FOREIGN DIRECT INVESTMENT IN RETAIL SECTOR.

INTRODUCTION

The onset of retailing in India is from times immemorial. Retail shops thrived in ancient India as low cost local 'kirana' shops; self traded stores and pavement vendors. With globalization a demonstration effect has partially organized Indian retailing rendering the rest unchanged. Thus India today witnesses the co-existence of large departmental stores and hypermarkets along with the traditional 'kirana' stores and hawkers.

Since globalization of Indian industries and the abolition of the 'Licensing Raj' inflow of cross border investment in the name of Foreign Direct Investment (FDI) has well nurtured the growing Indian economy. Various sectors of the economy have received adequate funds needed for their growth in the form of foreign assets brought in by Multi-national Companies and their investment in the shares of domestic enterprises. The foreign investors initially growing their roots in the developed countries have suddenly shown interest in the developing countries. Being cheap sources of labour, having vast untapped resources, being cheap suppliers of raw materials, having low cost of production and bearing easily penetrable markets, developing economies have tantalized such foreign investors. The growing liquidity in the hands of the gigantic middleclass has also been a reason for attraction of FDI too. The inflow of FDI is thus mutually beneficial to both the foreign investors and the developing country as the former caters to the financial support necessary for the sectoral development of the later and the later minimizes the cost of production of the former.

The growing contribution of the retail sector to the GDP of India has been quite conspicuous in the past few years. This can be well observed in table 1. The entry of hypermarkets such as Pantaloons, Big Bazaar, Reliance Fresh, Subhiksha, Metro Cash and Carry, Spencers etc. has offered several benefits to consumers. The consumers everywhere have been increasingly satisfied by the quality products sold by the above speciality stores at highly reasonable prices. Besides, such a set up gives a plethora of choiceto its customers in a comfortable environment. Shopping is made a pleasure by other modes of entertainment that these hypermarkets provide. Customer pleasure is coupled by a boost to the economic growth, as the supermarkets provide forward linkages for the large scale marketing of final goods. The mass sale of final goods thereby raises the volumes of production creating more employment opportunities and better standard of living. Thus a balanced growth path can be chalked out between industries and retail.

POLICY PROPOSAL

The Indian retail market has a wide scope for expansion. As per the Government of India retail industries can be developed in a large number of product categories. Such products range widely from food and grocery, logistics, garments, domestic equipments and other durables. After the Indian economy opened up in the global market the Government of India has provided for a 100 per cent FDI flow in single brand retail without making any provision for the entry of FDI in multi-brand retail outlets. In 24th November 2011, the Union Cabinet cleared a Policy in this respect, where 51 per cent FDI would be allowed in multi-brand retail through approved Government routes after making adequate safeguards for domestic stakeholders. The main features of the policy proposal are as follows:

- The policy rollout would cover only cities having a population above 1 million, as per the Census 2011.
- The policy would ensure a minimum investment $ 100 million with at least half the amount invested in back end infrastructure, including cold chains, refrigeration, transportation, packing, sorting and processing. This would insure the farmers against post harvest losses and bring them remunerative prices.
- In order to encourage an increasing scale of production to domestic small manufacturers and to raise employment opportunities and scope for technological up gradation,sourcing of a minimum of 30% from Indian Small andMedium Enterprises (SME) having capital investment of not more than $ 1 million has been made mandatory.
- In order to retain the essence of federalism the Government of India has also mandated that such foreign investment in retail sector would be made within the ambit of State laws and regulations.
- The Government also ensured the prevention to maladies such as the practices of predatory pricing, brought along with foreign investment in retail, by the establishment of a legal instrument called the Competition Commission.

<u>Proposals in Budget 2012</u>

AGRICULTURAL SECTOR

Introduction of foreign players in the retail sectors has been opposed from the perspective that it obliterates the middlemen in the supply chain, particularly in the agricultural structure.In reality though most of the middlemen have no direct contribution to the supply chain, they merely raise the cost of the end product. FDI in retail would automatically facilitate the direct marketing and would strengthen the supply chain. Existence of middlemen and intermediate traders in a supply chain costs to both the farmers and the final consumers. Direct link between the two would mutually benefit each other. The farmers would receive a higher price while the final consumers would be satisfied by a lower price. The system of an organized supply chain would also act as a shield to the brunt of inflation. The heat of inflation fanned by the hoarding practices of intermediate traders and middlemen would be thereby eliminated.

Indian agriculture post independence has never witnessed a distinguished revolution in techniques of cultivation. The effects of green revolution were highly localized and crop specific. Till the present day farmers and small producers have taken recourse to age old methods of production. The entry of foreign investment in retail sector is expected to create a mass demand for agricultural products. Such a demand for increased quantity of output would force the agricultural producers to adopt modern methods of production as traditional method would not be able to cater to the scale of production required to meet such a rise.The flooding in of big bannered retailers such as Walmart and Tesco into the food market would raise the demand for agricultural products. This in turn would raise the food prices in the short run and would benefit the farmers to get out of their state of subsistence. In the long run too, the farmers would have both surpluses and the incentive to expand agricultural production. However, looking at the condition of Indian farming community it is evident that large sections of the same are landless and subsistent farmers. In order to meet the increased demand of these larger retailers they have to buy supplies from the markets. Since the price of the rural market has raised already due to excess demands these farmers would suffer as rural consumers. Thus the effects of gain would be limited to only to farmers with marketable surpluses.

The entry of foreign players to the retail sector of the country, especially the food and grocery sector requires the opening of the agricultural sector to the world economy. Such an exposure to the still closed agricultural sector would no doubt raise its standards and would make it internationally competitive. The fear that the inflow of cheaper agricultural products from other countries would further lower the prices of agricultural products can be well taken care of by policy protections. In any case, edible oil, pulses are continuing to be imported due to shortages and international players might help reduce costs.

The 30 per cent reservation of goods from the SME sector would also help in development and advancement of the SME sector which has a wide scope for development in the Indian economy. Such a reservation creates a vent through which the modernizing effects of the FDI would creep into and upgrade the developing SME sector in India. The technologies brought in by the inflow of FDI would benefit both the agricultural and the SME sector. Thus it can be said that the positive implication of the FDI into the retail sector of India is not only limited to itself but has a far reaching effect beyond its boundaries.

The fear that the entry of giant retailers such as Wal-Mart would eliminate small competitors is to certain extent an over exaggeration. The establishment of large hypermarkets by these foreign investors would bring all types of products under a single roof. Local and small brands would also get a marketing outlet side by side world class brands. This has a positive implication for both the hypermarket as well as the local producers. The hypermarkets, by selling these low cost products would gain a greater margin while the local producers would gain strong marketing recognition at a low cost without much expenditure on sales promotion.

The inflow of FDI in the retail sector would also universalize regional goods restricted to regional markets. Rosogollas of Kolkata are gaining rapid recognition in far flung places both within as well as outside the country. This would allow regional brands to give tough competition to the large brands and would also control the rise in their prices.

The Indian retail sector like the agricultural sector has lacked restructuring since independence. Indian retailing has characteristics similar to those of the agricultural sector. Like agriculture it is an open sector. Low cost of establishment and operational cost makes it accessible to all. Small and fragmented investmentsbar the access to capital and thereby resist the sectors growth beyond a certain limit. The low operational cost and fragmented investments have made the retail sector in India collectively fragmented. There is a very high shopping density with too many investors investing in the same product.This often gives way to a perfectly competitive market and thus price rigidity.An easily accessible retail market sometimes channelizes the underemployed people from agriculture and industry to retail. This gives way to overcrowding. Thus there is a reduction in wages of individual seller and thereby a fall in their standard of living. A sector with low income level cannot be easily taxed. The sector thus acts as a burden to the Government as it increases its expenditure at the same time creating no scope for taxation. Thus the entry of foreign investors in the retail sector would amalgamate its fragmented nature, suffice the capital requirements and raise wages.

NEED FOR PRIORITISATION

From its introduction in the Parliament, the Bill permitting the entry of 51 per cent FDI in multi brand retailing has faced opposition on grounds that it would render both middlemen and farmers unemployed. Many of the State Governments including the Government of West Bengal has opposed its introduction. However, it is evident that out of the various sub sectors forming the retail sector in India, food and grocery retail forms the most important component. With the development of back-end infrastructure and a scope for forward integration through cold chains and retail managements, this sub-sector might create employment opportunity for the vast sections of the population. The employment generation attained therein would have a trickling down effect in both the urban and rural economy. The commencement of FDI in the food retail sector would also lead to the growth of well organized storage facilities which would prevent large scale pilferage of food products, which usually has to be eliminated in large quantities. This would also enable the Government to store food reserves as buffer stock for unseen exigencies.

The flow of FDI into multi-brand retailing has far and wide effects. Its effects also extends to logistics sector with the entry of foreign players into the retail market the effective demand for services such as warehousing and transport falling under the logistics sector would also increase. Accordingly, there would be a bifurcation of investments among pure-play logistics players and logistics subsidiaries of organized retail establishments. The logistics sector would also be benefitted from the perspective of mechanization. The imbibition of modern techniques in the sector would allot it a different outlook.

VIEWS OF THE CHAMBER

Thus the above analysis makes it crystal clear that the entry of foreign players into the Indian retail sector is a boon but at the same time is also a bane for certain other players. A cautious legislation by the Government in certain specific fields is a necessity. Developing nations such as China has successfully introduced liberalization in the retail sector without bearing its brunt. The Government of India should take the following initiatives inorder to be immuned from the feared maladies.

- The Indian economy lacks adequate social safety needs. Thus the Government should ensure a strong social safety law before permitting the foreign players to enter the Indian markets.
- The fear of the agricultural sector facing competition from imported foreign agricultural good is not baseless. Thus the Government should strengthen its agricultural sector before subjecting it to international competitions. At the same time policy regulations should be created to discourage import of agricultural goods from abroad.
- A gradual introduction of foreign players into the Indian retailing would ensure a healthy competition and at the same time would prevent a sudden elimination of some the dealers in the Indian retail sector. This gradualness would act as a shock absorbent till a Pareto Optimal balance is established in the Indian retail market.
- The Government should plug the loopholes left unplugged in the value chain before allowing the foreign players to enter the Indian retail market.
- Building a strong infrastructural base is a necessity before allowing the abolition of the FDI caps in the retail markets.

- Since the social cost of allowing FDI in retailing is very high with a stagnant industrial sector coupled with unemployment in the agricultural sector, the Government of India should develope the above two sector before opening up the retail sector to the world economy.
- FDI in the retail sector should be introduced within the framework of a fee structure the returns of which would be used for the development of rural markets and cold storages.
- A National Commission at the central level and Agricultural Boards at state levels which would act as watchdogs and control the flow of FDI into the Indian economy.