FDI in Retail Sector

Is it a Boon or Bane?

India in general and its retail business in particular has become a destination for Foreign Direct Investment (FDI). Recently, the government decided to allow 26% FDI in the retail sector. There are discussions going on in various quarters of the industry and business on whether it is appropriate to allow FDI in the retail sector. This debate puts forth some expert opinions on the decision.

PT Giridharan
Joint Director,
The Institute of Chartered Accountants of India.

Sundar Sankaran
Director,
Advantage-India Consulting Private Limited.

Nitisha Patel
Economist,
Watson Wyatt Worldwide.

Chowdari Prasad
Associate Professor,
TA Pai Management Institute.

❑ FDI was not allowed in the retail sector earlier. But suddenly the government is encouraging FDI in the retail sector. In what way will it be beneficial to the Indian consumers or producers?

PT Giridharan

The sudden move may not have any pervasive effect on the producers or consumers. Indian consumers or producers stand to substantially gain from the proposal to allow FDI in the retail sector. Consumers stand to gain as a result of the cost reduction at the level of the producers. Wastage in food and agro-based products can be minimized. FDI in retail sector means amplified employment, and prices in the departmental stores will be comparatively low, resulting in increased business for the producers and savings for the consumers. Ever since the implementation of the LPG (Liberalization, Privatization and Globalization), the country has witnessed several changes in different sectors, namely manufacturing, service, etc., on a large scale, and now the focus of attention is on the retail sector. The changes in different sectors evinced a lot of interest by foreign entrepreneurs and attracted massive inflow of FDIs. This has generated a lot of employment opportunities and the country is looked upon as a top destination for investment market.

Sundar Sankaran

The Indian consumers will get a wider choice of brands and product categories. Shopping experiences will be of international quality. They will meet the stated and unstated aspirations of consumers.

Producers will have several benefits:

- As significant proportions of the market shift to the organized sector, a producer's problem of counterfeit products will be reduced.
- Consumer financing schemes offered by the retailers too will help the producers.
- The congregation of focused consumers under a few roofs will give a boost to low-cost POP displays and marketing campaigns, thus minimizing the advertising costs for the industry.

Note: The views expressed by the participants are their own, and do not necessarily represent the views of the organizations they are associated with.

- Besides, the consumer and product tracking mechanisms of the organized retailers will provide useful product, consumer, and channel feedback to manufacturers. This will help them formulate better business strategies.
- Lastly, producers will be able to crash their supply chain, by having real-time networks with the retailers. This will help minimize the inventory holding cost, response time to market, etc. The resulting economic benefits might be shared by producers and consumers.

However, it won't be all hunky-dory for producers. We need to realize that their bargaining power will diminish. A retail chain contributing significantly to the turnover of the producer, will be able to negotiate hard bargains with the producer. This benefit again may flow to the consumers.

Nitisha Patel

With high GDP growth, increased consumerism, and liberalization of the manufacturing sector, India is being portrayed as an attractive destination for FDI in retailing. FDI in this sector will be beneficial to both consumers and producers in various ways. Consumers will benefit from increased range of products which the foreign retailers would offer. There will also be an improvement in the quality of services offered {these includes consistency, standardization, branding (including private labels), pricing, pre-sale activities, after-sale support, etc.}. It is generally perceived that FDI in the retail sector will be concentrated in the major cities and the rural consumers will not be affected by this. However, the rural consumer will benefit indirectly. The manufacturers are gearing themselves to face the competition from the global grocery retailers. Manufacturers such as HLL, ITC, Godrej, DCM Sriram Consolidated, and Reliance are setting up retail outlets in rural areas on the assumption that there is a huge untapped market in the rural areas and that even if FDI is allowed, foreign retailers will not enter rural areas in the first stage of their operation. ITC has already launched its first rural hypermarket at Sehore in Madhya Pradesh. Hence these developments, that have started taking place in India to face the competition from foreign retailers, are going to be beneficial to the rural consumers too.

Producers will also benefit from the increased demand for their products with the entry of foreign retailers. Foreign retailers would source products for their retail stores domestically. Based on the observation in other countries where FDI in retail is allowed (China, Brazil, etc.), foreign retailers would also source products for other international markets. Thus, Indian manufacturers will get an opportunity to showcase their products to foreign retailers. There will also be technology flows with the entry of foreign retailers. Players such as McDonald's and Metro Cash & Carry GmbH have already entered India, and are providing the best international practices to Indian farmers. For instance, McDonald's and its suppliers have worked closely with farmers in places like Ooty and Pune to cultivate high quality lettuce. This included sharing advanced agricultural technology and expertise, like utilization of drip-irrigation systems that reduced overall water consumption and agricultural management practices which resulted in greater yields. Also, the foreign retailers will source products from the farmers directly. This would mean better margins to them as compared to what they would get from selling to intermediaries. Organized retailers such as RPG now directly source from the farmers and offer better returns to them.

Chowdari Prasad

The Indian economy has been undergoing transformation in the last fifteen years. Economic reforms commenced in early1990s in the aftermath of the disastrous political cum economic conditions prevailing in late 1980s, when GOI had to pledge its gold. Abolishing of License Raj and reforms all over—in legal systems, industrial relations, capital market, banking, technology, etc.—have brought good to the country. Stability in the economy and politics made rich countries to invest in India. This has certainly led to our attaining high and global standards, and in turn, more business opportunities as well as employment to the youth.

❑ The government's action is attracting criticism from certain quarters of the economy. Is this criticism justified? Why?

PT Giridharan

The criticism is not new and rather it is unfounded. It is basically a fear factor that retail segment, especially the Small and Medium Enterprises (SMEs), will vanish. Today, the retail segment is fragmented, contributing only 10 to 14% of the country's GDP. Twenty-one million people are employed in the sector, which is 7% of labor force. In order to further amplify employment and growth of the economy for a projected scale of, say at least, 7 to 10%, the retail business is an important segment which has to be made global.

Sundar Sankaran

The criticism is not justified. Certain political parties are seeking to protect their electoral constituencies. We are overprotecting small traders and their employees to the detriment of the consumers.

We need to recognize that the small trader will still have a USP of locational convenience, personal touch, and easy transactions. But we cannot deprive consumers of their right to wider choice of brands and product categories, the comfort of complete shopping under one roof, and their desire to convert mundane shopping to an experience for the family.

Nitisha Patel

I don't think the criticism is justified. Those against FDI in retailing have argued that large international retailers can upset the import balance, by preferring to source more globally rather than investing in local production. However, India has significant competitive advantage in terms of low-cost labor, availability of raw materials, etc., and many foreign retailers such as Arrow, Levis, JC Penny, Wal-Mart, and GAP are already sourcing their products from India. With rising labor cost in the developed countries, many companies are shifting their operations to developing countries like India and China. The Indian government has also shown a keen interest in developing the country as an international sourcing hub for certain products like shoes, textiles, etc.

Another criticism which has been put forward is that foreign retailers would practice predatory pricing in India. Studies, however, have shown that the non-competitive nature of the current retail industry is resulting in steeper prices for consumers and higher margins for retailers. Allowing FDI will increase competition which will force domestic retailers to improve productivity and efficiency, and this will in turn lead to lower prices. All around the world, organized retailing has reduced consumer prices of basic-food products (relative to overall inflation) and greatly reduced the share of basic food in the overall consumer expenditure basket.

Chowdari Prasad

The said criticism is not justified. We had a clear picture of pre and post reforms with regard to economy, employment, industrial production, GDP growth rates, inflation, interest rates, etc. Today, the realistic efforts made by the successive governments and the Planning Commissions are yielding results. In an environment of LPG, the country cannot be closed for certain activities and open for some other. If we want to increase our exports, invite more MNCs and BPOs as well as foreign banks, we should also invite investment in stock markets, and be prepared to allow foreign exchange outflows in interest and dividend payments.

❑ Do you think allowing 26% FDI is sufficient? If not, what are your suggestions in this regard?

PT Giridharan

At the preliminary stage, allowing 26% FDI does not create any alarm for concern. The government is yet to release an official policy on the matter and opening the floodgates of FDI to retail sector can be gradual.

Sundar Sankaran

Frankly, we should not worry about even 100% FDI. Twenty-six percent might be more easily palatable, politically.

Nitisha Patel

I don't think 26% FDI will attract many foreign retailers. In my opinion, FDI up to 49% should be allowed. This will provide an opportunity for the domestic players to enter into joint-venture agreements. While the entry of foreign players will ease the financial pressures and bring in technical know-how and best management practices, the domestic players will retain control over the company through the majority holding. Joint ventures with foreign players will enable Indian organized retailers to access the international market.

Chowdari Prasad

To begin with, it is alright to invite 26% FDI in any sector including retail. But, we have already had experiences in other sectors and so in order to capitalize on opportunities, higher percent of FDI, say up to 74%, can be permitted in the retail sector. Banking is the best example, where transparency, technology, and competition are playing a vital role in improving efficiency of the system. "Survival of the Fittest" can be the policy in a perfect competitive environment. When a Communist country like China can welcome FDI, India need not lag behind to seek FDI in retail sector.

❑ Many influential people have commented that it is too early to allow FDI in retail sector. Does it make any difference, if the sector is first allowed to grow in size and then FDI is permitted in this sector?

PT Giridharan

Ever since the Industrial Policy Resolution, 1956, there has been a tendency to believe that protection to small units is beautiful especially since the protection available to big enterprises is bountiful. Allowing the sector to grow first and then permitting FDI is a retrograde step at this juncture.

Sundar Sankaran

The consumer will benefit from immediate FDI. Postponement will only serve the interests of the existing organized retailers. They can command a higher premium, when they dilute their shareholding in favour of joint-venture partners. The first level of dilution will take foreign holding to say, 26%. Subsequently, when the government relaxes the foreign holding limit, a further dose of dilution could happen at a higher valuation. This would benefit the existing organized retailer.

We also need to recognize the trickle-down benefit of FDI in retail. Once the JV partner feels comfortable with sourcing from India, it is highly likely that the partner will use India as a sourcing base for more products for their retail chains across the world. This benefit, which goes much beyond retail, will be missed by postponing FDI in retail.

Nitisha Patel

Foreign retailers are allowed to enter the Indian market if they set up manufacturing facilities or source products from the country on a franchising basis, and if they have wholesale cash and carry operations, etc. Hence, the existing ban on FDI has not acted as an entry restriction. On the contrary, by imposing the ban, the country is losing foreign investment while foreign players can access the market through various alternative routes. So, I suggest that FDI should be allowed. However, before we allow foreign players to enter our market, we need some policy reforms. There are many laws governing the sector and impeding its growth. Several state taxes have caused problems in the inter-state movement of goods, due to which domestic organized retailers have not been able to establish an efficient supply chain network. When FDI is allowed, the entry norms should clearly state the approval requirements, conditions/restrictions imposed, if any, etc. The government should also strictly enforce the quality standards for local production and imports.

Chowdari Prasad

No. We cannot wait for long, indefinitely vacillating on such decisions. Who are these influential people? What is their primary interest? How can the sector grow on its own strength without sufficient capital, technology, and expertise to back it up? We have spent more than 55 years as a Republic under planned era, but are still struggling to achieve the high standards. In contrast, our youth and intelligentsia (like IITians, IIM grads, academicians and scientists) are serving in other advanced countries, producing rich results.

❑ The retail sector requires huge investment in infrastructure and working capital. It may take more than two years to break-even, which means there is a risk. Do you think the Indian entrepreneurs have the required funds to invest and the ability to bear the risk involved?

PT Giridharan

The unorganized sector accounts for 98% of the retail business in India. There will be a tremendous growth in this segment in the next five years and it will require Rs. 110,000 cr, if the growth rate is to increase from the present level of 3 to 9% in 2010. In the era of M&A happening globally, restructuring is a *sine qua non* of prosperity and survival in the midst of global competitiveness. The risk element can be hedged and effectively arbitraged, if FDI is allowed.

Sundar Sankaran

Funding is not a problem. VCs are willing. The only issue is the retailing format. Those who blindly follow the international formats, will fall flat, and break-even will not happen even after five years. There will also be consolidation between retail outlets located too close to each other for any of them to make money.

Nitisha Patel

Not all of them, certainly! Organized sector still constitutes 2% in the total retail sector. Very few players in India have the deep pockets to take such a risk. Also, retailing is not regarded as an industry and as a result banks and financial institutions are not willing to invest in this sector. For the past few years, retailers' associations have been fighting for the industry status for this sector. Pantaloon, Trent and Shoppers' Stop have shown a way forward in accessing capital market and have got themselves listed in the stock market, which shows their appetite for risk. Foreign retailers who enter the Indian market may also raise capital in this way. This would bring in additional investment as small investors might invest in a foreign retail company listed in India, instead of investing in the same company listed in the US stock market.

Chowdari Prasad

The need for intensive investment in infrastructure was realized very late in India. Successive governments at the Center or State level, are unable to mobilize adequate funds and deploy them gainfully. Roads, railways, airports, bridges, industrial estates, telecommunication, water management (also linking of rivers), power sector, etc., are all starving for funds to grow and catch up with increasing demands. However, retail sector is catching up in the last four to five years, with malls, multiplexes, medical and health facilities, education, etc., and should receive adequate funds to meet the changing quality of life of an average Indian of the 21st Century. Indian Entrepreneurs have limited funds and risk-taking ability. Two years' break-even period is not a long wait in any business—large or medium or small scale, including retail business.

❑ Critics say that the FDI will result in unemployment in the country and that there may not be sufficient capital inflows, if the foreign players resort to borrowings from the banks in India.

PT Giridharan

These apprehensions were not well founded. Wall-Mart or Carrefour or other big stores became big because of the application of modern retailing and distribution concepts, and by bringing down the costs to 3% of sales as compared to 4.5% in the case of others. It is pointless political annotations on the subject matter, which deliberated debate on the matter. Big industrial units in India too believe that market for them lies ultimately in the retail segment and are exploring avenues on a long-term perspective. The argument that foreign players will resort to borrowings from banks in India is vague. Debate on politics is good. Politicizing for debate is no good. This adage holds good here too.

Sundar Sankaran

In fact, more jobs will get created:

- There would be a direct impact, when various support personnel will get recruited in the outlets. People, who would never have imagined that they would work in the organized sector, will be happy to find themselves there.
- Besides, the trickle-down benefit: When the JV partner makes India a base for international sourcing, more jobs will get created outside the retail sector, in several industries.

As regards to capital flows, the government can always insist on a certain minimum inflow from outside. Precedent for such a policy exists in the financial services sector. So long as that criterion is met, the government need not break its head on issues such as the proportion of debt in the project cost, and their source. The JV partner would have as much of an interest, if not more, in ensuring that the project succeeds.

Nitisha Patel

As I just pointed out that banks have been reluctant in lending to the retailers, foreign players will invest their own capital. The amount of investment that will have to be made, is enormous. Indian retail sector still suffers from underdeveloped and inefficient supply chain network and setting up an efficient supply chain network is an essential prerequisite for successful operation. As mentioned earlier, those foreign players that have operations in India (such as McDonald's, and Metro Cash & Carry Gmbh) have made significant investments in setting up supply chain networks and in transferring best management practices to the farmers.

Impact of the entry of foreign retailers on employment will be similar to that of the domestic organized retailing. It is believed that organized retailing would create more employment for educated youth, but there may be loss of employment among uneducated people in the unorganized sector. Thus, there may be new employment opportunities for certain categories of people while others may face unemployment. However, there will also be the creation of employment in industries such as agro-food processing. The development of the food processing industry is directly related to the demand for processed food which is generated by organized retailing.

Chowdari Prasad

It may happen in the initial stages, but in the course of time, the ancillary services will provide employment opportunities and the system will get balanced quickly. In the recent years, even Indian corporates have stopped borrowing from local banks at high rates of interest and are looking outside (like GDRs, ADRs, etc). Capital inflows in the form of FDI or FII will continue to be there, not only on the grounds of policy of the governments, but several other factors like rates of return, taxation, depreciation, foreign exchange remittance (repatriation) policies, besides economic and political stability. It is high time that all those who are against relaxations in FDI to India give a close look and correct their misapprehensions.♦

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