

IMPACT ANALYSIS OF FDI ON RETAIL INDUSTRY IN INDIA

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ABSTRACT

Liberalization of trade policies during the last one and half decade has led India to become an investment friendly country. Indian economy is basically an agro based as its 70% population engaged in the agriculture sector. When liberalization started in 1991, Foreign Direct Investment (FDI) was limited to only a few sectors like manufacturing, infrastructure etc. But change in FDI policy of India in 2012, allowing investment in multi-brand retail stores, aviation sector and pension plan sectors, may bring revolutionary changes in these sectors. For companies in the consumer products and retail industry, the pace of change is breakneck, global volatility is guaranteed, and fierce competition comes at every turn. Recently, a great debate has cropped up against the government plans for FDI in the Indian retail sector. FDI in retail is fundamentally different from that in manufacturing. FDI in manufacturing basically enhances the productive employment in most cases; but FDI in retail trade may create job losses and displacement of traditional supply chain. In this background the present paper makes an attempt to study the likely impact of FDI on Indian retail sector. Clearly, except for some existing Indian retail operations, the bulk of the Indian economy would gain, significantly, from the emergence of a well-capitalized retail industry that brings the latest technology and management practices to build modern supply chains in India, connecting country and town, connecting small producers with national and even global markets.

KEY WORDS: FDI, investment policy, organized retailing.

INTRODUCTION

Reform process in India was initiated with the aim of accelerating the pace of economic growth and eradication of poverty. The process of economic liberalization in India can be traced back to the late 1970s. However, the reform process began in earnest only in July 1991. It was only in 1991 that the Government signaled a systemic shift to a more open economy with greater reliance upon market forces, a larger role for the private sector including foreign investment, and a restructuring of the role of Government. The reforms of the last decade and a half have gone a long way in freeing the domestic economy from the control regime. An important feature of India's reform programme is that it has emphasized gradualism and evolutionary transition rather than rapid restructuring or "shock therapy". This approach was adopted since the reforms were introduced in June 1991 in the wake a balance of payments crisis that was certainly severe. However, it was not a prolonged crisis with a long period of non-performance. The reforms have

unlocked India's enormous growth potential and unleashed powerful entrepreneurial forces. Since 1991, successive governments, across political parties, have successfully carried forward the country's economic reform agenda. In 2012 government of India has further liberalized FDI in Multi-brand retail, Aviation Sector and Pension Sector. In this paper emphasis will be on impact of liberalization of the policy of FDI on retail sector of Indian economy. Retailing is 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 customers. A retailer is one who stocks the producer's goods and is involved in the act of selling it to the individual consumer, at a margin of profit. As such, retailing is the last link that connects the individual consumer with the manufacturing and distribution chain.

Retailing in India is one of the pillars of its economy and accounts for 14 to 15% of its GDP. 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. 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 multi-brand 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 Wal-Mart, Carrefour and Tesco, as well single brand majors such as IKEA, Nike, and Apple. 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. 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. AT Kearney, the well-known international management consultancy, recently identified India as the 'second most attractive retail destination' globally from among thirty emergent markets. It has made India the cause of a good deal of excitement and the cynosure of many foreign eyes. With a contribution of 14% to the national GDP and employing 7% of the total workforce (only agriculture employs more) in the country, the retail industry is definitely one of the pillars of the Indian economy. While European countries faced another year of turmoil in 2011, developing countries forged full speed ahead. With consumer confidence improving and spending increasing, global retailers continued their expansion in these markets. In the past 5 years, America based Wall mart, France based Carrefour, U.K. based Tesco and Germany based Metro group saw their revenues in developing countries grow 2.5 times greater than their home markets. The 2012 Kearney Foreign Direct Investment Confidence Index has ranked India 2nd most attractive destination for FDI, an improvement from its 3rd rank in 2010.

Retail Sector in India

The Retail sector in India can be divided into two parts. One is organized and other is unorganized sector. Organized sector retailers are licensed retailers, those who have registered for sales tax, income tax etc. They are generally privately owned large businesses like Tanishq, Croma etc. on the other hand unorganized retail stores are like Kirana store, departmental store etc. which neither registered with any tax authorities nor with any other govt. department. The data related to such stores is not available with the government.

Following are the three different forms through which organized retail trade in India is carried out.

Table 1

Mono/Exclusive/Single Brand Retail Shops	Multi brand Retail Shops	Convergence retail Outlets
Exclusive showrooms either owned or franchised out by the manufacturer. A complete range of all the products manufactured by the said manufacturer under one brand name	In these kinds of stores almost all brands of a single product are available. Customer has a very wide choice	These kinds of outlets have almost all products which a consumer may need.
Focus is on brand name	Focus is on nature of product	Focus is on diverse consumer needs
Nike show room etc.	Shoppers stop, Croma	Big bazaar etc.

Source: caclubindia.com

Table 2
Global Retail Development Index

2012 rank	Country	Market attractiveness (25%)	Country risk (25%)	Market saturation (25%)	Time pressure (25%)	GRDI Score	Change in Rank Compared to 2011
1	Brazil	100	85.4	48.2	61.6	73.8	0
2	Chile	86.6	100.0	17.4	57.1	65.3	0
3	China	53.4	72.6	29.3	100.0	63.8	+3
4	Uruguay	84.1	56.1	60.0	52.3	63.1	-1
5	India	31.0	66.7	57.6	87.9	60.8	-1
6	Georgia	27.0	68.7	92.6	54.0	60.6	NA
7	UAE	86.1	93.9	9.4	52.9	60.6	+1
8	Oman	69.3	98.3	17.4	50.4	58.9	NA
9	Mongolia	6.4	54.4	98.2	75.1	58.5	NA
10	Peru	43.8	55.5	62.9	67.2	57.4	-3

Source: IMF, World Bank, World Economic Forum

As per retail development index, india remained high potential market with accelerated growth of 15 to 20 % expected over next 5 years. Growth is supported by strong macro economic conditions, including a 6to 7% rise in GDP, higher disposable income and rapid urbanization. Yet, while the overall retail market contributes to 14 % of India’s GDP, organized retail penetration remained low, at 5 to 6 %, indicating room for growth. In January, 2012 FDI limit for single brand went upto 100% with a condition that sourcing must be 30% local. The changing FDI climate provides many large multibrands with the opportunity to enter and exoand in Insdian market. Groceries remained India’s largest source of retail sale. Hypermarkets and supermarkets continues to be dominant. Private equity firms are more interested in retail sale. As many as 29 transactions were conducted in first half of 2011 in the retail consumer product space.

Table 3
Retail Talent* Index

2012 Rank	Country	**Talent availability (40%)	*** Labour regulation (20%)	****Labour Costs (40%)	Scores
1	Malaysia	62.8	77.9	85.7	75.0
2	China	56.5	71.3	79.0	68.5
3	Chile	66.7	56.7	68.5	65.4
4	Indonesia	51.0	55.9	84.5	65.4
5	Azerbaijan	42.1	95.9	72.5	65.0
6	India	48.5	64.2	75.6	62.5

Source: AT Kearney Analysis

*Retail Talent Index has been calculated based on countries performance in three areas: Talent availability, Labour regulations and cost of labour. A countries vale is indexed on 0-100 point scale to allow for relative comparisons across the areas.

**Scores are based on quality of educational system and management schools, secondary and tertiary education enrollment, labour force participation and brain drain.

***scores are based on hiring and firing practices and flexibility of wage determination.

****scores are based on retail salaries for an average sales associate and pay and prodivicity metrices , a high score indicates lower cost labour country

New markets are as effective as their workforces. Harnessing a local talent is crucial for the success of a firm. As per talent Index India ranks 6th among the countries. India has a large young, well educated and attractive labor market. India also provides an attractive pool of talent for international retailers. The retail sector provides employability to 85 workforces which is bound to increase in times to come. Retail not big preferred career choice among Indian youth, would pose a challenge for country’s retail sector, as skilled middle management people would no longer be available in the market. So role of providing training in retail to Indian youth is to be taken over by these retail giants. According to the index given in table 3 availability of talent in India is fairly good (>40%). Labor regulations in India are on higher side as the labor policies are not flexible enough. On labor cost front, cheap labor is available in India.

Table 4
Country Share in Global Organized Retail Sale

Country	Share of organized trade (per cent) (2003)
India	4
China	17
Poland	20
Indonesia	30
Russia	33
Brazil	35
Thailand	40
Malaysia	55
USA	85

Source: M+M Planet Retail

It is clear from the table 4 that India's share in organized world trade is only 4%, which is just a meager share. Keeping in view the financial reforms which have taken place in 2012, it can be forecasted that Indian market has lot of potential to grow. Because of this world's major retail stores in multi-brand category are eyeing on Indian market.

Table 5
Share of Private corporate in Worlds Organized Retail Sale

Rank	Company	Estimated share of private labels in 2004 (per cent)
1	Aldi	95
2	Schwarz Group (Lidl)	63
3	Target	46
4	Tesco	45
5	Casino	40
6	Wal-Mart	37
7	ITM (Intermarché)	35
8	Carrefour	32
9	Seven & I	27
10	Rewe	25

Source: M+M Planet Retail

Private labels today account for 17 per cent of global retail sales, with the highest share of 23 per cent in Europe and the lowest share of 4 per cent in Asia. M+M Planet Retail data shows that private label penetration varies from 25 per cent to 95 per cent among some of the largest retailers in the world. Growing acceptance among consumers, increasing price competition, the need for differentiation among retailers and the ability to offer higher margins are the key factors contributing to the growth of private labels. Private labels provide the retailer an ability to offer a

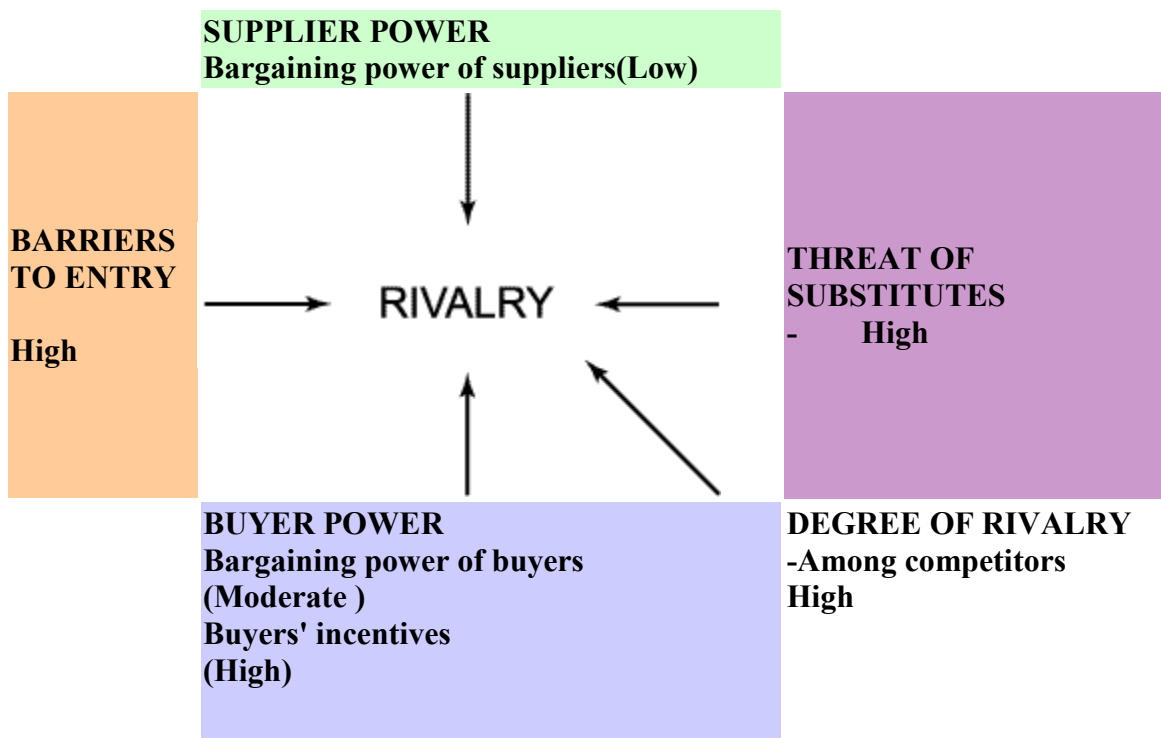
significant price advantage to consumers, their prices being 16 to 32 per cent lower than manufacturers' brands.

Impact Analysis

Impact of FDI on retail sector in India is analyzed using Michel Porter's model. Porter's five forces analysis is a framework for industry analysis and business strategy development. It draws upon industrial organization (IO) economics to derive five forces that determine the competitive intensity and therefore attractiveness of a market. Attractiveness in this context refers to the overall industry profitability. Three of Porter's five forces refer to competition from external sources. The remainders are internal threats. Porter's five forces include - three forces from 'horizontal' competition: threat of substitute products, the threat of established rivals, and the threat of new entrants; and two forces from 'vertical' competition: the bargaining power of suppliers and the bargaining power of customers.

Impact on Suppliers: When supermarkets modernize their procurement systems, they require more from suppliers with respect to volume, consistency, quality, costs, and commercial practices. Indian suppliers catering to the need of majority of retailers in unorganized retail sector may not be able to cope up with the new requirements by multinational retail giants in the beginning. Supermarket chains prefer, if they are able, to source from medium and large processing enterprises, which are usually better positioned than small enterprises to meet supermarkets' requirements. In order to be competitive these retailers would try to eliminate mediators in supply chain, which results in direct procurement from suppliers of raw material. In the beginning the supplier may not come to the expectation of the retailer in terms of quality and commercial practices. But it is also not possible for these retail giants to source everything from out of the country. So they have to train their prospective suppliers about the practices required by them. Ultimately when the supplier is supplying directly to the retailers, their returns would be better than the returns they are getting in existing supply chain, where a number of intermediaries eat into the returns of the supplier. When a supplier is fixed and trained by the retailer, the switching cost of supplier for a retailer would be very high. If the cost incurred by the retailer on supplier constitutes a major portion of the total cost then there would always a threat of vertical integration by the retailer and in the times to come the supplier may be working as a worker or the company. But in spite of these threats suppliers would be in a better position. During the course of time suppliers would also grow big along with the retailers. When suppliers enter supermarket channels, they tend to earn from 20 to 50% more in net terms. Among tomato farmers in Indonesia, for example, net profit (including the value of own labor as imputed cost) is 33–39% higher among supermarket channel participants than among participants in traditional markets. Farm labor also gains. But supplying supermarket chains requires farmers to make more up-front investments and meet greater demands for quality, consistency, and volume compared with marketing to traditional markets.

In a pan-Indian survey conducted over the weekend of 3 December 2011, overwhelming majority of consumers and farmers in and around ten major cities across the country support the retail reforms. Over 90 per cent of consumers said FDI in retail will bring down prices and offer a wider choice of goods. Nearly 78 per cent of farmers said they will get better prices for their produce from multi-format stores. Over 75 per cent of the traders claimed their marketing resources will continue to be needed to push sales through multiple channels, but they may have to accept lower margins for greater volume



Impact on Traditional Stores; Small and marginal traders constitute the biggest segment in service employment in the country, and they will be wiped out with the entry of foreign retailers. However, consumers in the large, urban and metropolitan cities are going to be benefited. The answer could be a co-existence. The major advantage for the smaller players is the size, complexity and diversity of our Indian Markets. If we look at the organized retail players, most of them have opened shop in the Metros, Tier 1 and Tier 2 towns. Very rarely do we find organized players in the rural areas and we have more than 70% of the population living in the rural areas. So megapolitan market would be served by the big retail stores and rural market would be served by Kirana stores. The successful deployment of 100%FDI in China is a case in point. Partial FDI in retail was introduced in 1992 in China. Subsequently, in December 2004, the Chinese retail market was fully opened up to utilize the enormous manpower and wide customer base available that has led to a rapid growth of the sector. Today, its retail sector is the second largest (in value) in the world with global retailers such as Wal-Mart, 7-Eleven and Carrefour comprising 10% of the total merchandise. FDI in multi-brand retail is therefore a necessary step that needs to be taken to propel further growth in the sector. This would not only prove to be fruitful for the economy as a whole but will also integrate the Indian retail sector with the global retail market

Impact on Barriers to Entry: It is not only incumbent rivals that pose a threat to firms in an industry; the possibility that new firms may enter the industry also affects competition. In theory, any firm should be able to enter and exit a market, and if free entry and exit exists, then profits always should be nominal. In reality, however, industries possess characteristics that protect the high profit levels of firms in the market and inhibit additional rivals from entering the market. Firms also may be reluctant to enter markets that are extremely uncertain, especially if entering involves expensive start-up costs. The existence of economies of scale creates a barrier to entry.

The greater the difference between industry Minimum Efficient Scale (MES) and entry unit costs, the greater the barrier to entry. Opening of retail sector for FDI would definitely increase the entry barrier for a firm intending to enter in this sector.

Impact on consumer: FDI in retail would create such an environment in which consumer in a true sense would be the king. The products and services provided by the retailers would move around the need satisfaction of the customers. Customers would be getting best quality at cheapest rate. Because a number of retailers would be struggling to target the same customer. In most countries supermarkets offer lower prices first in the processed and semiprocessed food segments.

Impact on business Rivalries: Firms strive for a competitive advantage over their rivals. The intensity of rivalry among firms varies across industries, and strategic analysts are interested in these differences. When a rival acts in a way that elicits a counter-response by other firms, rivalry intensifies. The intensity of rivalry commonly is referred to as being cutthroat, intense, moderate, or weak, based on the firms' aggressiveness in attempting to gain an advantage. In retail segment rivalry would be intense. It would result in welfare of the customers as companies strive their best to elate their customers so that they can capture the majority market share. To maximize the market share the firms would be resorting to product differentiation - improving features, implementing innovations in the manufacturing process and in the product itself, Changing prices and Exploiting relationships with suppliers.

Conclusion

The retail market in India offers an opportunity for large player to operate in retail business spanning multiple categories. Little wonder that large domestic business houses and international retailers have expressed a keen interest to enter the retail sector in India. To capitalize on the opportunity, however, players need to be aggressive in outlook and build scale quickly. FDI in retail will have a far-reaching impact on various aspects of the economy. If rolled out in phases and with proper checks and balances, it will give a boost to the economy. Customers will get a wide assortment of quality goods at reasonable prices. They will be able to buy the best brands across various categories.

Large investments in infrastructure would lead to a rise in farm productivity, manufacturing and food processing as well as cold storage facilities. This would cut down wastage and spur growth in employment, exports and GDP. It can also help revive the textile and handicrafts sector. With appropriate controls in place, our exports can double in three years.

The introduction of technology and good management practices will improve product availability, reduce wastage and improve quality and customer satisfaction. China is an example of successful execution of FDI in retail in a phased manner. After FDI in retail, Chinese retailers still hold a majority of retail share. The number of small retailers has doubled. Also, exports and GDP growth has continued unabated in that country. China continues to dominate global trade through large-scale FDI investment in the country. So it can be concluded that FDI is a double edged sword which if not handled well can harm the Indian economy and if handled well can act as a panacea for economy.

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