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Challenges of FDI on Domestic Retailors

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Abstract

India has growth prospect for domestic industry with a huge number of consumers and other favorable factors. But India’s domestic market remains largely off-limits to large international retailers like Wal-Mart, Tesco and Carrefour. Opposition to liberalizing FDI in this country raises concerns about employment losses, unfair competition resulting in large-scale exit of incumbent domestic retailers and infant industry. Argument is to protect the organized domestic retail sector that is at a nascent stage. In 2015, the Indian Government approved proposal of 50 percent FDI in domestic industries in India subject to certain loose conditions.

Keywords: Unorganized Retailers, Foreign Investment, Import, National Economy, Subsidy, Competency, Small Scale Industries

Introduction

Domestic industry consists all activities which are involved in selling goods or services directly to the final consumer for their personal, non-business use via shops, market, door-to-door selling, and mail-order where the buyer intends to consume the product. It involves a direct interface with the customer and the coordination of business activities from end to end- right from the concept or design stage of a product or offering, to its delivery and post-delivery service to the customer.

The Indian domestic sector, as it has developed over centuries, is very different from that of the developed countries. In the developed countries, products and services normally reach consumers from the manufacturer/producers through two different channels: (a) via independent retailers (vertical separation) and (b) directly from the producer (vertical integration).

In India, however, the above two modes of operation are not very common. Small and medium enterprises dominate the Indian industries. The trading sector is highly fragmented, with a large number of intermediaries. So also, wholesale trade in India is marked by the presence of thousands of small commission agents, stockiest and distributors who operate at a strictly local level. And that is why retail giants like US-based Wal-Mart and French Carrefour are very keen to enter in the segment.

Bharti Enterprises and Wal-Mart Stores entered into a joint venture in August 2007 and started cash-and-carry stores named 'Best Price Modern Wholesale' in 2009.

Retailing in India is one of the pillars of its economy and accounts for 14 to15% 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. India's retailing industry is essentially owner managed small shops.

With liberalization, economic growth and changes in Indian consumers’ demographic and economic profile and their shopping behavior, the retail sector is undergoing changes. At present, foreign retailers operate in India through both store and non-store formats. In terms of the shopping behavior of Indian consumers across different retail outlets, traditional outlets are preferred as consumers can bargain while modern outlets are preferred because they link entertainment with shopping.

Those who purchase at modern outlets have reported better product quality, one-stop shopping, choice of more brands and products, better shopping experiences with family and fresh stocks as some of the reasons for their choice of outlet but with a higher price.

On the other hand, proximity to residence, goodwill, credit availability, possibility of bargaining, choice of loose items, convenient timings, home delivery, etc., are some of the benefits of traditional outlets (Joseph and Soundararajan 2009). Consumers are the major beneficiaries of the retail boom as organized retailers are initiating measures such as tracking of consumer behavior and consumer loyalty programmes to retain their market share (Mukherjee and Patel (2005)).

Authors of ICRIER Policy series paper (August, 2011) and various other surveys have pointed out that most consumers are willing to experiment to different brands. Though it will provide Indian consumers more choices in the form of reputed, good quality brands, liberalizing multi-brand retailing in India is likely to facilitate much greater imports which will affect domestic economy adversely. To protect the interest of India we have to impose a condition that every single brand retailer should source at least 80% goods from India.

Instead of promoting FDI, the government in turn should promote the development of more efficient and lower cost domestic supply chains, resulting in better quality as well as lower-priced products for Indian consumers. This will increase consumer spending, which in turn, will drive growth in all sectors of the economy in a virtuous cycle.

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.

In November 2011, central government announced retail reforms for both multi-brand stores and single brand stores. These market reforms paved the way for competition with multi-brand retailers as well single brand majors which will ultimately weaken the already weaker domestic retailers·

The announcement sparked intense activism, both in opposition and in support of the reforms. In December 2011, under pressure from the opposition, 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·

IKEA announced in January that it is putting on hold its plan to open stores in India because of the 30% requirement· Fitch believes that the 30% requirement is likely to significantly delay if not prevent most single brand majors from Europe, USA and Japan from opening stores and creating associated jobs in India.

Review of Related Literature

Mukherjee and Patel *et al*. (2005) carried out a broad based survey on “FDI in the Domestic Sector in India”, which was sponsored by the Indian Council for Research on International Economic Relations (ICRIER), vehemently recommended the allowing of FDI in the organized format in retail industry over a period of only five to six years to boost the speed at which the organized sector is growing.

Kalhan *et al*. (2007) unambiguously indicated that there has been a severe impact of malls on the unorganized retail shops operating in the vicinity of malls. The study further stated that Mega Malls are making deep inroads in the sales of retailers operating in the unorganized retail sector.

Joseph *et al*. (2008) [9] stated that the malls interestingly have an adverse impact observed on the customers of sample shops. However, the study further revealed that Malls have severely impacted the turnover and operating profits of the sample shops.

A study of small unorganized retailers operating in close proximity to Food World and Subhiksha (CII-KSA Technologies) in Chennai explored that there was a little impact on the sales and inventory on the selected respondents in the initial period of time.

Gupta (2012) explored in her project “FDI In Indian Retail Sector: Analysis Of Competition In Agri-Food Sector” that there will be initial and displacement of middleman involved in supply chain of farm produce but they are likely to be absorbed by increase in food processing sector induced by organized retailing.

Chandu (2012) explored that the small retailers oppose allowing FDI in retailing in India as they are very much apprehensive about big stores. FDI policy must be well drafted as it will directly affect the agriculture sector and many other segments of the country. The study of above literature suggests that FDI will have definite unfavorable impacts on Indian retail sector. But a few studies have been reported after the amendment in the provisions related to foreign direct investment in retailing which require further research. This paper attempts to study the impact of FDI on various concerned segments.

Research Study

This paper is based on descriptive and comparative research. The secondary data has been used in this research which has been taken from various research articles, publications and related websites.

Modern retail formats, such as hypermarkets, superstores, supermarkets, discount and convenience stores are widely present in the developed world, whereas such forms of retail outlets have only just begun to spread to developing countries in recent years. In many of the developing countries, the retailing business continues to be dominated by family-run neighborhood shops and open markets.

Table 1: Share of Domestic Industries in India

Year	2005	2007	2009	2011	2013	2016(Expected)
Total (in billion INR)	7000	8250	10000	18450	19500	24000
Share	50	150	350	920	1350	2400
Share Of Retail (%)	0.70%	1.80%	3.50%	5.00%	7.00%	10.00%

(***Source*:** www.neilson.com)

As a consequence, wholesalers and distributors who carry products from industrial suppliers and agricultural producers to the independent family-owned shops and open markets remain a critical part of the supply chain in these countries. Recent statistics states that though organized retail in India constituted a meager 4 percent of total retail in 2006, but it is expanding at a much faster pace of 45-50 percent per annum and has quadrupled its share to 10 percent by 2011-12.

Makes Rich More Rich and Poor More Poor

There are many who believe that FDI will act as guardian for the economic development of the farmers and job seekers. But this is a wrong assumption. It is natural that big fish will eat small fishes; which is the basic concept in open market competition. In India 95% of the retail is in the un-organized sector. The remaining 5% are giant groups capable of swallowing the rest hence the collapse of domestic initiatives.

Studies prove that local chains like Big Bazaar and Spencer have dealt a deathblow to small retailers. So, the impact of FDI in retail is direct. The local traders are not strategic to resist the challenges raised by FDI are not agile to get wiped off. The offerings of multinationals such as home delivery and credit card facility cannot be matched by domestic retail players. It is claimed that FDI in retail is a step forward to eliminate the evils of adulteration, shortage in weights and measures, whereas many recent revelations shows that none are exception to the malpractice.

The government machinery should act to prevent unreasonable profit gained by traders due to large differences between the wholesale price and the printed maximum retail price (MRP) and the corruption in saving taxes which are leading to generate black money. The growth in the retail sector has so far been slower than what was projected, about 5 or 6 years back. This reality invites urgent intervention of the state in the sector.

Challenges Imposed on Domestic Industries

The latest changes in foreign direct investment (FDI) norms in India have made entry and control of foreign investors in a lot of sectors easier. Defense and civil aviation have been opened to 100% FDI under the government approval route (the FDI limit was 49% in airlines before).

Many other sectors have been allowed 100% or near to 100% FDI with government approval or through the automatic approval route. These include animal husbandry, trading of food products produced in India (including through e-commerce), private security services and broadcasting carriage services (such as DTH, cable networks and mobile TV). Up to 74% FDI (against the previous 49%) in Brownfield pharmaceutical industry projects will no longer require government approval. Brownfield airports too have been brought under the automatic approval route.

The condition of access to state-of-the-art technology in India has been removed in defense. In addition, for single-brand retail trading companies undertaking business with state-of-the-art technology, the restriction of sourcing up to a certain percentage of inputs locally has been totally relaxed for three years, followed by a partial relaxation for another five years – a favor granted apparently on Apple's appeal.

The stated objective of 100% FDI and other relaxations is to promote employment and improve infrastructure, along with greater FDI inflows and the ease of doing business in India. An official statement said that with most sectors coming under the automatic approval route, India is now the most open economy in the world for FDI.

India's Interests

While the latest FDI policy change will certainly boost FDI inflows and increase the ease of doing business in India, it is doubtful whether it will promote other more important socio-economic objectives. On the contrary, it might hurt them. Here are some of the major impacts.

Domestic Economy, Employment and Economic Security:
Rather than promoting employment, these FDI relaxations might accelerate the ongoing trend of jobless growth and rising inequality. With 100% FDI owned commercial entities, a much greater share of returns on investments will go outside India, decided based on business preferences of foreign owners. Therefore, multiplier effects of financial returns on the economy and employment will be limited. Relaxation of local sourcing restrictions will further add to the dampening of multiplier effects.

Infrastructure: It is inexplicable why infrastructure cannot be improved without FDI relaxation. India's infrastructure in major sectors including civil aviation and broadcasting services has already been witnessing substantial investments, growth and modernization. There are several Indian firms, both public and private, which have demonstrated a long experience of building facilities and networks with modern technology and systems, through either sole ownership or joint ventures. In infrastructure requiring the latest technology, growth could easily have continued through joint venture mechanisms.

Dependency of Agricultural Economy and Families: 100% FDI in animal husbandry, retail and trading of food products might lead to greater consolidation and control of farmland and other agricultural assets in the hands of large corporations. This will make a majority of small farmers and farm-dependent families more vulnerable and accelerate distress migration to cities. Alternately, the policy change should have been directed at improving economic security and technological skills of small farmers and farmers' cooperatives.

Small Manufacturing and Services Industries: Relaxation of local sourcing norms for state-of-the-art technology based retail trading companies will subdue opportunities for suppliers to increase their business and upgrade technology skills. Small industries, most of which are suppliers to larger firms, constitute an overwhelming majority of India's industrial base. A policy that goes against their interest is therefore detrimental to the 'Make in India' agenda.

Manufacturing and Services Industries Where India Demonstrated near World-Class Competence: There are industries where some Indian firms have proven high competency in technology and management. These include existing parts suppliers in the defense industry. They also include parts suppliers in the automotive industry, several of whom have the ability to upgrade and potentially supply to defense and civil aviation sectors. Additionally, raw material as well as finished product manufacturers in pharmaceuticals and a lot of retail industries have vast experience of selling high quality products and services.

Airlines services and airport projects in India too have established domestic players with track records of efficient and high quality performance in services and projects involving complex operations and technology. Similarly, there are routine service industries, such as private security, that have witnessed the emergence of domestic firms with professional work standards and management systems. And there is reasonable domestic competition in these industries.

The Indian pharmaceutical industry is known for reverse engineering, efficient operations and technological skills and is a major supplier of affordable medicines to many third world countries. In this scenario, what substantial benefit will 100% FDI bring? Instead, the effort should be to equip well-performing domestic firms to become globally competitive and increase their exports. That will boost the economy and employment, and upgrade technological skills.

Domestic R&D and Manufacturing Capability in State-of-the-Art Technology Areas: Removal of the condition of access to state-of-the-art technology in India in the defense sector and waiver of the minimum local sourcing condition in single-brand retail with state-of-the-art technology has directly hurt the opportunities for building those higher-end capabilities among Indian industries and entrepreneurs.

Rather than allowing foreign companies to bypass domestic suppliers while doing business in India, they must be asked to integrate domestic manufacturers and service providers within their supply chains so that they contribute directly to building India's economy as well as technological competence. Achieving higher value and creating capability through technology and innovation must be as important a goal for India's economy as universal employment generation. Unfortunately, both have been side-stepped.

Proper Tax System

One argument in favor of FDI is that it will cause increase in tax revenue like VAT and service tax. It is a fact that the organized sales with computerized billing system will also yield more revenue through commodity taxes to the government. But by strictly imposing the above condition on the domestic retail merchants, tax buoyancy of the economy can be increased. If there is a will there is a way.

Distribution system

A recent report shows that 30-35% of India's total production of fruits and vegetables is wasted every year due to inadequate cold storage and transport facilities. Almost half of this wastage can be prevented if fruit and vegetable retailers have access to specialized cold storage facilities and refrigerated trucks. Here is the role of a popular government.

The argument of the supporters of FDI is that the organized retail will bring in efficient practices that will help farmers in the procurement process, reduce wastage with finally efficient storage and will finally cut the losses. It is not true that only the giant retailers can help India to have strong storage system with highly developed transportation.

A patriotic government instead on inviting FDI should persuade and promote domestic retail merchants to go for high-tech warehousing. There should be financial assistance and subsidies for such projects if necessary under cooperative sector or under PPP which will definitely bring in synergies in distribution management practices of Indian merchants**.** This will equip the domestic merchants to manage mountains of inventories, to supply the perishable articles to key distribution centers and do it all faster, better and cheaper. This will directly promote Indian agricultural sector and ultimately the national economy.

Consumer satisfaction

Middle class who are three-fourth of Indian population will be benefited only if they are offered quality products at cheaper rate. The middle class are newly emerged and swelling. There is arising aspiration for a stylish and luxurious life in this class. There has been shift from necessities to luxurious life.

The emergence of large middle class in India and with rising disposable income, spends on branded products are likely to increase. Instead of keeping our doors open to the importers, the benefit of this new situation could be utilized by the national economy by introducing new and stylish Indian products to the domestic market and if possible to the international market.

Knowledge and Technology Enhancement

According to the reformers, FDI in retail will make way for inflow of knowledge from international experts. It is true that there will be drastic retail growth through the development of the retail capability. Advanced technology will definitely fasten the growth of Indian retail sector. But in order to achieve this goal we need not invite FDI as Indians have enough international exposure and are now familiar with the most modern management techniques as a result of information revolution.

Unhealthy Competition and Inflation

Many opine that with the entry of foreign players in Indian retail there will be a healthy competition in the sector. This is totally a baseless argument. The unorganized domestic retail sector is to be strengthened and regulated before the invasion of FDI is allowed or otherwise even the existing competitiveness too will wither away and it will cause strong more strong and weak more weak.

Domination of Organized Retailers

FDI in single-brand retail will strengthen only the 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 change 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 thousands of middleman who have been working in this industry will be thrown out of their jobs.

Loss of Self Competitive Strength

Indian retail sector, particularly unorganized retail, is still underdeveloped and in a nascent stage and that, therefore they may not be able to compete with big global giants. If the existing firms compete with the global biggies they might have to give up by losing their self-competitive strength.

Availability of Capital

It is a fact that the Indian economy has the shortage of capital which results in less investment. But it doesn't mean that we should allow FDI in Indian retail industry. The focus of FDI should be on sharpened towards developing our infrastructure like National and State Highways and Ports.

Increased Imports

International retailers will import with huge quantities of consumer goods from their mother country and elsewhere that are available relatively cheaper to the detriment of the interest of the domestic producers. The recent proposal is a control mechanism as it says that they retailers have to purchase 30% from the small scale industries but they could be anywhere in the world. So the Indian industry will not be benefited**.**

Increase in Cost of Real Estate

The foreign investors need a large space for establishing their shopping malls which will lead to increased demand for real estate. The higher demand and the higher paying capacity of foreign player will result in increased cost of real estate in India which will have a bad impact on various segments of India.

Distortion of Culture

With the entry of foreigners in retail sector their culture will also enter in India. This will effect Indian values and culture adversely. This cultural change will change the attitude and behavior of our coming generations which will result in the deterioration of Indian human values.

Significance of the Study

The Confederation of Indian Industry (CII) conducted a survey during December 2011 to January 2012 on the impact of FDI on Small and Medium Enterprises (SMEs) based on a large sample size of 250 companies covering different categories of SMEs according to sales turnover. A majority of the SME companies, surveyed have supported the government's decision and the notification allowing 100% FDI in single brand retail and about 52 percent of respondents hope for early implementation of 51% FDI in multi-brand retail.

On the question how the SME industry consider entry of MNC retailers as a threat or opportunity, majority of respondents (66.7%) see it as an opportunity for their sector while around 21 % of respondents perceive it as a threat. About 12.5 percent of respondents are of the opinion that the decision would have little or no impact on their company.

Traditional retailing has been established in India for many centuries, and is characterized by small, family-owned operations. Because of this, such businesses are usually very low-margin, are owner-operated, and have mostly negligible real estate and labor costs. Such small shops develop strong networks with local neighborhoods. The informal system of credit adds to their attractiveness.

Moreover, low labor costs also allow shops to employ delivery boys, such that consumers may order their grocery list directly on the phone. These advantages are significant, though hard to quantify. In contrast, players in the organized sector have to cover big fixed costs, and yet have to keep prices low enough to be able to compete with the traditional sector.

Getting customers to switch their purchasing away from small neighborhood shops and towards large-scale retailers may be a major challenge. The experience of large Indian retailers such as Big Bazaar shows that it is indeed possible. The local stores operate in a different environment catering to a certain set of customers and they will have continued to find new ways to retain them.

Conclusion

Through this paper, I've tried to give an overview of retail trade in India and the mechanisms of foreign funds in the retail sector. I conclude by adding that the economic dynamics and the political process of India will play an important role in determining the outcome of the move to allow FDI in the retail sector and that it will ultimately determine the effects on various stakeholders.

Many foreign companies have already entered into Indian market through the available modes such as, Franchising and Exporting. They are much eager to change their entry to FDI that would strengthen their operations in India as our country is a potential market for their products. And that is why FDI in retail is expected bring threats to the country. FDI should be initially allowed in less sensitive sectors like infrastructural development and also in the sectors wherein the domestic companies are incapable of establishing its presents. Entry of foreign players must be with care and gradual with social safeguards.

The Thai Government, which very magnanimously opened its door to invite the large retailers, now has created a separate fund to provide financial assistance to the local retailers. China Daily has quoted a Wall Street Journal report that mentions a Chinese supplier being forced to lay off staff because Wal-Mart has been ruthlessly pressing down on the supplier's margin. Indonesia & Malaysia have specified zones within which foreign retailers may operate. In Japan, such retailers need to seek the views of small local stores regarding their proposed new locations. Additionally, zoning laws have been imposed; this compels the foreign retailers to go outside the city limits etc. So, if multinational retailers were to recruit 1,000 people, close to 15,000 currently employed personnel would land up losing their jobs. India remains one of the few markets untouched by this frenzy.

So adequate attention should be paid to procuring, staff recruitment, investments in warehouse, cold storage, infrastructure, competition and retail formats so that not only does the money comes in but also it's a win-win situation for the current national retailer as well as "mom and pop" stores who account for 70% of the retail business even after the arrival of national retailers from the corporate giants like the Tata, Reliance, Future Group and the Birla's.

A National Commission should be set up to study the problems of the retail sector which should also evolve a clear set of conditionality on foreign retailers on procurement of farm produce, domestically manufactured merchandise and imported goods. This conditionality must state minimum space, size and other details like construction and storage standards.

The Indian Govt. should have well drafted policy to control the affairs of foreign investors. It should take some measures to strengthen the unorganized Indian retail industry which is in its upcoming stage.

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