A Conceptual Framework on Foreign Direct Investment
In Retail Sector – India

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ABSTRACT

Indian retail industry is one of the sunrise sectors with huge growth potential. According to the Investment Commission of India, the retail sector is expected to grow almost three times its current levels to $660 billion by 2015. However, in spite of the recent developments in retailing and its immense contribution to the economy, retailing continues to be the least evolved industries and the growth of organized retailing in India has been much slower as compared to rest of the world. Undoubtedly, this dismal situation of the retail sector, despite the on-going wave of incessant liberalization and globalization stems from the absence of an FDI encouraging policy in the Indian retail sector. The current paper discusses the FDI policy and FDI policy in Retail sector, and discussed Porter’s five force model for FDI in retail sector and types of FDI. The findings of the study point out that FDI in retail would undoubtedly enable India Inc. to integrate its economy with that of the global economy. Thus, as a matter of fact FDI in the buzzing Indian retail sector should not just be freely allowed but should be significantly encouraged.

KEYWORDS: FDI in retail sector, FDI-Porter’s five force model, FDI policy and types of FDI.

INTRODUCTION

Foreign Direct Investment in India

The fast and steadily growing economy of India in majority of its sectors, has made India one of the most famous and popular destinations in the whole world, for Foreign Direct Investment. India’s ever-expanding markets, liberalization of trade policies, development in technology and telecommunication, and loosening of diverse foreign investment restrictions, have further collectively made India, the apple of investors’ eye, for most productive, profitable, and secure foreign investment. According to a recent survey by the United Nations Conference on Trade and Development (UNCTAD), India has conspicuously emerged out as the second most popular and preferable destination in the entire world, after China, for highly profitable foreign direct investment.
In recent years, bulk of the foreign direct investment in Indian business sectors of infrastructure, telecommunication, information technology, computer hardware and software, and hospitality services, have been made by investors of countries like US, UK, Mauritius, Singapore, and many others. Global Jurix, one of the leading full-fledged legal organizations of India with global repute, has been helping companies, business corporations, organizations, and other potential investors of countries all around the world, in making foreign direct investment in Indian business sectors, in various ways described in the section below.

The current paper discusses the following:

- FDI policy
- FDI policy in Retail sector
- Types of FDI
- Porter’s five force model for FDI in retail sector

FDI Policy in India

FDI as defined in Dictionary of Economics (Graham Bannock et.al) is investment in a foreign country through the acquisition of a local company or the establishment there of an operation on a new (Greenfield) site. To put in simple words, FDI refers to capital inflows from abroad that is invested in or to enhance the production capacity of the economy. Foreign Investment in India is governed by the FDI policy announced by the Government of India and the provision of the Foreign Exchange Management Act (FEMA) 1999. The Reserve Bank of India (‗RBI‘) in this regard had issued a notification, which contains the Foreign Exchange Management (Transfer or issue of security by a person resident outside India) Regulations, 2000. This notification has been amended from time to time. The Ministry of Commerce and Industry, Government of India is the nodal agency for motoring and reviewing the FDI policy on continued basis and changes in sectoral policy/ sectoral equity cap. The FDI policy is notified through Press Notes by the Secretariat for Industrial Assistance (SIA), Department of Industrial Policy and Promotion (DIPP). The foreign investors are free to invest in India, except few sectors/activities, where prior approval from the RBI or Foreign Investment Promotion Board (‗FIPB‘) would be required.

FDI Policy with Regard to Retailing in India

It will be prudent to look into Press Note 4 of 2006 issued by DIPP and consolidated FDI Policy issued in October 2010 which provide the sector specific guidelines for FDI with regard to the conduct of trading activities.

a) FDI up to 100% for cash and carry wholesale trading and export trading allowed under the automatic route.
b) FDI up to 51 % with prior Government approval (i.e. FIPB) for retail trade of Single Brand products, subject to Press Note 3 (2006 Series)
c) FDI is not permitted in Multi Brand Retailing in India.

Foreign Direct Investment in Retail

The Retail Industry is the sector of economy which is consisted of individuals, stores, commercial complexes, agencies, companies, and organizations, etc., involved in the business of selling or merchandizing diverse finished products or goods to the end-user consumers directly
and indirectly. Goods and products of the retail industry or sector, are the finished final objects/products of all sectors of commerce and economy of a country.

The Retail sector of India is vast, and has huge potential for growth and development, as the majority of its constituents are un-organized. The retail sector of India handles about $250 billion every year, and is expected by veteran economists to reach to $660 billion by the year 2015. The business in the organized retail sector of India, is to grow most and faster at the rate of 15-20% every year, and can reach the level of $100 billion by the year 2015. Here, it is noteworthy that the retail sector of India contributes about 15% to the national GDP, and employs a massive workforce of it, after the agriculture sector. India's growing economy with a rate of approximately 8% per year, makes its retail sector highly fertile and profitable to the foreign investors of all sectors of commerce and economy, of all over the world. Global Jurix, a full-fledged legal organization prominent worldwide, provides all-encompassing services and advice for most lucrative and secured fdi in Indian retail sector.

AT Kearney (a globally famous international management consultancy) recognized India as the second most alluring and thriving retail destination of the world, among other thirty growing and emerging markets. At present, other profitable retail destinations of the world are China and Dubai of Asia. Diverse foreign direct investment in Indian retail is greatly cherished by most of the major and leading retailers of USA and European countries, including Wal-Mart (USA), Tesco (UK), Metro (Germany), and Carrefour (France). Liberalization of trade policy and loosening of barriers and restrictions to the foreign investment in the retail sector of India, have collectively made the fdi in retail sector quite easy and smooth. Our services are easily and economically available for the following ways of FDI in Indian retail.

As per the current regulatory regime, retail trading (except under single-brand product retailing FDI up to 51 per cent, under the Government route) is prohibited in India. Simply put, for a company to be able to get foreign funding, products sold by it to the general public should only be of a „single-brand‟; this condition being in addition to a few other conditions to be adhered to. India being a signatory to World Trade Organization‟s General Agreement on Trade in Services, which include wholesale and retailing services, had to open up the retail trade sector to foreign investment. There were initial reservations towards opening up of retail sector arising from fear of job losses, procurement from international market, competition and loss of entrepreneurial opportunities. However, the government in a series of moves has opened up the retail sector slowly to Foreign Direct Investment (FDI). In 1997, FDI in cash and carry (wholesale) with 100% ownership was allowed under the Government approval route. It was brought under the automatic route in 2006. 51% investment in a single brand retail outlet was also permitted in 2006. FDI in Multi-Brand retailing is prohibited in India.

Five Different Types of Foreign Direct Investment (FDI)

According to Chryssochoidis, Millar & Clegg, 1997 there are five different types of foreign direct investment (FDI).

The first type of FDI is taken to gain access to specific factors of production, e.g. resources, technical knowledge, material know-how, patent or brand names, owned by a company in the host country. If such factors of production are not available in the home economy of the foreign company, and are not easy to transfer, then the foreign firm must invest locally in order to secure access.
The second type of FDI is developed by Raymond Vernon in his product cycle hypothesis. According to this model the company shall invest in order to gain access to cheaper factors of production, e.g. low-cost labour. The government of the host country may encourage this type of FDI if it is pursuing an export-oriented development strategy. Since it may provide some form of investment incentive to the foreign company, in form of subsidies, grants and tax concessions. If the government is using an import-substitution policy instead, foreign companies may only be allowed to participate in the host economy if they possess technical or managerial know-how that is not available to domestic industry. Such know-how may be transferred through licensing. It can also result in a joint venture with a local partner.

The third type of FDI involves international competitors undertaking mutual investment in one another, e.g. through cross-shareholdings or through establishment of joint venture, in order to gain access to each other's product ranges. As a result of increased competition among similar products and R&D-induced specialisation this type of FDI emerged. Both companies often find it difficult to compete in each other's home market or in third-country markets for each other's products. If none of the products gain the dominant advantage, the two companies can invest in each other's area of knowledge and promote sub-product specialisation in production.

The fourth type of FDI concerns the access to customers in the host country market. In this type of FDI there are not observed any underlying shift in comparative advantage either to or from the host country. Export from the companies' home base may be impossible, e.g. certain services, or the capability to request immediate design modifications. The limited tradability of many services has been an important factor explaining the growth of FDI in these sectors.

The fifth type of FDI relates to the trade diversionary aspect of regional integration. This type occurs when there are location advantages for foreign companies in their home country but the existence of tariffs or other barriers of trade prevent the companies from exporting to the host country. The foreign companies therefore jump the barriers by establishing a local presence within the host economy in order to gain access to the local market. The local manufacturing presence need only be sufficient to circumvent the trade barriers, since the foreign company wants to maintain as much of the value-added in its home economy.

Porter's Five Force Model - FDI

1. Threat of New Entrants:

One trend that started over a decade before has been a decreasing number of independent retailers. While the barriers to start up a new store are not impossible to overcome, the ability to
establish favorable supply contracts, leases and be competitive is becoming virtually impossible. There vertical structure and centralized buying gives chain stores a competitive advantage over independent retailers. 95% of the market is made up of small, uncomputerised family run stores. Now there are finally signs that the Indian government dropping its traditional protectionist stance and opening up its retail market to greater overseas investment. It has already allowed 51% ownership in single-brand goods leading to entry of McDonalds, Marks & Spencer, Body Shop and Ikea and with proposal of raising the ownership to 100% will attract more foreign retailers.

2. Power of Suppliers:

Historically, retailers have tried to exploit relationships with supplier. A great example was in the 1970s, when Sears sought to dominate the household appliance market. Sears set very high standards for quality; suppliers that did not meet these standards were dropped from the Sears line. This could also be seen in case of Walmart that places strict control on its suppliers. A contract with a big retailer like Walmart can make or break a small supplier. In retail industry suppliers tend to have very little power.

3. Power of Buyers:

Individually, consumers have very little bargaining power with retail stores. It is very difficult to bargain with the clerk at Big Bazaar for better price on rapes. But as a whole if customers demand high-quality products at bargain prices, it helps keep retailers honest. Taking this from Porter’s side of the coin we can say customers have comparatively high bargaining power in unorganized sector than in organized sector. As the customer will demand products from organized units he will be more focused towards quality aspect.

4. Availability of Substitutes:

The tendency in retail is not to specialize in one good or service, but to deal in wide range of products and services. This means what one store offers is likely to be same as that offered by another store. Thus threat from substitutes is high.

5. Competitive Rivalry:

Retailers always face stiff competition and must fight with each other for market share and also with unorganized sector. More recently, they have tried to reduce cut throat pricing competition by offering frequent flier points, memberships and other special services to try and gain the customer's loyalty. Thus retailers give each other stiff but healthy competition which is evident from their aggressive marketing strategies and segment policies.
Conclusions:

The discussion above highlights:

(1) Small retailers will not be crowded out, but would strengthen market positions by turning innovative /contemporary.
(2) Growing economy and increasing purchasing power would more than compensate for the loss of market share of the unorganized sector retailers.
(3) There will be initial and desirable displacement of middlemen involved in the supply chain of farm produce, but they are likely to be absorbed by increase in the food processing sector induced by organized retailing.
(4) Innovative government measures could further mitigate adverse effects on small retailers and traders.
(5) Farmers will get another window of direct marketing and hence get better remuneration, but this would require affirmative action and creation of adequate safety nets.
(6) Consumers would certainly gain from enhanced competition, better quality, assured weights and cash memos.
(7) The government revenues will rise on account of larger business as well as recorded sales.
(8) The Competition Commission of India would need to play a proactive role.

In conclusion, the issue that India must grapple with now is the impact of reduced competition brought about by retailer concentration will have on various stakeholders and the ways in which competition laws and policy can deal with this growth of power before it is too late. The new Competition Act, 2002 has all the required provisions. It would, anyhow, depend on how it is implemented.

References/Bibliography: