by self-employed people. FDI in Retail involves traditional retailers going out of business. They wouldn't be able to compete because of the international competition. International experience of USA and Europe shows that supermarkets invariably displace small retailers.
- **Increase in real estate prices:** 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 cities. There shall be a war for place, initiated among such companies. It will result in increase in the cost of real estate that will eventually affect the interest of the ordinary people who desire to own their houses within the cities.
- **Creation of monopoly in the long-term:** The foreign companies, which shall be permitted through FDI in retail, will initially spend huge sum of money to chase the domestic companies out of business. The foreign giants will offer the products in the beginning at subsidized rates in order to capture a large market share. They can sustain for a longer period even in loss, but the same is not possible for domestic companies. Once, the domestic companies are suppressed fully and sent out of the market, the foreign companies will play like monopoly. This will only result in the exploitation of the interest of final consumers.
- **Adverse impact on farmers:** FDI in retail will leave the farmers at the mercy of the multi-nationals as they will fix the price of the products being procured from them. The giant retailers would have far greater bargaining power vis-à-vis the farmers. As against the ‘mandis’ that operate today, where several traders have to compete with each other in order to buy the farmers’ produce, there will be a single buyer in the case of the MNCs. This will make the farmers dependent on the MNCs and vulnerable to exploitation. The farmers may not be able to sell their entire product which is currently being undertaken by the government agencies.
- **Less choice and distortion of culture:** Fragmented markets give larger options to consumers. Consolidated markets make the consumer captive. Certain Indian brands may start losing their importance. As the similar kind of product will be available in a foreign brand, consumers will long to buy foreign brand product. The culture of the people in India will slowly be changed, which is not for good. The youth shall easily imbibe negative aspects of foreign culture and lifestyles and develop inappropriate consumption pattern, which is not suited to Indian cultural environment.

- **Creates Unemployment:** Jobs in the manufacturing sector will be lost because structured international retail makes purchases internationally and not from domestic sources. Moreover, the middlemen who have been working in this industry will be thrown out of their jobs as the foreign retailers will be directly procuring from the main supplier.

**Challenges in retail business in India**

There are several challenges that Indian retail sector has to face.

- **Real estate issues:** Due to high cost of real estate in most cities, it is difficult to find suitable properties in central locations for retail. Most of the retail outlets in India have outlets that are less than 500 square feet in area. This is very small by International Standards.
- **Lack of capital availability:** Capital availability for business is another challenge faced by this sector. Due to the absence of 'industry status' organized retail in India faces difficulties in procurement of organized finance and fiscal incentives.
- **Inefficient supply chain management:** Indian retailing is still dominated by the unorganized sector and there is still a lack of efficient supply chain management. India must concentrate on improving the supply chain management, which in turn would bring down inventory cost, which can then be passed on to the consumer in the form of low pricing.
- **Human resource problems:** There is a shortage of skilled manpower in the organized retail sector of India. The Indian retailers have difficulty in finding trained persons and also have to pay more in order to retain them. This again brings down the Indian retailers profit levels.
- **Frauds in retail:** It is one of the primary challenges the companies would have to face. Frauds, including vendor frauds, thefts, shoplifting and inaccuracy in supervision and administration are the challenges that are difficult to handle. This is so even after the use of security techniques, such as CCTVs and POS systems.
- **Challenges with infrastructure and logistics:** The lack of proper infrastructure and distribution channels in the country results in inefficient processes. Infrastructure does not have a strong base in India. Transportation, including railway systems, has to be more efficient. Highways have to meet global standards. Airport capacities and power supply have to be enhanced. Warehouse facilities and timely distribution are other areas of challenge.

**Conclusion**

India's Foreign Direct Investment (FDI) policy has been gradually liberalized to make the market more investor friendly. The results have been encouraging. These days, the country is consistently ranked among the top three global investment destinations by all international bodies, including the World Bank, according to a United Nations (UN) report. For Indian economy which has tremendous potential, FDI has had a positive impact. FDI inflow supplements domestic capital, as well as technology and skills of existing companies. It also helps to establish new companies. All of these contribute to economic growth of the Indian Economy. FDI off course might be one of the important sources of financing the economic development. However, one should not forget that FDI alone is not a solution for poverty eradication, unemployment and other economic ills. India needs a massive investment to achieve the goals of vision 20-20. Policy makers need to ensure transparency and consistency in policy making along with comprehensive long term development strategy.

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