

RetailDude.com

Guest Paper on – FDI Retailing in
India

Foreign Direct Investment in Retailing in India – Its Emergence & Prospects

Dr. Mandeep Singh, Deptt. Of Economics, G. N. Khalsa College, Yamuna Nagar (Haryana), 135001 India

Mr. Amanpreet Singh Banga, Post Graduate Diploma in Retail Management, Birla Institute of Management Technology (BIMTECH), Greater Noida (U.P.), 201 106 India

Abstract

In recent years the destination sectors in FDI have become more varied. FDI inflows have shifted from infrastructure, natural resources and export driven manufacturing to other areas such as retailing, tourism, construction and off shore services. A World Bank study showed that cumulative FDI inflows to the retail sector in the 20 largest developing countries amounted to US\$ 45 billion in 1998-2002 (about 7 per cent of the total of these countries). The study showed that after liberalization; countries such as Brazil, Poland and Thailand have received significant FDI in retailing.

In spite of the recent developments in retailing and its immense contribution to the economy, retailing continues to be are the least evolved industries and the growth of organised retailing in India has been much slower as compared to rest of the world. Over a period of 10 years, the show of organised retailing in total retailing has grown from 10 per cent to 40 percent in Brazil and 20 percent in China, while in India it is only 2 per cent (between 1995-2005). One important reason for this is that retailing is one of the few sectors where foreign direct investment is not allowed. Within the country, there have been protests by trading associations and other stakeholders against allowing FDI in retailing. On the other hand, the growing market has attracted foreign investors and India has been portrayed as an important investment destination for the global retail chains. The present paper attempts to analyze the reason why foreign retailers are interested in India, the strategies they are adopting to enter India and there prospects in India

After the waves of globalisation, liberalisation and privatisation marketing scenario particularly retailing has changed radically. These changes have resulted in emergence of new environment for buyers' behaviour and purchasing habits. The upper and upper middle strata of the society now prefers to purchase well established branded goods from standard showrooms and it has transformed the entire picture and perception not only in the metro cities but almost in all big cities of our country. It is worth mentioning that retailing in India has been hailed as one of the sun-rise sectors in the economy. According to A. T. Kearney, a well known International Management Consultant, "India is the second most attractive retail designation globally, among thirty emergent markets." Till now unorganised retailing sector was dominating retail trade in India by constituting 98% of all retailing trade but now not only traditional Indian retailers but giant Indian retailers like Reliance has entered in the area and is planning to expand its activities in this sector in a big way. Even world renowned retailing organisation like Wal-Mart has decided to enter in India via joint venture with Bharti and French retailer Carrefour is busy in chalking out strategy to enter the hyper market and supermarket retail format in India through Dubai based retail major Landmark group.

In this context an effort has been made in this paper to review the emergence of global retailers in India, to examine the govt. policy relating to FDI in retailing and to evaluate the prospects of global retailing in India.

Why Global Retailers are Interested in India?

More specifically the global players are interested in India due to following reasons:

I) Strategic Location & Geography: India enjoys unique geographical advantage. It is strategically located in Asia with access to all leading markets of the World. With total area of 32, 87,590 Sq. Km, Coastline of 7000 Km and borders with six countries India becomes most promising destination for the foreign direct investment.

II) Versatile Demographics: Demographically with a population of more than 1.1 billion and diverse culture, India is a land of all seasons. India presents a real cosmopolitan population with diverse religions and culture. Hinduism, Buddhism, Jainism, Sikhism, Christianity and Islam are the main religions of India. This variety of religions provides India with a diverse culture. Besides, India has versatile population of urban and rural nature. This versatility of population makes India a ready made market for foreign retailers.

III) Vast growing Economy: On economic front, India the largest democracy of the world, have a stable Govt. with robust programme of economic reforms. India with a foreign exchange reserve of more than US \$120 billion, FDI of more than US \$9.9 billion ,average GDP growth of more than 7% per annum, rupee appreciation Vs U.S dollar of more than 2% in last two years and with a rapidly growing investment in infrastructure has all the ingredients of a emerging economic super power. India is tipped to be third largest economy in terms of GDP by the year 2050 (Table 1)

Table 1: Forecast of GDP (\$ Trillion)

Country	2010	2050
China	3.0	44.5
U.S.A	13.3	35.2
India	0.9	27.8
Japan	4.6	6.7
Brazil	0.7	6.1
Russia	0.8	5.9
U.K.	1.9	3.8
Germany	2.2	3.6
Italy	1.3	2.1

Source: McKinsey Quarterly Nov.04

In such a scenario every multinational aims to set up a base in India, not to participate in Indian growth story, rather to build their own future.

IV) Retailing: The Emerging Revolution: Retailing is the largest private industry in India and second largest employer after agriculture. The sector contributes to around 10 percent of GDP. With over 12 million retail outlets, India has the highest retail outlets density in the world. This sector witnessed significant development in the past 10 years from small unorganized family owned retail formats to organized retailing. Liberalization of the economy, rise in per capita income and growing consumerism has encouraged large business and venture capitalist in investing in retail infrastructure. The importance of retail sector in India can be judged from following facts (a) Retail sector is the largest contributor to the Indian GDP (b) The retail Sector provides 15% employment (c) India has world largest retail network with 12 million outlets (d) Total market size of retailing in India Is U.S \$ 180 billion (e) Current Share of Organized Retailing is just 2% which comes around to \$3.6 trillion (f) Organized retail sector is growing @ 28% per annum.

V) Indian Retailing: Opportunities Unexplored: India is sometimes referred to as the nation of shopkeepers. This is because the country has the highest density of retail outlets - over 12 million. However, unlike most developed and developing countries, Indian retail sector is highly fragmented and bulk of the business is in the unorganized sector. As compared to China (Table 2) the presence of global players in India is very less

Table 2: Number of Foreign Retailers in India & China

Retailer	China	India
Wal- Mart	40	-----
Carrefour	53	-----
Tesco	30	-----
Metro	21	02
KFC	Over 1000	04
Starbucks	70	-----
McDonald's	580	47
Pizza Hut	110	75
Louis Vuitton	06	2
Prada	10	-----
B&Q	20	-----
Hugo Boss	60	02

Source: McKinsey Quarterly Nov.04

India in such a scenario presents following facts to foreign retailers:

- There is a huge, huge industry with no large players. Some Indian large players have entered just recently like Reliance, Trent

- India can support significant players averaging \$1 bn. in Grocery and \$0.3- 0.5 bn. in apparel within next ten years.
- The transition will open multiple opportunities for companies and investors

In addition to the above, improved living standards and continuing economic growth, friendly business environment, growing spending power and increasing number of conscious customers aspiring to own quality and branded products in India are also attracting to global retailers to enter in Indian market.

Major Global Players in Retailing: The top 30 global retailers together with their percentage of sale from grocery and the percentage of sales in domestic and foreign markets for the year 2003 are given in Table 3.

Table 3: Top 30 Global Retailers with their Sales in Grocery and Percentage Share of Domestic and Foreign sales in Total Retail Sales, 2003

Rank	Company	Country of Origin	Net Sales 2003 (USD mn)	Grocery Sales (%)	Domestic Sales(%)	Foreign Sales(%)
1.	Wal-Mart	USA	256,329	43.7	79.1	20.9
2.	Carrefour	France	79,609	77.4	50.7	49.3
3.	Ahold	Neth.	63,325	84.0	15.8	84.2
4.	Metro Group	Germany	60,532	50.5	52.9	47.1
5.	Kroger	USA	53,791	70.2	100.0	0.0
6.	Tesco	UK	50,326	74.6	80.1	19.9
7.	Target	USA	48,163	17.8	100.00	0.0
8.	Rewe	Germany	44,251	7.6	71.4	28.6
9.	Aldi	Germany	41,011	83.6	63.0	37.0
11.	ITM(Intermarche)	France	37,723	77.3	72.2	27.8
12.	Safeway(USA)	USA	35,552	75.5	85.3	14.7
13.	Schwarz Group	Germany	33,357	83.0	66.2	33.8
14.	Schwarz Group	Germany	33,357	83.0	66.2	33.8
15.	Walgreens	USA	32,505	38.0	100.00	0.0
16.	Auchan	France	32,422	57.2	57.5	42.5
17.	AEON	Japan	30,574	47.2	91.7	8.3
18.	Ito-Yokado	Japan	30,541	62.5	73.8	26.2
19.	Edeka	Germany	29,670	83.8	91.2	8.8
20.	Sainsbury	UK	27,995	73.3	85.1	14.9
21.	Tengelmann	Germany	27,721	69.7	49.1	50.9
22.	Leclerc	France	27,332	59.9	95.7	4.3
23.	CVS	USA	26,588	31.2	100.0	0.0
24.	Casino	France	25,958	73.3	58.9	41.1
25.	Kmart	USA	23,253	14.0	100.0	0.0
26.	Delhaize Group	Belgium	21,256	77.1	20.1	79.9
27.	Loblaw	Canada	18,002	77.5	100.0	0.0
28.	JC Penney	USA	17,786	16.9	99.4	0.6
29.	Coles Myer	Australia	17,523	58.5	99.4	0.6
30.	Daiei	Japan	17,158	43.3	98.9	1.1
Total Top 30			1,287,382			
Others			2,612,618			
Total Worldwide			3,900,000			

Source: Extracted from M+M Planet Retail

Arguments in favour of FDI in Retailing

FDI in retailing is favoured on following grounds:

(1) The global retailers have advanced management know how in merchandising and inventory management and have adopted new technologies which can significantly improve productivity and efficiency in retailing. (2) Entry of large low-cost retailers and adoption of integrated supply chain management by them is likely to lower down the prices. (3) FDI in retailing can easily assure the quality of product, better shopping experience and customer services. (4) They promote the linkage of local suppliers, farmers and manufacturers, no doubt only those who can meet the quality and safety standards, to global market and this will ensure a reliable and profitable market to these local players. (5) As multinational players are spreading their operation, regional players are also developing their supply chain differentiating their strategies and improving their operations to counter the size of international players. This all will encourage the investment and employment in supply chain management. (6) Joint ventures would ease capital constraints of existing organised retailers and (7) FDI would lead to development of different retail formats and modernisation of the sector.

Arguments against FDI in Retailing

Many trading associations, political parties and industrial associations have argued against FDI in retailing due to following reasons:

- (1) Indian retailers have yet to consolidate their position. The existing retailing scenario is characterized by the presence of a large number of fragmented family owned businesses, who would not be able to survive the competition from global players.
- (2) The examples of south east Asian countries show that after allowing FDI, the domestic retailers were marginalised and this led to unemployment.
- (3) FDI in retailing can upset the import balance, as large international retailers may prefer to source majority of their products globally rather than investing in local products.
- (4) Global retailers might resort to predatory pricing. Due to their financial clout, they often sell below cost in the new markets. Once the domestic players are wiped out of the market foreign players enjoy a monopoly position which allows them to increase prices and earn profits.
- (5) Indian retailers have argued that since lending rates are much higher in India, Indian retailers, especially small retailers, are at a disadvantageous position compared to foreign retailers who have access to International funds at lower interest rates. High cost of borrowing forces the domestic players to charge higher prices for the products.
- (6) FDI in retail trade would not attract large inflows of foreign investment since very little investment is required to conduct retail business. Goods are bought on credit and sales are made on cash basis. Hence, the working capital requirement is negligible. On the contrary; after making initial investment on basic infrastructure, the multinational retailers may remit the higher amount of profits earned in India to their own country.

FDI in Retailing in India - Policy and Entry Routes

In India, till recently, FDI was not allowed in retailing, but the Union cabinet on January 24, 2006 rationalised and simplified the FDI policy and allowed the contentious issue of foreign investment in retail sector by allowing FDI up to 51 percent with prior government approval for retail trade in single brand products. This would imply that foreign

companies would be allowed to sell goods sold internationally under a single brand, viz. Reebok, Nokia, Adidas. Retailing of goods of multiple brands, even if such products are produced by same manufacturer would not be allowed. However, there are indications that the Government may allow foreign investments in retail segments where small domestic players do not operate. The Department of Industrial Policy and Promotion is preparing a detailed policy for further liberalisation of FDI in the country, which is likely to be announced before the budget 2007-08. As part of the proposed move, the Ministry has marked out sports goods, electronics and building equipment as some of the sectors that may be opened up with a 51% cap on FDI. The government is also considering to permit multi-brand retail in such areas. The government is likely to discuss the matter with the left parties before taking a final call on the issue. The Left has initially stalled the government's plans to allow FDI in multi-brand retail on the grounds that it will adversely affect mom-and-pop stores.

It is worth mentioning that FDI restrictions have not deterred prominent international players from entering India. Many U.S and other international retailers and consumer goods companies consider India a top-priority market with the potential for breakthrough growth. In this context (a) Wal-Mart CEO, John Menzar visited India in 2005 and met with Prime Minister to discuss relevant issues. Wal-Mart's sourcing from India, which was U.S.\$300 million in 2004 reached to U.S.\$1.2 billion in 2005.(b) Fashion brand DKNY is set to foray into Indian fashion industry through franchise agreement with Indian company, S. Kumar's. (c) Tommy Hilfiger, International fashion icon says that "We are going to build a wonderful lifestyle business here" (d) Phillip Morris is ready to unveil its plans for kraft in India through Kraft Jacob Suchard (KJS) India, a wholly owned arm of Philip Morris India (e) Starbucks has expressed its interest in entering India through the franchise route.

Although before January 24, 2006 FDI was not allowed in retailing, many international players are operating in the country. Some of entry routes employed by them are discussed in details as below:

(a) Manufacturing and Local Sourcing: Companies that set up manufacturing facilities are allowed to sell the products in the domestic market. Consumer durable companies such as Sony and Samsung have entered the retail sector through this route. Due to high labour cost in their domestic market, many international brands are setting up manufacturing bases in developing countries such as India and China and / or are sourcing products from local manufacturers. For example, Levi's and Tommy Hilfiger are sourcing products from Indian manufacturers like Arvind Mills. Benetton has a manufacturing unit in India. Other international brands like GIVO from Italy have set up export-oriented manufacturing facilities. These companies are allowed to sell products to Indian consumers through franchising, local distributors, existing Indian retailers, own outlets, etc.

(b) Franchising: Franchising is the most preferred mode through which foreign players have entered the Indian market. It is the easiest route to enter the Indian market. Franchising is often used as a mode to expand the market of a particular retail enterprise outside domestic economy since it allows firms to expand without investing their own capital, is based on local expertise and enables firms to curb local oppositions and regulations. This is the most common mode for entry of fast food chains across the world. Apart from fast food chains like Pizza Hut, players such as Lacoste, Mango, Nike and Marks and Spencer, have entered the Indian market through this route.

For setting up franchising operation, the foreign players are required to take permission from the Reserve Bank of India (RBI). RBI often imposes the condition that franchisers have to bring in foreign investment and set up a base for carrying on operational activities. A foreign franchiser not wishing to make a direct investment would have to render

technical assistance to the franchisee. Some franchisee, such as Pizza Hut has made significant investment in the supply chain.

The arrangements between franchisee and franchiser are found to be extremely flexible and are based on negotiation between the two. Some Indian franchisees have complained about high franchising fees together with high real estate costs, high import duties and other costs escalate the prices. For instance, the cost of a Marks and Spencer product is higher than not only the brands produced domestically but also in comparison to the price of the product in the UK. The high prices restrict the ability of the foreign players to penetrate the market but they have entered the country to make their brands visible to the huge Indian market.

If FDI is allowed in retailing, franchisees are not very sure whether they would hold the retailing rights for the brands. According to industry representatives, since franchisees largely constitute of domestic traders (even some unorganised retailers have take up franchising rights) who have made significant investment in infrastructure, government through legislation must ensure that they do not loose out their franchising rights if FDI is allowed in retailing and the franchisers decide to change the mode of operation. The existing franchisees have also expressed an interest in entering into joint venture with the franchisers if FDI is allowed in retailing.

(c) Test Marketing: Test marketing is another route through which many foreign players have entered the Indian market. Foreign investment Promotion Board (FIPB) allows foreign companies for test marketing of their products for a two-year period by the end of which they are required to set up manufacturing facilities in India. Direct selling companies like Amway and Oriflame entered the Indian market through this route. Initially, Amway got an approval for test marketing for a period of two years but they managed to secure an extension of one more year. At the end of the third year, they set up contract manufacturing facilities and brought in foreign investment and technical know-how. Oriflame too extended its test marketing license for a third year and at the end of which had set up a manufacturing facility in Noida (UP) for producing certain specific products. Other products are imported and would continue to be imported from abroad.

Nokia came to India through the test marketing route in mid-1990s. Initially they got a license for two years to test their products in the Mumbai circle. After three months of their entry they tied up with the service providers to provide integrated services to their customers. Due to pressure from the FIPB, Nokia had tied up with the HCL Infotech as a strategic partner for all India distribution of Nokia products. After the success of its products in the country, Nokia had opened up an office but had not set up a manufacturing facility and continued to import all products (even models made specifically for India). After another two years they divided the country into four zones and entered into a strategic alliance for distribution with Supreme for East and West India while HCL continued with North and Southern zone. Nokia had also applied for the cash and carry license from the FIPB and has recently got the license. Nokia is aggressively targeting the Indian consumers and plan to capture 75 percent of the mobile market in the next seven years. The company, which currently operates as a wholesale cash-and carry, recently announced that it would set up manufacturing facilities very soon.

The test marketing route allows foreign players to test the demand for their products in Indian market before undertaking investment. Even if FDI is allowed in retailing, many foreign players would like to enter the Indian market through this route.

(d) Wholesale Cash-and-Carry Operation: This is the route through which large international retailers such as Germany's Metro Cash & Carry GmbH and Shoprite Checkers of South Africa have entered the Indian market. The wholesale cash-and-carry operation is

defined as any trading outlets where goods are sold at the wholesale rate for retailers and businesses to buy. The transactions are only for business purposes and not for personal consumption as in the case of retailing.

(e) Distributor: Companies such as Swarovski and Hugo Boss have set up distribution offices in India and these offices supply the products to local retailers. All products of Hugo Boss are imported and distributed through the company's distributor.

(f) Special Cases: The Sri Lankan retailers have entered the India market through the initiatives of Export Development Board of Sri Lanka (EDB) which obtained special permission from the RBI to set up retail operations in India. The EDB has leased 17 retail outlets in Spencer Plaza in Chennai in which Sri Lankan retailers are showcasing and selling their products. The Sri Lankan products showcased in these stores are mostly at the higher end of the quality spectrum and can be brought into the country free of duty. This gives an advantage to large Sri Lankan retailers like Hameedia not only to establish a global presence but also to access the large customer base of India at competitive prices. The EDB is also exploring the possibilities of setting up similar trade centres in other cities like Delhi and Mumbai. Although this mode has allowed retailers from Sri Lanka to enter the Indian market without domestic manufacturing and sourcing conditions and some products sold by these traders are similar to those sold by Indian retailers, EDB did not face any opposition from Chambers, retailers and the trading houses.

Although the official policy is that FDI in retailing is allowed only in one brand and that too up to 51% in retailing, but it has not acted as an entry barrier. Foreign players have a substantial presence in the country and have used several alternative unique routes to enter Indian Trading Sector. Some of the existing foreign players are listed below in table 4.

Table 4: Some Existing Foreign Players and Prospective Entrants

Retailers	Type	Status
7-Eleven	Supermarket	Evaluating
Amway	Direct selling	Already in
Auchan	Hypermarket	Evaluating
Carrefour	Multi-format retailer	Wait and watch
Dairy Farm	Multi-format retailers	Tied up with RPG
JC Penny	Product sourcing	Already in
Landmark	Department Store	Already in
Lee Cooper	Product sourcing	Already in
Levi's	Product sourcing	Already in
Mango	Apparel retailer	Already in
Marks & Spencer	Department Store	Already in
Metro	Cash & carry	Already in
Oriflame	Direct selling	Already in
Reebok	Joint venture	Already in
Shoprite	Wholesale cash-and-carry and franchising	Already in
Sony	Manufacturer Retailer	Already in
Wal-Mart	Hypermarket	Agreement with Bharti

Source: FDI in Retail Sector, Department of consumer affairs, Government of India, p. 115.

Conclusion

It is evident that ever growing urban and rural markets in India represent an unprecedented and vast unexplored opportunity for retailing to all types of formats. Initially there may be certain reservations and apprehensions in allowing global players in India's retailing but if they are allowed in a phased manner on the basis of a well conceived and chalked out policy, they are likely to lead to more investment in organized retailing and allied sectors. As already discussed, it would also lead to inflow of latest technical know how,

establishment of well integrated and sophisticated supply chains, availability of standard, latest and quality products, help in up gradation of human skills and increased sourcing from India. Yet the following points may be kept into consideration in this context:

1. Since the Indian retail sector is highly fragmented and domestic retailers are in the process of consolidating their position, the opening up of FDI regime should be in phased manner over 5 to 10 years time frame so as to give the domestic retailers enough time to adjust changes.
2. FDI should not be allowed for multi brand stores in near future, as Indian retailers will not be able to face competition with these stores immediately.
3. At present it is also not desirable to increase FDI ceiling to more than 51% even for single premium brand stores. It will help us to ensure check and control on business operations of global retailers and to protect the interests of domestic players. However, the limit of equity participation can be increased in due course of time as we did in telecom, banking and insurance sectors.
4. Foreign players should not be allowed to trade in certain sensitive products like arms and ammunition, military equipment, etc. and the list of excluded products should be clearly stated in the FDI policy.
5. Certain zoning restrictions may be imposed by the state government / local bodies for town planning. Generally super markets and hyper markets should not be allowed in the mid of city so as to protect the existence of unorganised or comparatively medium sized retail organizations.

The strategy of opening up should be backed by appropriate reform measures. India can learn from the experiences of other developed and developing countries and develop its own strategies, laws and regulations that would be in the best interest of the country. As of now, there is no proper definition of retailing or retail formats in India. International players are exploiting the situation and are often entering the market and expanding their businesses through multiple routes and are operating in the country with more than one format of retailing. The regulatory regime should address these issues. The entry norms should clearly state the approval requirements, conditions / restrictions if any imposed, etc. The government should also strictly enforce the quality standards for local production and imports.

References

1. FDI in Retail Sector in India, Department of Consumer Affairs, Ministry of Consumer Affairs, Public and Food Department, Government of India.
2. U.S. Department of Labour, Bureau of Labour Statistics. http://stats.bls.gov/iag/whole_retailtrade.htm
3. <http://www.brc.org.uk/latesdata.asp>
4. Bajpai and Das Gupta (2004) 'Multinational companies and FDI in China and India' CGSO Working paper no. 2, January. The Earth Institute of Columbia University.
5. Palmade, V. and Andrea Anayiotas (2004) "Foreign Direct Investments Trends : Looking Beyond the current gloom in Developing Countries". Public Policy Journal, September 2004. Note number 273. The World Bank Group Website : <http://rru.worldbank.org/documents.pdf>
6. Swapna Pradhan: Retailing Management, The McGraw-Hill Companies(2007)
7. Chetan Bajaj, Rajnish Tuli & Nidhi Srivastav: Retail Management, Oxford University Press (2006)
8. Suja Nair: Retail Management, Himalaya Publishing House (2006)

Authored for "RetailDude.Com", The content can be used by the downloader for personal reference and the use of content for any commercial purpose will require consent of the Author.

Download Source: <http://www.retaildude.com>