FOREIGN DIRECT INVESTMENT IN INDIA’S RETAIL SECTOR:
A MACRO APPROACH

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Abstract

Foreign Direct Investment is the sum of equity capital, reinvestment of earnings and other long or short term capital. Foreign direct investment usually involves participation in management, joint venture, transfer of technology and expertise. FDI in retail industry can be a powerful catalyst to spur competition, enable Indian consumers access to foreign brand, access to best global management practices, design and technological knowhow. The multilayer retailing is the most decentralised activity in India after agriculture. It constitutes almost 98% of total trade with estimated 12 million outlets. It is the largest employment provider after agriculture. The Union Government sanctioned 51% foreign direct investment (FDI) in multi-brand like Wal-Mart, Carrefour etc. and upto 100% in single brand retail like Nokia etc. The new policy allows multi-brand FDI to setup shop only in cities with a population of more than 10 lakhs as per 2011 census. Foreign retailers have to put up 50% of FDI in backend infrastructure excluding that on front end expenditure. Big retailers will need to source atleast 30% of manufactures or processed products from small retailers. The entry of FDI in retail sector should be slow and foreign companies should ensure that they purchase goods from domestic sources. A National Commission should be established to evolve policies that will enable it to cope with FDI.

Keywords: FDI, Retail Sector, Consumer Benefits, Infrastructure

Introduction

Foreign direct investment refers to the net inflows of investment to acquire lasting management interest in an enterprise operating in an economy other than that of the investor. Foreign direct investment is the sum of equity capital, reinvestment of earnings and other long or short term capital as shown in the country’s balance of payments. Foreign direct
investment usually involves participation in management, joint venture, transfer of technology and expertise.

Foreign Direct Investment (FDI) is of two types: (1) Inward foreign direct investment and (2) Outward foreign investment. FDI excludes investment through purchase of shares. Foreign direct investment can be used as one measure of growing economic globalization.

The Indian retail industry is the largest among all the industries accounting for over 10 per cent of the country’s Gross Domestic Product (GDP). It accounts for around 8 per cent of employment. FDI has been recognised as an important driver for economic growth and development. FDI in retail industry can be a powerful catalyst to spur competition, enable Indian consumers access to foreign brand, access to best global management practices, design and technological knowhow. Despite the various arguments in favour of FDI in retail sector there are apprehensions about its elimination of jobs in unorganised sector.

Retail Industry in India

The unorganised retail industry in India represents the traditional community centric low cost employment intense retailing that includes kirana shops, owner run general stores, pan beedi shops, convenient stores and handcart and pavement vending. In this model the whole family works in one shop and a whole community is engaged in trade in a defined area. Further, the multilayer retailing is the most decentralised activity in India after agriculture. Second it constitutes almost 98% of total trade with estimated 12 million outlets. In contrast organised trade accounts for 2%. It is largest employment provider after agriculture. In contrast the world’s largest retail chain Wal-Mart employs just about five lakhs. Fourth being self-employed with their families this activities comprises of 120 million people.

Policy Towards FDI in Retail Sector in India

Indian economy has been opened to foreign direct investment through organised retail. The union government sanctioned 51% foreign direct investment in multi-brand like Wal-Mart, Carrefour etc. and upto 100% in single brand retail like Gucci, Nokia and Reebok. The new policy will allow multi-brand foreign retailers to set up shop only in cities with a population of more than 10 lakhs as per 2011 census. There are 53 such cities. This means big retailers can move beyond metropolises to smaller cities. The final decision will however lies with the state governments.
Foreign retailers will have to put up 50% of total FDI in backend infrastructure excluding that on frontend expenditures. Expenditure on land cost and rentals will not be counted for the purpose of backend infrastructure. Big retailers will need to source at least 30% of manufactured or processed products from small retailers.

Implications of FDI in Retail Trade in India

Conflicting claims by experts and trade agencies have been made about the implications of FDI in retail trade. Major arguments in favour of FDI in retail trade relate to the following:

- FDI in retail trade has huge potential for generating employment. Millions of additional jobs will be created during the building of and maintenance of retail stores, roads, cold storage centres, software industry, electronic cash registers and other retail supporting organisations. Instead of job losses retail reforms are likely to be massive boost to Indian job availability.

- It is argued that FDI in retail trade leads to the benefit of the consumer by both price reductions and improved selection brought about by the technology and knowhow of foreign players in the market. This in turn lead to greater output and domestic consumption.

- Global investment capital through FDI is necessary for financing the building of infrastructure, hospitals, housing and schools for its growing population. Beyond capital the Indian retail industry needs knowledge and global integration. Global retail leaders can bring this knowledge. Global integration can potentially open export markets for Indian farmers and producers. Wal-Mart for example expects to source some $1 billion worth of goods from India every year.

- With 51% FDI limit in multi-brand retailers, nearly half of any profits will remain in India. Any profits will be subject to taxes and such taxed will reduce Indian government budget deficit.

- Indian farmers would be benefitted by the FDI in retail trade. They will be able to improve their productivity. They will not only be able to increase their output but will also get better rewards in terms of supplying to organised retailers by typing up long term contracts with them. Foreign retailers will purchase raw materials from the farmers and other goods from the original producer. Farmers would get direct access to the market and
gain higher profits through higher prices and the middlemen are avoided through direct selling.

- Indian retailers have the partnership opportunity with foreign investors. It involves lot of learning and could take them to higher profitability. Foreign investors need partners as the central government stipulates 51% foreign investment in retail trade.

Important factors against FDI driven ‘modern retailing’ are related to;

- Labour displacing effect as the FDI in retailing can only expand by destroying the traditional retail sector.
- The super markets like Wal-Mart will typically sell everything from vegetables to the latest electronic gadgets at extremely low prices that will most likely undercut those in nearly local stores selling similar goods. Wal-Mart would also be more likely to source its raw materials from abroad. This means a foreign company will be big from India and abroad and be able to sell low – severely undercutting the small traders. Once a monopoly situation is created this strategy will logically turn into buying low and selling high.
- FDI in retail trade has also labour displacing impact leading to unemployment of workers. The western concept of efficiency of modern retailing by way of maximising output while minimising the number of workers involved will only increase social tension in a developing country like India where tens of millions are still seeking gainful employment.

**Conclusion and Suggestions**

A national commission should be established to study the problems of retail sector and to evolve policies that will enable it to cope with FDI. The proposed commission should evolve clear set of conditionalities on the foreign retailers on the procurement of farm produce, domestically manufactured merchandise and imported goods. These conditionalities must be aimed at encouraging the purchase of goods in the domestic market. Entry of foreign players must be gradual and with social safeguards so that the effect of labour dislocation can be analysed and policy fine-tuned. Given the WTO regime entry of FDI in retail sector is inevitable. But under its public policy instruments the government can create conditions that slow down their entry. Government can try to ensure that the domestic and foreign players are approximately on an equal footing and that the domestic traders are not at special disadvantage.
References