Foreign Direct Investment in Retail Sector of India

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India being a signatory to World Trade Organization's General Agreement on Trade in Services, which include wholesale and retailing services, had to open up the retail trade sector to foreign investment. There were initial reservations towards opening up of retail sector arising from fear of job losses, procurement from international market, competition and loss of entrepreneurial opportunities. However, the government in a series of moves has opened up the retail sector slowly to Foreign Direct Investment (FDI). In 1997, FDI in cash and carry (wholesale) with 100 percent ownership was allowed under the Government approval route. It was brought under the automatic route in 2006. 51 percent investment in a single brand retail outlet was also permitted in 2006. FDI in Multi-Brand retailing is prohibited in India. The Foreign Direct Investment means "cross border investment made by a resident in one economy in an enterprise in another economy, with the objective of establishing a lasting interest in the investee economy. FDI is also described as "investment into the business of a country by a company in another country". Mostly the investment is into production by either buying a company in the target country or by expanding operations of an existing business in that country". Such investments can take place for many reasons, including to take advantage of cheaper wages, special investment privileges (e.g. tax exemptions) offered by the country. These are fully described below.

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Reasons for allowing FDI in retail Sector

Foreign Direct Investment (FDI) complements and supplements domestic investment. Domestic companies are benefited through FDI, by way of enhanced access to supplementary capital and state-of-the-art technologies; exposure to global managerial practices and opportunities of integration into global markets. Government had instituted a study, on the subject of "Impact of Organized Retailing on the Unorganized Sector", through the Indian Council for Research on International Economic Relations (ICRIER), which was submitted to Government in 2008. The ICRIER study indicated significant benefits for various stakeholders, such as consumers, farmers and manufacturers, arising from the growth of organized retail. Based upon the study, as well as the experience of other countries, it is the Government's assessment that implementation of the policy permitting FDI, up to 51%, in multi-brand retail trading, is likely to facilitate greater FDI inflows into front and back-end infrastructure; technologies and efficiencies to unlock the potential of the agricultural value chain; additional and quality employment; and global best practices. This, in turn, is expected to benefit consumers and farmers in the long run, in terms of quality and price. The 30% mandatory sourcing condition has been incorporated to encourage local value addition and manufacturing. The increased level of activity, in the front-end, as well as in the back-end, resulting from greater FDI inflows, is expected to create additional employment opportunities for rural and urban youth. It is, further, expected to encourage existing traders and retail outlets to upgrade and become more efficient, thereby providing better services to consumers and better remuneration to the producers from whom they source their products. There is no procedure to shortlist companies. Foreign investors desirous of investing in retail trade (multi brand or single brand) in India are required to submit their applications in the Department of Industrial Policy & Promotion, where their applications are examined to determine whether the proposed investment satisfies the notified guidelines, before being considered by the Foreign Investment Promotion Board, in the Ministry of Finance, for Government approval.

Major benefits of Foreign Direct Investment

(a) Improves forex position of the country;

(b) Employment generation and increase in production ;

(c) Help in capital formation by bringing fresh capital;

(d) Helps in transfer of new technologies, management skills, intellectual property

(e) Increases competition within the local market and this brings higher efficiencies

(f) Helps in increasing exports;

(g) Increases tax revenues

Brief Latest Developments on FDI

- **2012 – October**

In the second round of economic reforms, the government cleared amendments to raise the FDI cap

(a) in the insurance sector from 26% to 49%;

(b) in the pension sector it approved a 26 percent FDI;

- **2012 - September**

The government approved the

(a) Allowed 51% foreign investment in multi-brand retail,

(b) Relaxed FDI norms for civil aviation and broadcasting sectors. – FDI cap in Broadcasting was raised to 74% from 49%;

(c) Allowed foreign investment in power exchanges

- **2011 – December**

The Indian government removed the 51 percent cap on FDI into single-brand retail outlets and thus opened the market fully to foreign investors by permitting 100 percent foreign investments in this area.

Routes for FDI

An Indian company may receive Foreign Direct Investment under the two routes as given below:

1. **Automatic Route**

FDI is allowed under the automatic route without prior approval either of the Government or the Reserve Bank of India in all activities/sectors as specified in the consolidated FDI Policy, issued by the Government of India from time to time.

2. **Government Route**

FDI in activities not covered under the automatic route requires prior approval of the Government which are considered by the Foreign Investment Promotion Board (FIPB), Department of Economic Affairs, Ministry of Finance.

FDI is not allowed in India

FDI is prohibited under the Government Route as well as the Automatic Route in the following sectors:

- Atomic Energy
- Lottery Business
- Gambling and Betting
- Business of Chit Fund
- Nidhi Company
- Agricultural (excluding Floriculture, Horticulture, Development of seeds, Animal Husbandry, Pisciculture and cultivation of vegetables, mushrooms, etc. under controlled conditions and services related to agro and allied sectors) and Plantations activities (other than Tea Plantations)
- Housing and Real Estate business (except development of townships, construction of residential/commercial premises, roads or bridges to the extent specified in notification
- Trading in Transferable Development Rights (TDRs).
- Manufacture of cigars , cheroots, cigarillos and cigarettes , of tobacco or of tobacco substitutes.

FDI Policy in India

FDI as defined in Dictionary of Economics is investment in a foreign country through the acquisition of a local company or the establishment there of an operation on a new (Greenfield) site. To put in simple words, FDI refers to capital inflows from abroad that is invested in or to enhance the production capacity of the economy.

Foreign Investment in India is governed by the FDI policy announced by the Government of India and the provision of the Foreign Exchange Management Act (FEMA) 1999. The Reserve Bank of India ('RBI') in this regard had issued a notification, which contains the Foreign Exchange Management (Transfer or issue of security by a person resident outside India) Regulations, 2000. This notification has been amended from time to time.

The Ministry of Commerce and Industry, Government of India is the nodal agency for motoring and reviewing the FDI policy on continued basis and changes in sectoral policy/ sectoral equity cap. The FDI policy is notified through Press Notes by the Secretariat for Industrial Assistance (SIA), Department of Industrial Policy and Promotion (DIPP).

The foreign investors are free to invest in India, except few sectors/activities, where prior approval from the RBI or Foreign Investment Promotion Board ('FIPB') would be required.

FDI Policy with Regard to Retailing in India

It will be prudent to look into Press Note 4 of 2006 issued by DIPP and consolidated FDI Policy issued in October 2010 which provide the sector specific guidelines for FDI with regard to the conduct of trading activities.

a) FDI up to 100% for cash and carry wholesale trading and export trading allowed under the automatic route.
b) FDI up to 51 % with prior Government approval (i.e. FIPB) for retail trade of 'Single Brand' products, subject to Press Note 3 (2006 Series)
c) FDI is not permitted in Multi Brand Retailing in India.

Foreign Investor's Concern Regarding FDI Policy in India

For those brands which adopt the franchising route as a matter of policy, the current FDI Policy will not make any difference. They would have preferred that the Government liberalize rules for maximizing their royalty and franchise fees. They must still rely on innovative structuring of franchise arrangements to maximize their returns. Consumer durable majors such as LG and Samsung, which have exclusive franchisee owned stores, are unlikely to shift from the preferred route.
For those companies which choose to adopt the route of 51% partnership, they must tie up with a local partner. The key is finding a partner which is reliable and who can also teach a trick or two about the domestic market and the Indian consumer. Currently, the organized retail sector is dominated by the likes of large business groups which decided to diversify into retail to cash in on the boom in the sector – corporate such as Tata through its brand Westside, RPG Group through Food world, Pantaloon of the Raheja Group and Shopper's Stop. Do foreign investors look to tie up with an existing retailer or look to others not necessarily in the business but looking to diversify, as many business groups are doing?

An arrangement in the short to medium term may work wonders but what happens if the Government decides to further liberalize the regulations as it is currently contemplating? Will the foreign investor terminate the agreement with Indian partner and trade in market without him? Either way, the foreign investor must negotiate its joint venture agreements carefully, with an option for a buy-out of the Indian partner's share if and when regulations so permit. They must also be aware of the regulation which states that once a foreign company enters into a technical or financial collaboration with an Indian partner, it cannot enter into another joint venture with another Indian company or set up its own subsidiary in the 'same' field' without the first partner's consent if the joint venture agreement does not provide for a 'conflict of interest' clause. In effect, it means that foreign brand owners must be extremely careful whom they choose as partners and the brand they introduce in India. The first brand could also be their last if they do not negotiate the strategic arrangement diligently.

FDI in Single Brand Retail

The Government has not categorically defined the meaning of "Single Brand" anywhere neither in any of its circulars or nor any notifications.

In single-brand retail, FDI up to 51 per cent is allowed, subject to Foreign Investment Promotion Board (FIPB) approval and subject to the conditions mentioned in following
(a) Only single brand products would be sold (i.e., retail of goods of multi-brand even if produced by the same manufacturer would not be allowed)
(b) Products should be sold under the same brand internationally,
(c) single-brand product retail would only cover products which are branded during manufacturing and
(d) Any addition to product categories to be sold under "single-brand" would require fresh approval from the government.

FDI in Multi Brand Retail

The government has also not defined the term Multi Brand. FDI in Multi Brand retail implies that a retail store with a foreign investment can sell multiple brands under one roof.

In July 2010, Department of Industrial Policy and Promotion (DIPP), Ministry of Commerce circulated a discussion paper on allowing FDI in multi-brand retail. The paper doesn't suggest any upper limit on FDI in multi-brand retail. If implemented, it would open the doors for global retail giants to enter and establish their footprints on the retail landscape of India. Opening up FDI in multi-brand retail will mean that global retailers including Wal-Mart, Carrefour and Tesco can open stores offering a range of household items and grocery directly to consumers in the same way as the ubiquitous '*kirana'* store.

Conclusion and Suggestions

India's retailing industry is essentially owner manned small shops. In 2010, larger format convenience stores and supermarkets accounted for about 4 percent of the industry, and these were present only in large urban centers. India's retail and logistics industry employs about 40 million Indians (3.3% of Indian population). Until 2011, Indian central government denied foreign direct investment (FDI) in multi-brand retail, forbidding foreign groups from any ownership in supermarkets, convenience stores or any retail outlets. Even single-brand retail was limited to 51% ownership and a bureaucratic process. In November 2011, India's central government announced retail reforms for both multi-brand stores and single-brand stores. The announcement sparked intense activism, both in opposition and in support of the reforms. In December 2011, under pressure from the opposition, Indian government placed the retail reforms on hold till it reaches a consensus. In January 2012, India approved reforms for single-brand stores welcoming anyone in the world to innovate in Indian retail

market with 100% ownership, but imposed the requirement that the single brand retailer source 30 percent of its goods from India. Indian government continues the hold on retail reforms for multi-brand stores.

The government has added an element of social benefit to its latest plan for calibrated opening of the multi-brand retail sector to foreign direct investment (FDI). Only those foreign retailers who first invest in the back-end supply chain and infrastructure would be allowed to set up multi brand retail outlets in the country. The idea is that the firms must have already created jobs for rural India before they venture into multi-brand retailing.

Moreover, in the fierce battle between the advocators and antagonist of unrestrained FDI flows in the Indian retail sector, the interests of the consumers have been blatantly and utterly disregarded. Therefore, one of the arguments which inevitably need to be considered and addressed while deliberating upon the captioned issue is the interests of consumers at large in relation to the interests of retailers.

It is also pertinent to note here that it can be safely contended that with the possible advent of unrestrained FDI flows in retail market, the interests of the retailers constituting the unorganized retail sector will not be gravely undermined, since nobody can force a consumer to visit a mega shopping complex or a small retailer. Consumers will shop in accordance with their utmost convenience, where ever they get the lowest price, max variety, and a good consumer experience.

The Industrial policy 1991 had crafted a trajectory of change whereby every sectors of Indian economy at one point of time or the other would be embraced by liberalization, privatization and globalization.FDI in multi-brand retailing and lifting the current cap of 51% on single brand retail is in that sense a steady progression of that trajectory. But the government has by far cushioned the adverse impact of the change that has ensued in the wake of the implementation of Industrial Policy 1991 through safety nets and social safeguards. But the change that the movement of retailing sector into the FDI regime would bring about will require more involved and informed support from the government. One hopes that the government would stand up to its responsibility, because what is at stake is the stability of the vital pillars of the economy- retailing, agriculture, and manufacturing.

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