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# Bearing of Overseas Investors on Organised Retailing: The Indian Scenario

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## Abstract

FDI in retail, the primary focus would be on the effects of FDI on various organizations. In order to initiate this discussion, we would initially present an overview of Indian retail Industry. Then, talk about the entry options of foreign players prior to FDI Policy. For those brands which adopt the franchising route as a matter of policy, the current FDI Policy will not make any difference. They would still rely on innovative structuring of franchise arrangements to maximize their returns. Consumer durable majors such as LG and Samsung, which have exclusive franchisee owned stores, are unlikely to shift from the preferred route right away.

However, should a foreign investor tie up with an existing retailer or look to others not necessarily in the business but looking to diversify is to be seen. An arrangement in the short to medium term may work wonders but what happens if the Government decides to further liberalize the regulations as it is currently contemplating. The foreign investor must negotiate its joint venture agreements carefully, with an option for a buy-out of the Indian partner's share if and when the regulations so permit. They must also be aware of the regulation which states that once a foreign company enters into a technical or financial collaboration with an Indian partner, it cannot enter into another joint venture with another Indian company or set up its own subsidiary in the same field without the first partner's consent if the joint venture agreement does not provide for a 'conflict of interest' clause. In effect, it means that foreign brand owners must be extremely careful whom they choose as partners and the brand they introduce in India.

## An Overview of Indian Retail Industry

Retailing is the last link that connects the individual consumer with the manufacturing and distribution chain. Retailing can be said to be the interface between the producer and the individual consumer buying for personal consumption [1]. This excludes direct interface between the manufacturer and institutional buyers such as the government and other bulk customers. A retailer is involved in the act of selling goods to the individual consumer at a margin of profit. Retail is a booming sector of India in the present times. Retail, one of India's largest industries, has presently emerged as one of the most dynamic and fast paced industries with several players entering the market accounting for over 10 per cent of the country's GDP and around eight per cent of the employment. Retailing in India is gradually inching its way toward becoming the next boom industry.

As the contemporary retail sector in India is reflected in sprawling shopping centers, multiplex- malls and huge complexes offer shopping, entertainment and food all under one roof, the concept of shopping has altered in terms of format and consumer buying behavior, ushering in a revolution in shopping in India. This has also contributed to large scale investments in the real estate sector with major national and global players investing in developing the infrastructure and construction of the retailing business. The trends that are driving the growth of retail sector in India are:

Low share of organized retailing
Rising real estate prices
Increase in disposable income and customer aspiration
Increase in expenditure for luxury items

Another credible factor in the prospects of retail sector in India is the increase in young working population. In India, hefty pay-packets, nuclear families in urban areas along with increasing working-women population and emerging opportunities in the services sector have been the growth drivers of the organized retail sector in India which now boast of retailing almost all the preferences of life - Apparel & Accessories, Appliances, Electronics, Cosmetics and Toiletries, Home & Office Products, Travel and Leisure and many more. With this the retail sector in India is witnessing a rejuvenation as traditional markets make way for new formats such as departmental stores, hypermarkets, supermarkets and specialty stores.

The retailing configuration in India is fast developing as shopping malls are increasingly becoming familiar in large cities. When it comes to development of retail space specially the malls, the Tier II cities are no longer behind in the race. The government of Delhi and National Capital Region (NCR) are very upbeat about permitting the use of land for commercial development thus increasing the availability of land for retail space making NCR render to 50% of the malls in India.

India is being seen as a potential goldmine for retail investors from over the world and latest research has rated India as the top destination for retailers for an attractive emerging retail market. India's vast middle class and its almost untapped retail industry are key attractions for global retail giants wanting to enter newer markets. Even though India has well over 5 million retail outlets, the country sorely lacks anything that can resemble a retailing industry in the modern sense of the term. This presents international retailing specialists with a great opportunity. The organized retail sector is expected to grow stronger than GDP growth in the next five years driven by changing lifestyles, burgeoning income and favorable demographic outline.

## Organized Vs Unorganized Retailing

Retailing is the largest private industry in India which is mainly divided into:
1) Organized and
2) Unorganized Retailing

Organized retailing refers to trading activities undertaken by licensed retailers, that is, those who are registered for sales tax, income tax, etc. These include the corporate-backed hypermarkets and retail chains, and also the privately owned large retail businesses.

Unorganized retailing, on the other hand, refers to the traditional formats of low-cost retailing, for example, the local kirana shops, owner manned general stores, paan/beedi shops, convenience stores, hand cart and pavement vendors, etc.

The Indian retail sector is highly fragmented with 97 per cent of its business being run by the unorganized retailers. The organized retail however is at a very nascent stage. The sector is the largest source of employment after agriculture, and has deep penetration into rural India generating more than 10 per cent of India's GDP [2]. The performance of this sector has a strong influence on consumer welfare. In its quest for cost reduction, capitalism has a tendency to continue to replace labour with automation. Large number of jobs that are promised to be created will be blue collar jobs and will be taken up by those who are well educated. The jobs that are going to be destroyed will be that of semi-literate.

## Entry Options for Foreign Players prior to FDI Policy

Although prior to Jan 24, 2006, FDI was not authorized in retailing, most general players had been operating in the country. Some of the entrance routes used by them have been discussed below:-

### 1. Franchise Agreements

It is an easiest track to come in the Indian market. In franchising and commission agents services, FDI (unless otherwise prohibited) is allowed with the approval of the RBI under the Foreign Exchange Management Act.

### 2. Cash And Carry Wholesale Trading

The wholesale cash and carry operation is defined as any trading outlet where goods are sold at the wholesale rate for retailers and business to buy. The transaction is only for the business purposes and not for personal consumption. 100% FDI is allowed in wholesale trading which involves building of a large distribution infrastructure to assist local manufacturers. The wholesaler deals only with retailers and not Consumers. Metro was the first significant global player to enter India through this route. Carrefour also entered Indian Market through this route.

### 3. Strategic Licensing Agreements

Some foreign brands give exclusive licences and distribution rights to Indian companies. Through these rights, Indian companies can either sell it through their own stores, or enter into shop-in-shop arrangements or distribute the brands to franchisees. Mango, the Spanish apparel brand has entered India through this route with an agreement with Piramyd, Mumbai. SPAR entered into a similar agreement with Radhakrishna Foodlands Pvt. Ltd

### 4. Manufacturing and Wholly Owned Subsidiaries

The foreign brands such as Nike, Reebok, Adidas, etc. that have wholly-owned subsidiaries in manufacturing are treated as Indian companies and are, therefore, allowed to do retail. These companies have been authorized to sell products to Indian consumers by franchising, internal distributors, existent Indian retailers, own outlets, etc. For instance, Nike entered through an exclusive licensing agreement with Sierra Enterprises but now has a wholly owned subsidiary, Nike India Private Limited.

## FDI in Single Brand Retail

The Government has not categorically defined the meaning of “single brand” anywhere neither in any of its circulars nor in any notifications.

In single-brand retail, FDI up to 51 per cent is allowed, subject to Foreign Investment Promotion Board (FIPB) approval and subject to the conditions mentioned in Press Note 3 [3] that (a) only single brand products would be sold (i.e., retail of goods of multi-brand even if produced by the same manufacturer would not be allowed), (b) products should be sold under the same brand internationally, (c) single brand product retail would only cover products which are branded during manufacturing and (d) any addition to product categories to be sold under “single brand” would require fresh approval from the government. While the phrase 'single brand' has not been defined, it implies that foreign companies would be allowed to sell goods sold internationally under a 'single brand', viz., Reebok, Nokia, and Adidas. Retailing of goods of multiple brands, even if such products were produced by the same manufacturer, would not be allowed.

FDI in single brand retail implies that a retail store with foreign investment can only sell one brand. For example, if Adidas were to obtain permission to retail its flagship brand in India, those retail outlets could only sell products under the Adidas brand and not the Reebok brand, for which separate permission is required. If granted permission, Adidas could sell products under the Reebok brand in separate outlets.

## Importance of FDI in Retail

Foreign direct investment (FDI) or foreign investment refers to the net inflows of investment to acquire a lasting management interest in an enterprise operating in an economy other than that of the investor. It is the sum of equity capital, reinvestment of earnings, other long-term capital, and short-term capital. It usually involves participation in management, joint-venture, transfer of technology and expertise.

FDI is a measure of foreign ownership of productive assets, such as factories, mines and land. Increasing foreign investment can be used as one measure of growing economic globalization. FDI provides an inflow of foreign capital and funds, in addition to an increase in the transfer of skills, technology, and job opportunities.

India's retail market, valued at US$ 350 BN in 2008-09 is projected to grow at 13% per annum. The country's retail sector is the second largest employer after agriculture, with retail trade employing 35.06 MN and wholesale trade generating an additional employment of 5.48 MN. Food is the largest segment in terms of its contribution to the total value of the retail market, followed by fashion accessories. India is at an early stage of evolution in organized retail with its current penetration being 5%, which indicates a huge potential for growth. The share of organized retail in total Indian retail trade is projected to grow at 40% per annum. Organized retail formats including departmental stores, hypermarkets, supermarkets and specialty stores are fast replacing traditional retail formats such as "kirana stores" (small 'mom and pop' general stores) due to rising consumer expectations.

Challenges for the Indian Retail Sector are:

Inflation
Taxation problem
Skilled workers
Competition
Real estate problem
Market power
Supply chain management
Problem in raising funds

Also, Market power is in hands of unorganized retail. Unorganized sector constitutes 95% whereas organized sector is 5% only. Potential of Indian Market is US$ 200 billion whereas India is just earning its 3%.

While FDI is good because it brings in the best practices and also more competition, FDI in retail is different from FDI in other sectors. For e.g. FDI in Banking and Insurance Sector is different from retail sector as Insurance penetration is less than 5% people, i.e. less than 5% of the people are insured. Likewise large numbers of people, particularly in rural areas don't have bank accounts. An FDI in this sector would help in spreading banking and insurance services. Retail is already there and a huge chunk of people are dependent on this.

For e.g. FDI in Defense is different as compared to retail. Every year India imports 70% of its defense equipment worth billions of dollars. India does not even have the capacity to produce bullet proof jackets, leave alone high-end aircrafts and warships. Most countries are unwilling to share the latest technologies.

## FDI Policy with regard to Retailing in India

Retailing is the largest private sector industry in the world economy with the global industry size exceeding $6.6 trillion and a latest survey has projected India as the top destination for retail investors. Government has plans to allow 51% FDI in single brand retail outlets. As the government is in a process to initiate a second phase of reforms, it is cautiously exploring the avenues for multi-brand segment. The Government is seeking these options keeping in view the existing social framework of India and will ensure that the entry of global retail giants do not displace the existing employment in the retail business. The domestic retailers are still operating in India and the kirana shops have survived the onslaught. The annual rate of closure of retail shops is less than 2%.

Free markets means FDI in retail should be allowed as everyone seems to be propagating this agenda. As the FDI influence on the Indian retail sector sets in, the total size of retail trade is expected to grow extensively in the coming years and the consumer segments patronizing the big malls will create frenzy for organized retailing predicting a growth of 25-30 per cent per annum over the next decade. Moreover, Indian retail chains would get integrated with global supply chains since FDI will bring in technology, quality standards and marketing thereby leading to new economic opportunities and creating more employment generation.

Industry trends for retail sector indicate that organized retailing has major impact in controlling inflation because large organized retailers are able to buy directly from producers at most competitive prices. World Bank attributes the opening of the retail sector to FDI to be beneficial for India in terms of price and availability of products as it would give a boost to food products, textiles and garments, leather products, etc., to benefit from large-scale procurement by international chains; in turn, creating jobs opportunities at various levels.

The sector specific guidelines for FDI with regard to the conduct of trading activities are as follows [4]:

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) [5].

c) FDI is not permitted in Multi Brand Retailing in India.

As foreign investors are exploring their potential in the retail sector, they are also keen on developing malls in India. The size of organized retailing is expected to touch $30 billion by 2012 or approximately 10 per cent of the total. This has initiated market-entry announcement from some retailers and has signaled to international retailers about India's seriousness in promoting the sector. While there are reports of international retailers like Wal-Mart analyzing business opportunities in India; Reliance, the largest Indian conglomerate is investing $3.4 billion to become India's largest contemporary retailer. There are also reports of investments for 'Hypercity Retail' by K.Raheja Group to establish 55 hypermarkets by 2015. All these factors will contribute in taking Indian retail business to unexpected growth based on the consumer preference for shopping in congenial environment and also availability of quality real estate.

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