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FDI in Retail; the Indian Saga

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Abstract: **Retailing is one of the India's largest private industries. Liberalization in FDI has caused a massive restructuring in retail industry. The benefit of FDI in retail industry superimposes its cost factors. Opening the retail industry to FDI will bring forth benefits in its terms of advance employment, organized retail stores, availability of quality products at a better and cheaper price. It is to be noted that there is a prevalent widespread opposition, especially by the left parties towards FDI retail in India. May be in 1990s employing safeguard to protect the domestic retailers was the need of the day. Almost more than one and a half decades down the line there is a need for Foreign Direct Investment in retail trade.**

Keywords: **FDI, Retail trade, India, Economy, Retail sector.**

1. INTRODUCTION

The age old saying 'For fun look to the west and for fortune look to the east' has always kept its relevance throughout the evolution of the global economy. Let it be the early Portuguese who have sailed through the oceans for the eastern spices or the multi billion giant Walmart eager to harvest the Indian gold mine. East, especially the sub continent of India has always been in the focus of the global man's fortune searches. India is without doubt a growth economy and many consider it an attractive country to invest in, particularly in its rapidly growing and changing retail market. However, Foreign Direct Investment (FDI) is restricted in the retail sector, and despite many years of debate, the regulations are still only changing very slowly and there are still lots of uncertainties. Foreign Investors are watching India, ready for a piece of the action in the retail market, but there are still plenty of uncertainties, restrictions and potential socio-economic risks. From street/cart retailers working on pavements/roadsides and small family run businesses to international brands such as Rolex® and Nike®, the retail market in India is vibrant, colourful and highly fragmented. As retailing in India is attracting the attention of many global players, the Indian Government is paying increased attention to the country's retail environment. FDI in retailing remains a widely debated and heated issue in India's economic and political environment. However, the Government is gradually taking steps to open the sector. That India should be well on the radar for foreign retailers was recently supported by A.T. Kearney, whose 2011 Global Retail Development Index ranks the nation as fourth globally. India's retail industry is estimated to be worth approximately US$411.28 billion and is still growing, expected to reach US$804.06 billion in 2015. As part of the economic liberalization process set in place by the Industrial Policy of 1991, the Indian government has opened the retail sector to FDI slowly through a series of steps.

It has been said that India has one foot grounded in time-honoured traditions and the other fervently striding into the entrepreneurial e-age. India truly does embrace diversity with a passion like very few places in the world. Retailing in India is slightly different than in developed markets, in that it is divided in to organized and unorganized retail. Organized retail could be described as when trading is taking place under a license or through people that are registered for sales tax or income tax. Unorganized retail is India's more traditional style of low-cost retailing, for example, the local kirana shops, owner-manned general stores, convenience stores, hand carts and pavement vendors. This division of the retail sector, which has a very heavy weighting towards, unorganized, is just one of the issues contributing to the sensitive debate on FDI in India at the moment.

2. FDI IN RETAIL - A HISTORICAL PERSPECTIVE

60+ years after independence India's government is now starting to take a closer look at liberalising its foreign investment policies. In 2006 the Government of India promoted limited FDI in single-brand retailing and considered opening up further in a phased system with emphasis on joint ventures with domestic players, as evidenced by the highly

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controversial joint venture between Wal-Mart with Bharti Group. Studying other countries such as China, where restrictions were initially imposed on the locations and formats in which foreign retailers could operate, was also on the agenda of the Indian Government. Organised retail in 2005 accounted for a meagre 2% per cent of the total market as against 20% in China and 40% in Thailand and there is a growing demand for modern retailing formats in India. This created significant debate for allowing FDI regulations to open up, with different progress achieved for single and multibrand retailing formats. In 2005, the move by the Indian Government to allow FDI in real estate integrated townships had been an opportune move and although multi-brand retailing was still not allowed, FDI in single-brand retailing elicited heightened interest. The government created a specific Board to deal with promotion of FDI in India and to be the sole agency to handle matters related to FDI. The 'Foreign Investment Promotion Board' (FIPB) as it is known, is chaired by the Secretary Industry (Department of Industrial Policy & Promotion or DIPP) within the office of the Prime Minister. Its key objectives are to promote FDI in India with investment promotion activities both domestically and internationally by facilitating investment in the country via international companies, NRIs (non-resident Indians) and other forms of foreign investors. The FIPB today is responsible for reviewing policy and puts appropriate institutional arrangements in place with transparent rules, guidelines, and procedures for investment promotion and approval. The FIPB meets every week, ensuring that the cases that are pending are dealt with quickly.

3. POLICY AND REGULATORY ENVIRONMENT

Alongside the Foreign Investment Promotion Board (FIPB) previously mentioned, there is also the Investment Commission which was established in December 2004 as part of the Ministry of Finance to facilitate and enhance investment in India. They make recommendations on policy and procedure to the Government and recommend projects that should be fast tracked through the approval process. They also assist in promoting India as an investment destination. The Investment Commission believes the Foreign Investment regime in India is one of the most transparent and liberal among emerging and developing countries. Foreign investment can be approved via one of two different routes:

1. Automatic Approval route requires no prior approval, and filing of the investment details to the Reserve Bank of India (RBI) postfacto is for data records only. The automatic route is appropriate for a few sectors where there is no 'sector cap' i.e. sectors where 100% foreign ownership is allowed.
2. FIPB Approval route is for proposals where the shareholding is intended to be above a prescribed 'sector cap', or where the activity is one where FDI is currently not allowed, or where it is mandatory for the application to be approved by the FIPB (for example, sectors requiring an industrial licence.) Today in the Retail sector, foreign investment is currently limited to 51% in multi-brand retail stores and allows for 100% FDI in single-format and wholesale cash and carry formats. Subject to these equity conditions, a foreign investor can set up a registered company and operate under the same rules and regulations as an Indian company. Foreign investments are freely repatriable, and are regulated under the Foreign Exchange Management Act (1999) (FEMA), administered by the Reserve Bank of India's Exchange Control Department.

The Government of India today is progressively undertaking reforms and liberalising the retail sector; thereby attracting significant foreign investment. The regulatory and supervisory policies are being reshaped and reoriented to meet the new challenges and opportunities in this sector. To facilitate easier flow of Foreign Direct Investments' in-flow, instead of having to seek Foreign Investment Promotion Board ("FIPB") approval, FDI up to 100 per cent is allowed under the automatic route for cash and carry wholesale trading and export trading. FDI up to 51 per cent is allowed, with prior Government approval for retail trade in multi-brand stores with the objective of attracting investment, technology and global best practices and catering to the demand for such branded goods in India. This implies that foreign companies can now sell goods sold globally under a single brand, such as in the case of Reebok, Nokia and Adidas. Further relaxations of FDI restrictions is being vigorously pursued by the business and trade coalitions and are expected to fall in place over the next 3-5 years. As it stands today, there are a number of market entry methods available for retailers under current FDI policy, for which the most common methods are:

- Strategic license agreements (agreement with domestic player)
- Cash and carry wholesale trading (100% ownership)
- Joint ventures

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- Franchising
- Distribution &
- Manufacturing

Cash and carry and single-brand retail are attractive options for foreign investors as complete ownership (100%) is allowed in these formats. Several global players including Wal-Mart and Metro have entered the Indian market through the cash and carry (wholesale) format and are currently considering multi-brand retail entry.

4. CURRENT STATUS OF FDI REFORMS

As of September 2014, the Government of India allowed FDI in the following sectors:

- Up to 100% in Single Brand Retail Trading by only one non-resident entity whether owner or the brand or otherwise
- 30% domestic sourcing requirement eased to preferable sourcing rather compulsory
- 305 domestic sourcing computations further clarified
- Further clarification on FDI companies that cannot engage in B2C e-commerce
- Up to 51% in Multi-Brand Retail Trading
- At least US$100m as equity into Indian company
- At least 50% of the total FDI is to be invested in back end infrastructure within3 years
- At least 30% of the value of procurement of processed product shall be sourced from Indian "Small Industries"
- Fresh agricultural produce is permitted to be sold unbranded Indian states have been given the discretion to accept or refuse to implement FDI. More than 8 states have already given their consent
- Retail outlets can be set up in cities having a population of at least 1 million
- Application needs to be approved by two levels at Department of Industrial Policy (DIPP) and Foreign Investment Promotion Board (FIPB)

5. FORECASTS FOR RETAIL SECTOR GROWTH IN INDIA

The data from private consulting company reports suggest that growth in the retail market has been rapid despite major restrictions on FDI. In the third-quarter report of 2014, the BMI India Retail Report forecasts that the total retail sales will grow from US$ 353 billion in 2010 to US$ 543.2 billion by 2014.1 An important consideration, the report suggests, is the fast-growing middle and upper class consumer base. The analysis also suggests that in the next few years there will be major opportunities in India's smaller cities. AT Kearney, a global management consulting firm, rates India as the most attractive nation for retail investment. The study, presented in the Global Retail Development Index of 2013, is carried out annually for 30 emerging markets, and has rated India highest four times in the last five years. This report expresses even more optimism, and estimates that suggests that India's retail market is expected to be about US$735 billion by 2015, with around 13 per cent coming from organized retail. Other estimates are more conservative, though still impressive. According to McKinsey, a research and consulting firm, organized retail in India is expected to increase from 5 per cent of the total market in 2008 to 14-18 per cent of the total retail market and reach US$ 450 billion by 2015. Even if growth is more conservative than estimated, the spill-over effects of this rapid expansion could be felt by many other sectors of the economy. A report published by Knight Frank India in May 2014 looks at the question of land and available retail space. It estimates that, during 2014-15, around 55 million square feet of retail space will be ready in the major cities like Mumbai, the national capital region (NCR), Bengaluru, Kolkata, Chennai, Hyderabad and Pune. Furthermore, between 2013 and 2015, the organized retail real estate stock is expected to grow from the existing 41 million square feet to 95 million square feet.4 Arguably, this could drive up real estate prices, with consequent knock-on effects.

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6. CONCLUSION

Despite the current policy and regulatory environment not being 'perfect' for foreign investors, there are clearly moves towards improving the current position and facilitating FDI inflows without having a detrimental impact on various sectors of the economy. The current policy is trying to encourage Joint Ventures in multi-brand retailing so as to boost the domestic retailer's growth in this area. However, there is also the risk that some foreign retailers will not be interested in investing unless they have 100% ownership and that the current policy will prevent them from choosing India as a Retail destination. In our view, the advantages outweigh the disadvantages of allowing unrestrained FDI in the retail sector, as successful experiments in countries like Thailand and China demonstrate. In both countries, the issue of allowing FDI in the retail sector was first met with incessant protests, but allowing such FDI led to GDP growth and a rise in the level of employment. The International Business Times (US edition) has already confirmed that Walmart is to launch its first Indian store within 12-18 months. Thus, being the first to enter the US$500 billion retail market of India. The government has approved the Walt Disney Company South East Asia's foreign direct investment (FDI) proposal to transfer INR 10 billion into Walt Disney Company India to increase foreign equity. Besides Disney's proposal, the government has also approved nine other FDI proposals amounting to approximately INR 2.59 billion. With this, a plethora of business opportunities in India has been thrown open to the foreign investors. India has seen an eightfold increase in its FDI in March 2012, at a time when the aforesaid norms were not even approved – a sign that suggests India is set to be one of the favoured destinations for foreign investors in the retail sector.

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