# FDI in Multi-Brand Retail: Boon or Bane?

**An in-depth look at why the Indian Economy should welcome Foreign Direct Investment in retail.**

India is a retailer's dream due to its large upwardly mobile population and impressive growth rate. With the domestic retail sector projected to grow exponentially in the coming years, India has consistently been rated as one of the most desirable destinations for global retailers across an array of surveys and market reports.

While the country's foreign direct investment (FDI) regime has witnessed progressive liberalization over the past decade, entry into the highly coveted multi-brand retail segment - which encompasses departmental stores that aim to provide consumers with all their myriad shopping needs under one roof - continues to remain barred. However, global retail giants like Walmart, Carrefour, Metro AG and Harrods may believe they have good reason to cheer with the recent decision of the Union Cabinet to permit FDI upto 51% in this hitherto prohibited sector.

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## Terms and conditions apply

A reading of the fine print accompanying the proposal that has been greenlighted by the Union Cabinet is quite revealing. For starters, FDI in multi-brand retail comes under the approval route, which means that the investment requires clearance of the Foreign Investment Promotion Board (FIPB). While at first sight this may not appear encouraging, foreign investors must take note that India has traditionally preferred to tread cautiously with respect to reforms in sensitive sectors, with restrictions generally being eased gradually over time.

Parallels can be drawn with the 'cash and carry wholesale trade' segment, which was allowed by the Indian government upto 100% under the approval route in 1997. In 2006, such investment was brought under the automatic route, which meant that prior approval of the government would not be required, thereby giving it a tremendous fillip. Similarly, while investment upto 51% in the single brand retail segment under the approval route was permitted in 2006, today it is at the cusp of being allowed upto 100%.

Foreign investors should maintain a long-term outlook and welcome the positives of having a tie-up with an Indian partner who would, among other things, give them the benefit of local knowledge and facilitate a cultural fit. From the Indian point of view, such collaboration would help in the transfer of technology and retail inventory and management skills - something organised Indian retailers presently seek to do by sending executives on overseas secondments.

## Waste not, want not

A foreign entrant into the Indian multi-brand retail sector has to comply with a host of other conditions. The minimum entry threshold of foreign investment in this sector is pegged at US$ 100 million. Of this, at least 50% of the amount invested is necessarily required to be allocated for the purposes of investment in back-end infrastructure such as cold chains, refrigeration, packaging, storage and transportation.

While India is the second largest producer of agricultural produce in the world, a significant chunk of it gets wasted due to non-availability of adequate storage facilities. This inefficiency results in lesser availability of foodgrains to consumers, which invariably results in escalation in prices. Farmers too are deprived of the chance of obtaining fair returns on their efforts due to wastage of produce at the post-harvest stage.

The domestic distribution and management systems currently in place also require a drastic facelift with stories of scarcity in one part of the country being reported concurrently with warehouses with rotting foodgrains in yet another part. By making it mandatory for foreign retailers to designate an appreciable portion of their investment to value creation in the crucial yet oft neglected back-end infrastructure, there is hope that this will yield multiple benefits for farmers as well as consumers.

## Thinking locally

Unlike Indian players who predominantly rely on domestic suppliers, foreign retailers can access global markets and obtain supplies based on cost advantages. The entry of foreign investment in this hitherto protected sector could, as per the views of some opponents, lead to a distortion in the existing set-up and closure of indigenous manufacturing units. The envisaged proposal for opening multi-brand retail to foreign investment has put to rest such criticism by innovatively transforming this threat into an opportunity for spurring indigenous manufacturing activity and creation of jobs.

This has been sought to be achieved by imposing a condition which makes it mandatory for foreign retailers to source at least 30% of their stocks from Indian micro, small and medium enterprises (MSMES) having a capital investment of not more than US$ 1 million.

Introduction of mandatory local sourcing would help provide small producers a platform to reach the final consumer. The entry of foreign retailers, which operate on a large scale and have an extensive product line ranging from cosmetics to electronics, could therefore lead to a renaissance of Indian MSMES, village and cottage industries.

## Concerns about foreign retail behemoths

India's reluctance to allow FDI in multi-brand retail cannot be appreciated without a proper understanding of the importance of the retail sector in the Indian economy. The domestic retail sector is highly fragmented, with only a small segment comprising organised players. But the overwhelmingly predominant form of retail in India is unorganised and operates on a small-scale drawn from the ranks of proprietor-manned mom-and-pop stores, convenience stores, itinerant hawkers and those selling their wares in public spaces like on pavements or in markets *(bazaars and haats)*.

In this context, there are concerns that foreign retail giants - who see India as a vital market with tremendous potential for long-term growth - will not hesitate to deploy the substantial financial resources at their disposal to attempt to monopolize the market by means such as predatory pricing. Once competitors have been 'eased out' of the market, they can exploit their position of virtual monopoly over the marketplace by hiking prices at will as consumers have no other recourse than buying from them.

However, dystopian fears of a country forced to passively submit to economic neo-colonialism by permitting entry of FDI in multi-brand retail seem highly improbable and far-fetched in a country like India. There is ample space for various types of organizations to exist in the retail sphere, as gigantic hypermarkets that provide a one-stop shopping experience cater to a different need as compared to the local shop around the corner (*kirana* stores).

A legal bar to monopolistic activities also currently exists under the domestic competition law regime, which frowns upon predatory pricing, deemed to fall under the broader ambit of abuse of dominant position by a company. From an economic

perspective, use of such a strategy would not be likely to bear results in the Indian market where several large competitors with equal financial clout are vying for the attention of consumers. Therefore, a scenario where prices are hiked at whim and consumers forced to pay through the nose for basic necessities cannot be considered as realistic grounds to halt in-bound investment in this space.

## Every individual counts

Another major apprehension interconnected with the prospect of traditional retailers being forced to down their shutters is that of widespread job loss. The retail sector ranks second only to agriculture in terms of the number of people employed by it. Further, as opening and operating a retail store on a low cost and a small scale provides an avenue of self-employment without requiring much capital, it is often a last resort for many people who would otherwise remain unemployed. This is diametrically opposite to their would-be foreign competitors who typically prefer capital-intensive operations with high levels of automation rather than reliance on manpower. Thus, many are sceptical of claims that the entry of retail giants would lead to job creation as the new entrants would possibly not be able to reabsorb even the majority of the people who have been driven out of the retail market in the aftermath of entry of foreign investment.

These are admittedly serious concerns, which the government has sought to address in two ways. As stated before, an impetus has been given to indigenous industries by ensuring a minimum amount of products stocked by foreign retailers are sourced locally. This might motivate many to shift to manufacturing, thereby causing real value addition to the economy instead of the present situation where retail is often a form of disguised unemployment.

Secondly, the proposed FDI policy states that retail stores funded by foreign investors will presently be permitted only in cities having a population greater than one million. By restricting the influx of such stores only to a miniscule percentage of the country (as per the 2011 Census figures, there are nearly 8,000 towns and cities in India, of which only 53 have a population more than a million), the government has given itself a chance to empirically verify whether the predicted *en masse* job loss actually occurs.

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## A stop gap solution for inflation?

With India experiencing a sustained period of inflation, its policy makers are looking high and low for answers that will provide relief to the masses from high prices of various essentials. Providing supply side solutions within the domestic economy, such as increasing supply through increase in productive capacity, are intrinsically medium to long term in nature and their effects would take a while to be felt at the ground level.

In the interim, permitting global retail giants to enter the domestic market could help combat inflation, especially in terms of food prices. These organisations are characterised by superior technology and managerial practices in respect of storage and distribution of perishables, which permit them to substantially eliminate overhead costs and offer produce to customers at significantly lower prices. Transfer of know-how in this regard could only benefit the retail sector in the long run. Additionally, farmers would be benefitted as foreign retailers purchase crops at a fair price directly from agriculturists, thereby leading to elimination of profits accruing to middlemen.

## Many a slip between the cup and the lip

The Union Cabinet’s resolution approving the proposal to welcome foreign investment in multi-brand retail was widely appreciated by the market as a bold and positive step forward in taking India’s growth story forward. However, the strident protests that followed in the wake of this announcement seem to have muted the celebrations of foreign investors. With this issue put on the back-burner until a consensus can be reached, stakeholders are presently monitoring the situation with bated breath. However, well-informed discussion and debate in this regard should be welcomed as it would reveal that the pros far outweigh the perceived drawbacks, ultimately paving the way for FDI in the retail sector.

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