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IMPACT OF FOREIGN DIRECT INVESTMENT (FDI) ON INDIAN ECONOMY

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Abstract

Foreign direct investment ***(FDI)*** *or foreign investment refers to the net inflows of investment to acquire a lasting management interest (10 percent or more of voting stock) in an enterprise operating in an economy other than that of the investor. It is the sum of equity capital,other long-term capital, and short-term capital as shown in the balance of payments. It usually involves participation in management, joint-venture, transfer of technology and expertise. There are two types of FDI: inward foreign direct investment and outward foreign direct investment, resulting in a* **net** *FDI* **inflow** *(positive or negative) and "stock of foreign direct investment", which is the cumulative number for a given period. Direct investment excludes investment through purchase of shares.*

***Keywords**: **FDI**, UNCTAD, WalMart, FICCI, Unorganised retailing, retail market*

Foreign Direct Investments in India

Starting from a baseline of less than $1 billion in 1990, a recent UNCTAD survey projected India as the second most important FDI destination (after China) for transnational corporations during 2010-2012. As per the data, the sectors which attracted higher inflows were services, telecommunication, construction activities and computer software and hardware. Mauritius, Singapore, the US and the UK were among the leading sources of FDI.

FDI in 2010 was $24.2 billion, a significant decrease from both 2008 and 2009. Foreign direct investment in August 2010 dipped by about 60% to aprox. $34 billion, the lowest in 2010 fiscal, industry department data released showed. In the first two months of 2010-11 fiscal, FDI inflow into India was at an all-time high of $7.78 billion up 77% from $4.4 billion during the corresponding period in the previous year.

The world's largest retailer WalMart has termed India's decision to allow 51% FDI in multi-brand retail as a "first important step" and said it will study the finer details of the new policy to determine the impact on its ability to do business in India.

Impact on 51% FDI on India

The decision to hold back FDI in multi-brand retail will have a strong impact on the domestic and foreign investor sentiment, another chamber, the Confederation of Indian Industry (CII), said in a release. "We firmly hope that this would not be a rollback and a quick consensus is reached," CII Director General Chandrajit Banerjee said.

Describing the volte face as a case of "missed opportunity", Assocham Secretary General D S Rawat said, "It will send a very negative message to foreign investors."

FICCI urged the government to move ahead with this progressive reform and proposed solutions like considering a maximum of 49 per cent FDI in multi-brand retail and increasing the percentage of sourcing from the small scale sector, which was proposed to be fixed at a minimum 30 per cent.

Impact in Tamil Nadu

Chennai, Nov 27: Opposing the government policy of allowing 51 percent FDI in multi-brand retail sector in India Tamil Nadu Chief Minister J Jayalalithaa on Sunday (today) said that she would not allow multi-brand global palyer to set up hyper markets in Tamil Nadu.

Jayalalithaa further said that government should reverse its “ill advised” move as it will monopolise the market, exploit farmers and consumers. “I am constrained to state that my government will not allow the multi brand global players as permitted under the new policy to set up their hyper markets in Tamil Nadu,” Jayalalithaa declared.

The government new FDI retail policy to allow 51% foreign direct investment (FDI) in multi-brand retail segment will permit world’s top retail giant like Walmart, Carrefour and Tesco to set up market in the country. Earlier, such retailers were not allowed to coduct retail business in India.

Current Indian Market Situation

Retailing in India is one of the pillars of its economy and accounts for about 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.

Organised retailing, absent in most rural and small towns of India in 2010, refers to trading activities undertaken by licensed retailers, that is, those who are registered for sales tax, income tax, etc. These include the publicly-traded supermarkets, corporate-backed hypermarkets and retail chains, and also the privately owned large retail businesses. Unorganised retailing, on the other hand, refers to the traditional formats of low-cost retailing, for example, the local mom and pop store, owner manned general stores, paan/beedi shops, convenience stores, hand cart and pavement vendors, etc.

Supermarkets and similar organized retail accounted for just 4% of the market in 2008. Until recently, regulations prevented most of the foreign investment in retailing. Some retails faced complying with over thirty regulations such as “signboard licences” and “anti-hoarding measures” before they could open doors. There are taxes for moving goods to states, from states, and even within states in some cases. However, the Indian government has been opening the retail market and simplifying regulations. In November 2011, Indian central government announced major reforms paving way for giants such as Walmart, Carrefour and Tesco, as well single brand majors such as IKEA, Nike, and Apple to enter one of the fastest growing retail market of 1.2 billion people. This announcement immediately caused intense activism – both in opposition and in support – within India. On 7 December 2011, Indian government conceding to the opposition, announced it is suspending the retail reforms till it reaches a consensus.

Most Indian shopping takes place in open markets or millions of small, independent grocery and retail shops. Shoppers typically stand outside the retail shop, ask for what they want, and cannot pick or examine a product from the shelf. Access to the shelf or product storage area is limited. Once the shopper requests the food staple or household product they are looking for, the shopkeeper goes to the container or shelf or to the back of the store, brings it out and offers it for sale to the shopper. Often the shopkeeper may substitute the product, claiming that it is similar or equivalent to the product the consumer is asking for. The product typically has no price label in these small retail shops; although some products do have a manufactured suggested retail price (MSRP) pre-printed on the packaging. The shopkeeper prices the food staple and household products arbitrarily, and two consumers may pay different prices for the same product on the same day. Price is sometimes negotiated between the shopper and shopkeeper. The shoppers do not have time to examine the product label, and do not have a choice to make an informed decision between competitive products.

India's retail and logistics industry, organized and unorganized in combination, employs about 40 million Indians (3.3% of Indian population). The typical Indian retail shops are very small. Over 14 million outlets operate in the country and only 4% of them being larger than 500 sq ft (46 m^2) in size. India has about 11 shop outlets for every 1000 people. Vast majority of the unorganized retail shops in India employ family members, do not have the scale to procure or transport products at high volume wholesale level, have limited to no quality control or fake-versus-authentic product screening technology and have no training on safe and hygienic storage, packaging or logistics. The unorganized retail shops source their products from a chain of middlemen who mark up the product as it moves from farmer or producer to the consumer. The unorganized retail shops typically offer no after-sales support or service. Finally, most transactions at unorganized retail shops are done with cash, with all sales being final.

Between 2000 to 2010, consumers in select Indian cities have gradually begun to experience the quality, choice, convenience and benefits of organized retail industry.

Growth After 2011

Before 2011, India had prevented innovation and organized competition in its consumer retail industry. Several studies claim that the lack of infrastructure and competitive retail industry is a key cause of India's persistently high inflation. Furthermore, because of unorganized retail, in a nation where malnutrition remains a serious problem, food waste is rife. Well over 30% of food staples and perishable goods produced in India spoils because poor infrastructure and small retail outlets prevent hygienic storage and movement of the goods from the farmer to the consumer.

One report estimates the 2011 Indian retail market as generating sales of about \$470 billion a year, of which a miniscule \$27 billion comes from organized retail such as supermarkets, chain stores with centralized operations and shops in malls. The opening of retail industry to free market competition, some claim will enable rapid growth in retail sector of Indian economy. Others believe the growth of Indian retail industry will take time, with organized retail possibly needing a decade to grow to a 25% share. A 25% market share, given the expected growth of Indian retail industry through 2021, is estimated to be over $250 billion a year: revenue equal to the 2009 revenue share from Japan for the world's 250 largest retailers.

The Economist forecasts that Indian retail will nearly double in economic value, expanding by about $400 billion by 2020. The projected increase alone is equivalent to the current retail market size of France.

In 2011, food accounted for 70% of Indian retail, but was under-represented by organized retail. A.T. Kearney estimates India's organized retail had a 31% share in clothing and apparel, while the home supplies retail was growing between 20% to 30% per year. These data correspond to retail prospects prior to November announcement of the retail reform.

Indian Retail Market

Indian market has high complexities in terms of a wide geographic spread and distinct consumer preferences varying by each region necessitating a need for localization even within the geographic zones. India has highest number of outlets per person (7 per thousand) Indian retail space per capita at 2 sq ft (0.19 m^2)/ person is lowest in the world Indian retail density of 6 percent is highest in the world. 1.8 million households in India have an annual income of over 45 lakh (US$91,260).

Delving further into consumer buying habits, purchase decisions can be separated into two categories: status-oriented and indulgence-oriented. CTVs/LCDs, refrigerators, washing machines, dishwashers, microwave ovens and DVD players fall in the status category. Indulgence-oriented products include plasma TVs, state-of-the-art home theatre systems, iPods, high-end digital cameras, camcorders, and gaming consoles. Consumers in the status category buy because they need to maintain a position in their social group. Indulgence-oriented buying happens with those who want to enjoy life better with products that meet their requirements. When it comes to the festival shopping season, it is primarily the status-oriented segment that contributes largely to the retailer's cash register.

While India presents a large market opportunity given the number and increasing purchasing power of consumers, there are significant challenges as well given that over 90% of trade is conducted through independent local stores. Challenges include: Geographically dispersed population, small ticket sizes, complex distribution network, little use of IT systems, limitations of mass media and existence of counterfeit goods.

Major Indian Retailers

Indian apparel retailers are increasing their brand presence overseas, particularly in developed markets. While most have identified a gap in countries in West Asia and Africa, some majors are also looking at the US and Europe. Arvind Brands, Madura Garments, Spykar Lifestyle and Royal Classic Polo are busy chalking out foreign expansion plans through the distribution route and standalone stores as well. Another denim wear brand, Spykar, which is now moving towards becoming a casual wear lifestyle brand, has launched its store in Melbourne recently. It plans to open three stores in London by 2008-end.

The low-intensity entry of the diversified Mahindra Group into retail is unique because it plans to focus on lifestyle products. The Mahindra Group is the fourth largest Indian business group to enter the business of retail after Reliance Industries Ltd, the Aditya Birla Group, and Bharti Enterprises Ltd. The other three groups are focusing either on perishables and groceries, or a range of products, or both.

Entry of MNC

The world's largest retailer by sales, Wal-Mart Stores Inc and Sunil Mittal's Bharti Enterprises have entered into a joint venture agreement and they are planning to open 10 to 15 cash-and-carry facilities over seven years. The first of the stores, which will sell groceries, consumer appliances and fruits and vegetables to retailers and small businesses, is slated to open in north India by the end of 2008.

Carrefour, the world's second largest retailer by sales, is planning to setup two business entities in the country one for its cash-and-carry business and the other a master franchisee which will lend its banner, technical services and know how to an Indian company for direct-to-consumer retail.

The world's fifth largest retailer by sales, Costco Wholesale Corp (Costco) known for its warehouse club model is also interested in coming to India and waiting for the right opportunity.

Opposition to the retailers' plans have argued that livelihoods of small scale and rural vendors would be threatened. However, studies have found that only a limited number of small vendors will be affected and that the benefits of market expansion far outweigh the impact of the new stores.

Tesco Plc., plans to set up shop in India with a wholesale cash-and-carry business and will help Indian conglomerate Tata group to grow its hypermarket business.

Challenges

A McKinsey study claims retail productivity in India is very low compared to international peer measures. For example, the labor productivity in Indian retail was just 6% of the labor productivity in United States in 2010. India's labor productivity in food retailing is about 5% compared to Brazil's 14%; while India's labor productivity in non-food retailing is about 8% compared to Poland's 25%.

Total retail employment in India, both organized and unorganized, account for about 6% of Indian labor work force currently – most of which is unorganized. This about a third of levels in United States and Europe; and about half of levels in other emerging economies. A complete expansion of retail sector to levels and productivity similar to other emerging economies and developed economies such as the United States would create over 50 million jobs in India. Training and development of labor and management for higher retail productivity is expected to be a challenge.

Economists and Entrepreneurs

Many business groups in India are welcoming the transformation of a long-protected sector that has left Indian shoppers bereft of the scale and variety of their counterparts in more developed markets.

B. Muthuraman, the president of the Confederation of Indian Industry, claimed the retail reform would open enormous opportunities and lead to much-needed investment in cold chain, warehousing and contract farming.

Organized retailers will reduce waste by improving logistics, creating cold storage to prevent food spoilage, improve hygiene and product safety, reduce counterfeit trade and tax evasion on expensive item purchases, and create dependable supply chains for secure supply of food staples, fruits and vegetables. They will increase choice and reduce India's rampant inflation by reducing waste, spoilage and cutting out middlemen. Fresh investment in organized retail, the supporters of retail reform claim will generate 10 million new jobs by 2014, about five to six million of them in logistics alone.

Organized retail will offer the small Indian farmer more competing venues to sell his or her products, and increase income from less spoilage and waste. A Food and Agricultural Organization report claims that currently, in India, the small farmer faces significant losses post-harvest at the farm and because of poor roads, inadequate storage technologies, inefficient supply chains and farmer's inability to bring the produce into retail markets dominated by small shopkeepers. These experts claim India's post-harvest losses to exceed 25%, on average, every year for each farmer.

Unlike the current monopoly of middlemen buyer, retail reforms offer farmers access to more buyers from organized retail. More buyers will compete for farmers produce leading to better support for farmers and to better bids. With less spoilage of staples and agricultural produce, global retail companies can find and provide additional markets to Indian farmers. Walmart, since its arrival in India's wholesale retail market, already sources and exports about $1 billion worth of Indian goods for its global customers.

Not only do these losses reduce food security in India, the study claims that poor farmers and others loose income because of the waste and inefficient retail. Over US$50 billion of additional income can become available to Indian farmers by preventing post-harvest farm losses, improving transport, proper storage and retail. Organized retail is also expected to initiate infrastructure development creating millions of rural and urban jobs for India's growing population. One study claims that if these post-harvest food staple losses could be eliminated with better infrastructure and retail network in India, enough food would be saved every year to feed 70 to 100 million people over the year.

Supporters of retail reform, The Economist claims, say it will increase competition and quality while reducing prices helping to reduce India's rampant inflation that is close to the double digits. These supporters claim that unorganized small shopkeepers will continue to exist alongside large organized supermarkets, because for many Indians they will remain the most accessible and most convenient place to shop.

Current Supermarkets

Existing Indian retail firms such as Spencer's, Foodworld Supermarkets Ltd, Nilgiri's and ShopRite support retail reform and consider international competition as a blessing in disguise. They expect a flurry of joint ventures with global majors for expansion capital and opportunity to gain expertise in supply chain management. Spencer's Retail with 200 stores in India, and with retail of fresh vegetables and fruits accounting for 55 per cent of its business claims retail reform to be a win-win situation, as they already procure the farm products directly from the growers without the involvement of middlemen or traders. Spencer's claims that there is scope for it to expand its footprint in terms of store location as well as procuring farm products. Foodworld, which operates over 60 stores, plans to ramp up its presence to more than 200 locations. It has already tied up with Hong Kong-based Dairy Farm International. With the relaxation in international investments in Indian retail, India's Foodworld expects its global relationship will only get stronger. Competition and investment in retail will provide more benefits to consumers through lower prices, wider availability and significant improvement in supply chain logistics.

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