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A STUDY OF ROLE OF FOREIGN DIRECT INVESTMENT IN INDIAN RETAIL SECTOR

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Abstract

Foreign direct investment (FDI) plays an extraordinary and growing role in global business. It can provide a firm with new markets and marketing channels, cheaper production facilities, access to new technology, products, skills and financing. For a host country or the foreign firm which receives the investment, it can provide a source of new technologies, capital, processes, products, organizational technologies and management skills, and as such can provide a strong impetus to economic development. Foreign investment comes in several forms. Portfolio investment, foreign loans and foreign direct investment are the three important types. Of these foreign direct investments in retailing play an crucial role. This study aims to analyze the role of foreign direct investment in Indian retail sector. It intends to know the losses suffered by the farmers and the challenges being faced by global retailers from FDI. Research methodology is descriptive in nature.

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Introduction

Foreign direct investment (FDI) plays an extraordinary and growing role in global business. It can provide a firm with new markets and marketing channels, cheaper production facilities, access to new technology, products, skills and financing. For a host country or the foreign firm which receives the investment, it can provide a source of new technologies, capital, processes, products, organizational technologies and management skills, and as such can provide a strong impetus to economic development. The perception of the role foreign direct investment (FDI) plays in the development process has evolved over time. Starting from the mid - sixties when the role of FDI in economic development was recognised and obstacles to the flow of FDI from industrialized to developing countries were sought to be removed. Many policy makers and academics contend that foreign direct investment (FDI) can have important positive effects on a host country's development effort.[@] In addition to the direct capital financing it supplies, FDI can be a source of valuable technology and know-how while fostering linkages with local firms, which can help jumpstart an economy. Based on these arguments, industrialized and developing countries have offered incentives to encourage foreign direct investments in their economies.

Retailing in India:

It is one of the pillars of its economy and accounts for 14 to 15% of its GDP.[1][2] The Indian retail market is estimated to be US$ 450 billion and one of the top five retail markets in the world by economic value. India is one of the fastest growing retail markets in the world, with 1.2 billion people.[3][4] India's retailing industry is essentially owner manned small shops.

In 2010, larger format convenience stores and supermarkets accounted for about 4% of the industry, and these were present only in large urban centers. India's retail and logistics industry employs about 40 million Indians (3.3% of Indian population). Until 2011, Indian central government denied foreign direct investment (FDI) in multibrand retail, forbidding foreign groups from any ownership in supermarkets, convenience stores or any retail outlets. Even single-brand retail was limited to 51% ownership and a bureaucratic process. In November 2011, India's central government announced retail reforms for both multi-brand stores and single-brand stores. These market reforms paved the way for retail innovation and competition with multi-brand retailers such as Walmart, Carrefour and Tesco, as well single brand majors such as IKEA, Nike, and Apple.[5] The announcement sparked intense activism, both in opposition and in support of the reforms.

In December 2011, under pressure from the opposition, Indian government placed the retail reforms on hold till it reaches a consensus.[6] In January 2012, India approved reforms for single-brand stores welcoming anyone in the world to innovate in Indian retail market with 100% ownership, but imposed the requirement that the single brand retailer source 30% of its goods from India. Indian government continues the hold on retail reforms for multi-brand stores.[7] IKEA announced in January that it is putting on hold its plan to open stores in India because of the 30% requirement.[8] Fitch believes that the 30% requirement is likely to significantly delay if not prevent most single brand majors from Europe, USA and Japan from opening stores and creating associated jobs in India

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@ The vast literature on foreign direct investment and multinational corporations has been surveyed many times. For recent surveys see Markusen (1995) and Caves (1996).

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Definition:

According to the International Monetary Fund, foreign direct investment, commonly known as FDI, "... refers to an investment made to acquire lasting or long-term interest in enterprises operating outside of the economy of the investor." The investment is direct because the investor, which could be a foreign person, company or group of entities, is seeking to control, manage, or have significant influence over the foreign enterprise

Definition of Retail

In 2004, The High Court of Delhi defined the term 'retail' as a sale for final consumption in contrast to a sale for further sale or processing (i.e. wholesale). *A sale to the ultimate consumer.* Thus, retailing can be said to be 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 customersRetailing is the last link that connects the individual consumer with the manufacturing and distribution chain. A retailer is involved in the act of selling goods to the individual consumer at a margin of profit.

FDI is a major source of external finance which means that countries with limited amounts of capital can receive finance beyond national borders from wealthier countries. Exports and FDI have been the two key ingredients in China's rapid economic growth. According to the World Bank, FDI and small business growth are the two critical elements in developing the private sector in lower-income economies and reducing poverty. Foreign direct investment (FDI) plays an important role in India's growth dynamics. There are several examples of the benefits of FDI in India. FDI in the retail sector can expand markets by reducing transaction and transformation costs of business through adoption of advanced supply chain and benefit consumers, and suppliers (farmers). This also can result in net gains in employment at the aggregate level. This paper brings forth a few conceptual issues and analysis of qualitative information, data and stylized facts on these issues.

NEED FOREIGN DIRECT INVESTMENT

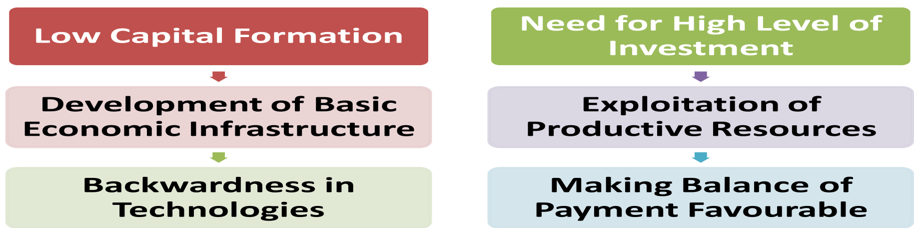


Figure:1

Literature Review:

Alvin and Wint (1992) Reviews the liberalization of FDI regulation in ten developing countries and concludes that there can be a disconnect between formal liberalization and the actual implementation of the screening process. **Bhattacharyya (1994), Jain (1994),** examined the determinants of FDI found that the availability of primary material inputs for manufacture and the large size of the domestic market for the sale of the manufactured products are the two principal economic determinant of location of FDI inflow. Other two factors that influenced the FDI are the growth rate of GDP and the level of infrastructure facility. **Dornbusch and Park (1995),** Observe that foreign investors pursue a positive feedback strategy, which makes stocks to overreact to change in fundamentals. **Borensztin et al (1998)** Examined that absorptive capacity of recipient country, which is measured by stock of human capital required for technological progress; it takes place through 'capital deepening' associated with new capital goods brought into an economy by FDI. **Nair-Reichart and Weinhold (2001)** suggested that Postulate panel and time series estimators to impose homogeneity assumptions across countries in the relationship between FDI and growth and they marshal evidence to show considerable heterogeneity across countries**Pradhan, Prakash J. (2003),** "Rise of service sector outward foreign direct investment from Indian economy: trends, patterns, and determinants" reviewed the recent trends and patterns and tries to identify determinants of such investment. As compared to the eighties, the character of service sector OFDI flows has gone through several transformations. In the seventies it is largely a phenomenon led by firms from hotels & restaurants, finance and marketing segments and is being directed at developing regions in overwhelming cases and is mostly minority owned.**Basker (2005)** found that "…immediately after entry, retail employment in the country increases by approximately 100 jobs; this figure declines by half over the next five years as some small and medium size retail establishments close. Wholesale employment declines by approximately 20 jobs over five years."**Fishman (2006)** observes "The Wal-Mart effect is the suburbanization of shopping; the downward pressure on wages at all kinds of stores trying to compete with Wal-Mart; the consolidation of consumer product companies trying to compete with Wal-Mart's scale; the relentless scrutiny of unnecessary costs that allows companies to survive on thinner profits; the success of a large business at the expense of its rivals and the way in which that succeeds builds on itself… In the same decade that Wal-Mart has come to dominate the grocery business in the United States, 31 supermarket chains have sought bankruptcy protection; 27 of these chains cite competition from Wal-Mart as a factor. **Ghemawat and Mark (2006)** argue that Wal-Mart has grown the economic pie available to be divided among its various stakeholders instead of slicing up a fixed pie in a way that favors one group over another. They cite the McKinsey Global Institute's study of the U.S. labor productivity growth between 1995 and 2000 (by Robert Solow) which shows that Wal-Mart contributed significantly for its growth. Given that Wal-Mart's prices are 8 percent lower than competitors, the U.S. consumers save on the order of $ 18 billion per year. For each job lost through Wal-Mart effect, consumers saved more than $ 7 million per year. This would imply that in terms of net effects more jobs were created through increase in incomes and expenditure than those of direct losses. **Dr. S.R. Rathnamma (2008) found that** The Effect of FDI on India and Chinese Economy: A Comparative Analysis: stated that India and China are the two emerging economic giants of the developing world, both situated in Asia with 37% of world population (Asian Development Outlook2005) and with more than 9% growth in their respective GDP of their economies (World Development Report 2006).Finally, **Javorcik and Li (2008)** estimate a positive effect of FDI in Romania's retail sector on the TFP of manufacturing suppliers to that sector. **Singh, Shikha (2009)** stated that foreign direct investment (FDI) policies play a major role in the economic growth of developing countries around the world. Attracting FDI inflows with conductive policies has therefore become a key battleground in the emerging markets. The prospect of new growth opportunities and outsized profits encourages large capital inflows across a range of industry and opportunity types. **Saini A., Law S. H., Ahmad A. H. (2010)** proved that the positive impact of FDI on growth "kicks in" only after financial market development exceeds a threshold level. Until then, the benefit of FDI is non-existent. **TFP while Arnold et al. (2010)** find signifiant positive effects of banking, telecommunications, and transport reforms on Indian manufacturing firms' TFP. **Singh S., Singh M. (2011)** suggested the reasons behind the fluctuations of the FDI inflow in India and to search the cause that is responsible for the fluctuations of the trends of FDI. **Singh Y., Bhatnagar A. (2011),** "FDI in India and China; A comparative analysis" The study found that both enjoys healthy rates of economic growth but FDI inflow in china is higher than India. **Agarwal G., Khan M. A. (2011)** "Impact of FDI on GDP: A Comparative Study of China and India", the study found that 1% increase in FDI would result in 0.07% increase in GDP of China and 0.02% increase in GDP of India. We also found that China's growth is more affected by FDI, than India's growth. **Bhattacharyya Jita et.al (2012)** revealed that there was a long term relationship between FDI, merchandise, service trade and economic growth of India. Bi-directional causality is observed between merchandise trade and economic growth, services trade and economic growth. Unidirectional causality is observed from FDI to economic growth and FDI to merchandise trade. .

<u>Research Methodology:</u>

This research is a descriptive study in nature. The secondary data was collected from various sources which are as follows:

Researcher used the Secondary data:

- Websites of Government.
- Journals like journal relates with FDI.
- Books and magazines related to FDI inflows relate with different sectors.
- Reports and publications of various associations connected with business and industry, Agencies, government, Department of Industrial Policy & Promotion, RBI bulletin, online data base of Indian Economy, articles, news papers, data are various Economic Surveys of India and Ministry of Commerce and Industry data.

THE ORGANIZATION OF INDIA'S RETAIL INDUSTRY

In the year 2012, the Indian retail sector is estimated to be Rs. 18,673 billion and it accounts for around 15 percent of GDP and 8 percent of total employment. The sector is highly fragmented with about 96 percent of the stores in the unorganized sector. The Kirana stores (Mom and Pop stores) number around 12 million spread across 5,000 towns and 600,000 villages throughout India.

Boston Consulting Group (2012) estimated that the retail sales were $ 471 billion with 7 percent share for the organized retail ($ 34 billion) in 2011. It also shows that by 2020 the size of the organized retail to be around $ 260 billion with a penetration of 21 percent. Increasing middle class incomes and use of automobiles, refrigerators, credit cards and adoption of technology for supply chain is expected to shift the balance in favor of organized retail in metros and small towns.

The Reliance fresh stores operate both large stores and relatively small ones depending on the real estate available in the areas populated with middle income and richer consumers. They stack up with food grains both in large quantity and smaller quantity packets, processed foods of all kinds, fresh vegetables and fruits and some stores have fresh meat and fish set up separately from the main store. Vegetables, fruits and meat products are brought in everyday while the processed foods and food grains are stacked up in relation to turnover. They ensure the products meet the grading and quality requirements both at the procurement and final sale stages.

Bharati Wal-Mart has three forms of business models: Cash and Carry, Small Supermarkets (Easy Day) and Compact Hyper Markets. In the case of Cash and Carry format there are no policy restrictions on goods sold as it is basically a business to business model. However, the government issued only 60 licenses for Cash and Carry operation for the whole country. Small and medium scale businesses are given a registered card with which they can buy goods in bulk and sell them to consumers with a mark-up. These stores carry a wide range of manufactured goods procured from all over India and grocery items. As the firm derives scale advantage in procuring goods they sell them at a lower price than traditional wholesalers, thereby benefitting consumers indirectly.

Bharati Wal-Mart currently sources its private labels from 120 Indian companies. They have about 70.000 members which include small shop owners, hotels, restaurants, schools, colleges, the police force and even the Indian army. The Bharati Wal-Mart's Cash and Carry operation in Guntur city is successful with medium scale businesses preferring to procure bulk quantities of items from the entity. It issues membership cards to businesses with licenses with which they can buy a whole range of manufacture goods, food grains, pulses and fruits and vegetables both at large and small quantities. Most of the members are hotels, restaurants, colleges, hospitals, small supermarkets, and medium scale Kirana stores. It has gotten into an exclusive agreement with the Kotak Bank which issues credit cards to the members with which they can buy the produce on credit with competitive interest rates. It procures manufactured goods and food grains and pulses at the national level and vegetables from the local farmers through a vendor. Its supply chain in vegetables is still rudimentary.

Objectives of the study:

- To study the role of FDI in the development India Economy.
- To study the losses suffered by the farmers and the challenges being faced by global retailers from the FDI in retail.
- To study the FDI with the help of Porter's model.
- To find out the different companies and the transactions in FDI.

Data Analysis and interpretation:

Obj 1: To study the role of FDI in the development India Economy.

Figure:2

Interpretation:

The above diagram shows that the FDI plays an important role in the economic development by reduces the price gap, aid to Indian agriculture ,to increase liquidity and Raise investment and production.

Obj2:To study the losses suffered by the farmers and the challenges being faced by global retailers from the FDI in retail.

losses suffered by farmers:

Figure:3

(i) **Credit**: They pay high interest rates for loans from the unorganized credit markets, sometimes more than 50 per cent.

(ii) **Poor quality seeds**: fertilizers and pesticides obtained at higher prices. The dealers and middlemen provide credit for purchase of agricultural inputs and palm off substandard items.

(iii) **Poor farming practices**: Farmers are unable to apply fertilizer and pesticides at right time during the right time owing to lack of liquidity.

(iv) **Tied sales:** Farmers are forced to sell their output to the money lenders at low prices as a part of the loan conditions.

(v) **Distress sales** at the harvest time: Owing to lack of storing abilities, farmers have to sell off their output at harvest time. The difference in price between the flush and lean season could be 100 per cent or more.

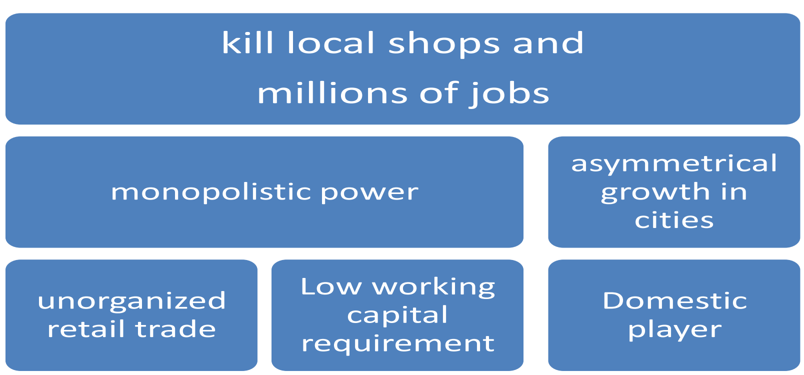
<u>Challenges of Retailing in India</u>

- The first challenge facing the organized retail sector is the competition from unorganized sector. the Indian retail sector is overwhelmingly swarmed by the unorganized retailing with the dominance of small and medium enterprises in contradiction to the presence of few giant corporate retailing outlets

- Organised retailers have been facing a difficult time in attracting customers from traditional kirana stores, especially in the food and grocery segment.
- This lack of adequate infrastructure facilities, lack of trained work force and low skill level for retailing management further makes the sector quite complex.
- The intrinsic complexity of retailing- rapid price changes, threat of product Obsolescence, low margins, high cost of real estate and dissimilarity in consumer groups are the other challenges that the retail sector in India is facing.
- Organized retail sector has to pay huge taxes, which is negligible for small retail business. Thus, the cost of business operations is very high in India.
- The trading sector is also highly fragmented, with a large number of intermediaries
- who operate at a strictly local level and there is no _barrier to entry‟, given the
- structure and scale of these operations.

Challenges for Global Retailers

Figure:4



Obj3:To study the FDI with the help of Porter's model

Porter's Five Force Model

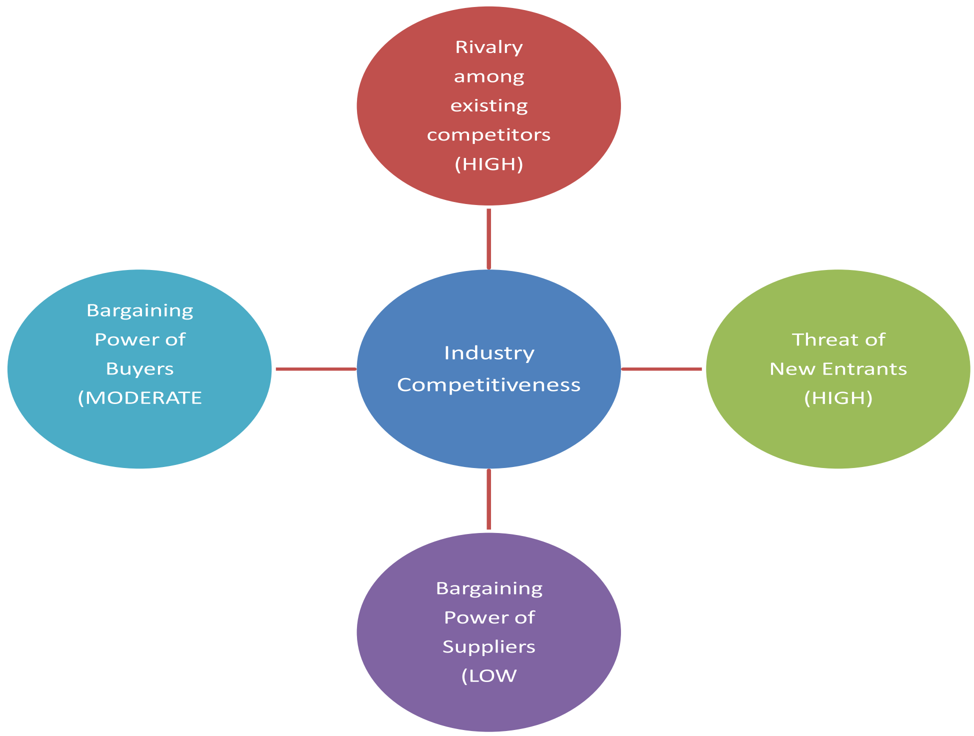


Figure:5

Interpretation:

The Porter model states the profit potential of an industry depends on the combined strength of the different components like: Threat of new entrants,rivalry among existing firms,pressure from substitute product,bargaining power of buyer and seller.Thus, it is consider as the best tool for identifying the investment opportunities.

Obj4:To find out the different companies and the transactions in FDI.

Sl. No	Name of Indian Company	FDI Route	Name of Foreign Collaborator	RBI Regional Office	Item of Manufacture	Amount of FDI Inflows	
						(In Rs crore)	(In US$ million)
1	RELOGISTICS INFRASTRUCTURE P. LTD.	RBI	BIOMETRIX MARKETING P. LTD.	MUMBAI	BOTTLING OF NATURAL GAS OR LIQUIFIED PETROLEUM GAS	1,851.91	458.89
2	DLF ASSETS LTD	RBI	DAL SINGAPORE INVESTMENTS PTE LTD	NEW DELHI	CONSTRUCTION	1,794.59	387.37
3	AAA GLOBAL VENTURES PVT LTD	RBI	BARCLAYS BANK PLC	MUMBAI	FINANCIAL LEASING COMPANIES ACTIVITIES.	1,711.24	368.35
4	ESSEL MINING INDUSTRIES LTD.	RBI	SURYA ABHA INVESTEMENT PTE.	KOLKATA	MINING OF IRON ORE	1,496.00	378.62
5	LPCUBE SYSTEMS (I) P. LTD.	RBI	VIDHYA JAYARAMAN	CHENNAI	DATAPROCESSING SOFTWARE DEVELOPMENT AND COMPUTER CONSULTANCY SERVICES	1,406.25	328.27
6	HINDUSTAN COCO-COLA HOLDINGS PVT LTD	FIPB	HINDUSTAN COCA-COLA OVERSEAS HOLDING PT	MUMBAI	INVESTMENT RESEARCH AND COUNSELLING ACTIVITIES	1,334.18	273.21
7	HINDUSTAN COCO-COLA HOLDINGS PVT LTD	FIPB	HINDUSTAN COCA-COLA OVERSEAS HOLDING PTE	MUMBAI	INVESTMENT RESEARCH AND COUNSELLING ACTIVITIES	1,334.18	273.21
8	HINDUSTAN COCO-COLA HOLDINGS PVT LTD	FIPB	BHARAT COCO-COLA OVERSEAS HOLDINGS PTE L	MUMBAI	INVESTMENT RESEARCH COUNSELLING ACTIVITIES	1,170.32	239.65
9	RELIANCE GAS TRANSPORTATION INFRAS.	RBI	BIO METRIX MARKETING P. LTD.	MUMBAI	GENERATION OF GAS IN GAS-WROKS	875.60	222.01
10	RELIANCE PORTS AND TERMINALS LTD.	RBI	BIOMETRIX MARKETING PVT.LTD.	AHMEDABAD	OTHER BUSSINESS SERVICES NOT ELSEWHERE CLASSIFIED OR INCLUDED.	830.33	205.75
Grand Total						13,804.60	3,135.34

Interpretation:

The above table shows the different companies and thei collaboration with and the product which they produce and the amount of the truncation they did in the FDI or thr FDI inflows.

Conclusion:

It can be observed from the above analysis that the foreign direct investment play an crucial role in the economic development. It not only provide aid to Indian agriculture, but also help to increase liquidity and Raise the level of investment and production. Along with this, there are many challenges being faced by the retailers of the domestic country. The main reason why retailing has not given success to many India is because of the requirement of huge financial assistance, as india is an developing country so the availability of sources of finance are not so much. The impact of the FDI, in Indian retail, is expected to not just develop strong backward linkages but also create a domestic supply chain of international standards.

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