



FDI in Indian retail sector: Challenges and opportunities

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Abstract

Foreign Direct Investment (FDI) plays a vital role in economic development e.g. increasing purchasing power of people, improvement in infrastructure, and brand proliferation with increasing awareness of consumers. FDI in retail in India has always been a contentious issue. The government has been progressively liberalising the retail sector in India for foreign direct investment. The last major move came in 2012 when 100% FDI was allowed in single-brand retail. FDI as an important means to reorganize the production facilities globally is regarded as an important vehicle for economic development particularly for developing economies. Indian government promotes FDI in retail sector by providing up to 51% for single brand segment and 100% in wholesale segment. It gives an opportunity for the global retail giants to enter India. In this paper an effort has been made to highlight on retail industry along with the opportunities of FDI in retail sector and the major challenges that it faces.

Keywords: Capital Infusion, FDI, Indian retail sector, multi brand retail trading, single brand retail trading

Introduction

India being most-populous country has immense scope for retail expansion as along with time urbanization and consumerism has also been increasing. Further, India's GDP has also been growing at fast rate as it continued to be the second fastest growing economy in the world after China and as the income of the country increases, demand for goods also increases because there is positive relation between demand and income. Initially India was conservative regarding FDI; it imposed restriction on foreign companies to limit their share in equity capital of their Indian subsidiaries but over the time Government of India gradually liberalized foreign investment in various sectors. In 2011 India permitted 100% FDI in single brand retail and in 2012, 51% FDI permitted in multi brand. In this paper we are analysing the impact of such decision on various sectors like food retail sector, farmers, traditional & employment and food inflation.

In the last twenty years since the economic liberalization of India in 1991, India's middle class has significantly expanded, and so has its expanding purchasing power. However, over the years, unlike other major emerging economies, India has been slow to open its retail sector to foreign investment. Foreign Direct Investment (FDI) is defined by the Reserve Bank of India (RBI) as when a foreign company wants to establish any business operation in India which may include company under the company Act, 1956 (joint venture or wholly owned subsidiary) or set up a Liaison office or project office or a branch office of the foreign company which can undertake activities permitted under the Foreign Exchange Management Regulation, 2000.

At present, almost all the developing countries liberalizing their FDIs and India is not different. Since liberalization India's Gross Domestic Product (GDP) has been increasing and India's middle class has expanded as well. India has been slow in opening economy for FDI in retail sector, but recent policy changes suggest that perspective of government is changing. In 2006, the government first time relaxed retail policy and since then, there has been gradual increase in FDI in the retail sector. It may bring in investment in completely backward area like infrastructure required for Food transfer from farmers to consumer that will improve efficiency in food sector, we can expect that retail sector will become organized and will save farmers from middlemen exploitation or it may also result in job loss in unorganized sector, it may become tough to procure food for Public Distribution System (PDS). In this paper we will study few aspects of FDI liberalization into retail sector; mainly we will study effect of FDI in food retail sector, farmers, traditional & employment and food inflation.

Retail Sector in India

The Indian retail sector is a vibrant and integral component of the nation's economy. It contributes significantly to the Indian GDP and employs millions. As a crucial link between producers and consumers, the retail industry plays a pivotal role in shaping consumption patterns. India's retail sector boasts an impressive market size, ranking fourth globally and contributing over 10% to the nation's GDP. In 2022, the market stood at a staggering INR 91,891 billion, and it's projected to surge at a CAGR of more than 13% by 2027. This phenomenal growth signifies a thriving ecosystem fuelled by a confluence of factors, including:

- **Rising disposable incomes:** With a burgeoning middle class and increasing disposable incomes, consumer spending power is on the rise, driving demand for a wider range of products and services.

- **Rapid urbanization:** The rapid migration of people towards urban centres is creating new consumer pockets with evolving needs and preferences.
- **Technological advancements:** The widespread adoption of smartphones and internet connectivity has fuelled the growth of e-commerce, offering greater convenience and choice to consumers.

India is the world's fifth-largest global destination in the retail space. India is the world's fifth-largest global destination in the retail space and ranked 63 in the World Bank's Doing Business 2023. The sizeable middle class and nearly unexplored retail market in India are the main enticing factors for international retail behemoths seeking to move into newer markets, which will help the Indian retail business grow more quickly. The urban Indian consumer's purchasing power is increasing, and branded goods in categories like apparel, cosmetics, footwear, watches, beverages, food, and even jewellery are gradually evolving into business and leisure that are well-liked by the urban Indian consumer. The retail sector in India is expected to reach a whopping US\$ 2 trillion in value by 2032, according to a recent analysis by the Boston Consulting Group (BCG).

FDI in the Retail Sector

Foreign direct investment (FDI) in retailing is not 100% permitted under Indian statute or law. As per the latest policy issued by the Department of Industrial Policy and Promotion (DIPP), 100% Foreign Direct Investment (FDI) is allowed in case of Single Brand Retail Trading (SBRT) and duty-free shops through an automatic route. FDI in the retail trading sector in India means that foreign businesses or companies in specific categories can sell their products via their own retail shops in the domestic market. The Government of India has permitted FDI for specific brands or products in the retail trading sector. As of now, India is a developing country. FDI must be promoted but kept under control as it can affect the country's economy.

The Indian retail market is approximately USD 600 billion. Economic value shows it is among the top five retail marketplaces worldwide. With a rising population of more than a billion people, it is also one of the marketplaces that are expanding the fastest. The retail market is anticipated to expand significantly. By 2020, the retail market is anticipated to have grown to USD 1.1 trillion. By 2020, overall consumer spending will amount to roughly USD 3600 billion. Also, online retail sales are predicted to increase by more than 30%.

With the sector accounting for around 10% of the Gross Domestic Product, retail is one of the economic foundations of the Indian economy. Just 9% of this industry is organised, and the unorganised sector dominates. In India, the unorganised retail industry employs 7% of the total labour force. Most retailers utilise smaller than 500 square feet of retail space.

The introduction of FDI in the retail sector in India has been a contentious issue, with proponents arguing that it would bring in much-needed investment and modernize the sector. At the same time, opponents fear it would lead to the displacement of small businesses. Despite some challenges, several international retailers have entered the Indian market since introducing the policy in 2012.

FDI in Single Brand Retail Trading (SBRT)

Single Brand Retail Trading (SBRT), where the products are sold under a single brand name domestically and internationally, Foreign Direct Investment in Single Brand Retail Trading (SBRT) sector is aimed at attracting foreign investments in manufacturing and marketing, enlarging the vacuity of similar products for their consumer, encouraging the sourcing of goods from India, and perfecting the competitiveness of Indian companies or market through access to world level designs, technological infrastructures and administrating practices. The Government of India has now permitted 100% FDI under its automated route for SBRT.

Previously, the FDI policy of Single Brand Retail Trading allowed only 49 % FDI under the automatic route and FDI beyond 49 % and up to 100% through the Government approval route. The FDI in retail in India has evolved tremendously from traditional village fairs and street hawkers or vendors to splendid malls and organized stores. Currently, the retail sector contributes more than 10 percent of the Gross Domestic Product (GDP) and is forecast to grow to USD 1.1-1.3 trillion by 2025 from USD 0.8 trillion in 2020.

However, The Indian retail sector is quite unorganized and highly decentralized and more than 90% of retail trade consists of small trading retail outlets or business and some mom-&-pop stores. As compared to other developed countries, the share or portion of organized retail trade in India is hardly 12% as compared to 80% in the USA or 20% in China.

Even an increase in purchasing capacity, educated youth and rising middle class has changed the face of the retail industry in India. Similarly, the government of India liberalized its policy with respect to the FDI retailing through supermarkets, department stores and other forte outlet chains. As retail giants such as Amazon & Tesco and Marks have already made inroads into the Indian retail sector, the retail industry is expected to get stronger.

FDI in Multi Brand Retail Trading (MBRT)

Multi Brand Retail Trading (MBRT) sells products of different brands under an umbrella domestically and internationally. For example, Amazon, Walmart, Shopper Stop, Carrefour, etc.

Foreign Direct Investment (FDI) in Multi Brand Retail Trading (MBRT) has been a contentious issue in India for many years. In 2012, the Indian government opened the MBRT sector to FDI, allowing foreign companies to

own up to 51% of Indian retail ventures. However, many restrictions and conditions were imposed to safeguard the interests of small retailers and farmers.

The minimum investment must be \$100 million, with 50% of it going towards backend infrastructure, such as cold storage and transportation facilities. The FDI can only be allowed in cities with more than 1 million population. The foreign retailer must source at least 30% of its goods from small and medium-sized Indian suppliers. Despite these restrictions, there has been significant opposition to FDI in MBRT from various political parties and traders' associations, who fear that it will lead to the displacement of small retailers and the exploitation of farmers.

However, proponents of FDI in MBRT argue that it will lead to increased investment in the retail sector, improved supply chains, and greater efficiency, ultimately benefiting consumers and small retailers. Many multinational retail companies such as Walmart, Tesco, and Carrefour have not entered the Indian market due to the various conditions and restrictions imposed by the Indian government. As such, the impact of FDI in MBRT in India is yet to be fully realized.

Impact of FDI in Retail Sector

Retailing is not an activity that can boost GDP by itself. It is only an intermediate value-adding process. If there aren't any goods being manufactured, then there will not be many goods to be retailed, thus underlining the importance of manufacturing in a developing economy. The opening of Indian retail sector to Foreign Direct Investment (FDI) is considered a win-win situation for farmers. Farmers would benefit significantly from the option of direct sales to organized retailers. The profit realization for farmers selling directly to the organized retailers is expected to be much higher due to transparency than that received from selling in the mandis/small markets.

FDI in multi-brand retail is likely to result in increase in investments and growth in Indian retail sector, which is ranked amongst the top retail destinations in the world. Besides new entrants / joint ventures, this could also result in combination of existing cash and carry operations of foreign players with retail operations of Indian retailers, or, foreign retailer acquiring stakes in existing Indian retail entity. Also, this could provide further options to existing Indian retail chains / groups to raise long term capital for expansion. Foreign multi brand retailers may now explore Indian presence by having stake in Indian retail company.

- **Growth and Improvement in Retail capability building:** Due to lack of retail experience & capability there has been subdued growth in these years. FDI in retail will make way for inflow of knowledge from international experts which can give boost to the overall growth of the industry. Apart from financial investments, capability building is extremely important for the industry.
- **Greater availability of jobs:** With the advent of FDI in retail sector there shall be more job and employment opportunities. New technologies and its diffusion will provide new talents and cater to the needs of many.
- **Boost to Infrastructure and improvement in management of supply chain:** FDI in retail will boost investment in infrastructure from the retail players, 3rd party supply chain companies as well as the Government in the back of a sophisticated front end that international players are likely to bring. This will improve the efficiency of the supply chain, which will bring down the wastage, increase efficiency and reduce the overall cost to the consumer.
- **Push to productivity-The Farming Community in India:** The productivity in food & agriculture is one of the areas where there is a significant opportunity for up-liftment of output with investment in better farming practices. FDI in retail will mean that the farming community will have a new support group with a common interest which is expected to give a great push to productivity. The small farmers shall reap better profits by direct approach to suppliers without the aid of middlemen.

Advantages and Disadvantages of FDI in the Retail Sector in India

FDI in retail will thrust the organized retail market, positively impacting several shareholders, including producers, manufacturers, workers, employees, consumers, the government, and thus, the overall economic growth.

The following may be regarded as major perceived benefits of allowing FDI in retail in India:

- **Capital Infusion:** This would provide an opportunity for cash-deficient domestic retailers to bridge the gap between capital required and raised. In fact FDI is one of the major sources of investments for a developing country like India wherein it expects investments from Multinational companies to improve the countries growth rate, create jobs, share their expertise, back-end infrastructure and research and development in the host country.
- **Boost Healthy Competition and check inflation:** Supporters of FDI argue that entry of the many multinational corporations will obviously promise intensive competition between the different companies offering their brands in a particular product market and this will result in availability of many varieties, reduced prices, and convenient distribution of the marketing offers.

- **Improvement in Supply Chain:** Improvement of supply chain/ distribution efficiencies, coupled with capacity building and introduction of modern technology will help arrest wastages (in the present situation improper storage facilities and lack of investment in logistics have been creating inefficiencies in food supply chain, leading to significant wastages).
- **Improvement in Customer Satisfaction:** Consumers in the organized retail will have the opportunity to choose between a number of internationally famous brands with pleasant shopping environment, huge space for product display, maintenance of hygiene and better customer care. There is a large segment of the population which feels that there is a difference in the quality of the products sold to foreign retailers and the same products sold in the Indian market. There is an increasing tendency to pay for quality and ease and access to a “one-stop shop” which will have a wide range of different products. If the market is opened, then the pricing could also change, and the monopoly of certain domestic Indian companies will be challenged.
- **Improved technology and logistics:** Improved technology in the sphere of processing, grading, handling and packaging of goods and further technical developments in areas like electronic weighing, billing, barcode scanning etc. could be a direct consequence of foreign companies opening retail shops in India,. Further, transportation facilities can get a boost, in the form of increased number of refrigerated vans and pre-cooling chambers which can help bring down wastage of goods.
- **Benefits for the Farmers:** Presumably, with the onset of multi-brand retail, the food and packaging industry will also get an impetus. Though India is the second largest producer of fruits and vegetables, it has a very limited integrated cold-chain infrastructure. Lack of adequate storage facilities causes heavy losses to farmers, in terms of wastage in quality and quantity of produce in general, and of fruits and vegetables in particular. With liberalization, there could be a complete overhaul of the currently fragmented supply chain infrastructure. Extensive backward integration by multinational retailers, coupled with their technical and operational expertise, can hopefully remedy such structural flaws. Also, farmers can benefit with the “farm-to fork” ventures with retailers which helps (i) to cut down intermediaries; (ii) give better prices to farmers, and (iii) provide stability and economics of scale which will benefit, in the ultimate analysis, both the farmers and consumers.
- **Creation of More and Better Employment Opportunities-** The entry of foreign companies into Indian Retailing will not only create many employment opportunities but, will also ensure quality in them. This helps the Indian human resource to find better quality jobs and to improve their standard of living and life styles on par with that of the citizens of developed nations.

Critics of FDI are of the opinion that it will adversely affect the unorganized retailers and farmers. It will also lead to imbalanced development. Major challenges of FDI in India are

- **Domination of Organized Retailers:** FDI in single-brand retail will strengthen organized retail in the country. These organized retailers will tend to dominate the entire consumer market. It would lead to unfair competition and ultimately result in large-scale exit of domestic retailers, especially the small family managed outlets (local “mom and pop” stores will be compelled to close down).
- **Create Unemployment:** Retail in India has tremendous growth potential and it is the second largest employer in India. Any changes by bringing major foreign retailers who will be directly procuring from the main supplier will not only create unemployment on the front-end retail but also the middleman who have been working in this industry will be thrown out of their jobs.
- **Loss of Self Competitive Strength:** The Indian retail sector, particularly organized retail, is still under-developed and in a nascent stage and that, therefore the companies may not be able to compete with big global giants. If the existing firms collaborate with the global biggies they might have to give up at the global front by losing their self-competitive strength.
- **Indirectly Leads to Increase in Real Estate Cost:** It is obvious that the foreign companies which enter into India to open up their malls and stores will certainly look for places in the heart of the cities. There shall be a war for place, initiated among such companies. It will result in increase in the cost of real estate in the cities that will eventually affect the interest of the ordinary people who desire to own their houses within the limit of the cities.
- **Distortion of Culture:** Though FDI in Indian retail will indirectly or directly contribute for the enhancement of Tourism, Hospitality and few other Industries, the culture of the people in India will slowly be changed. The youth will easily imbibe certain negative aspects of foreign culture and lifestyles and develop inappropriate consumption pattern, not suited to our cultural environment.

Summing-up

Retail sector is an important pillar of Indian economy and is growing at a fast pace and the changes taking place in this sector are making it attractive for foreign investment. Being a member of WTO, India had to open retail sector to FDI. In such an environment on 20 September 2012 the Government of India approved 51% FDI in multi-Brand retail and 100% in single brand retail sector through Government route with some riders. Allowing healthy FDI in retail sector wouldn't only lead to substantial surge in the country's GDP and overall economic development Opening retail sector to FDI would be beneficial in terms of price, employment generation, capital infusion. Opponents of FDI in retail argue that it will bring major job losses but frankly it will cause only re-distribution of jobs with drying up (like middlemen) and new ones sprouting up. So, FDI in retail sector in India has both pros and cons, it depends only on the way of implementing in our country. Thus, the priority steps would be according to Industrial environment of retail sector of India. FDI may be promoted but must be kept under control to ensure that big retailers do not dislocate small retailers by unfair means.

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