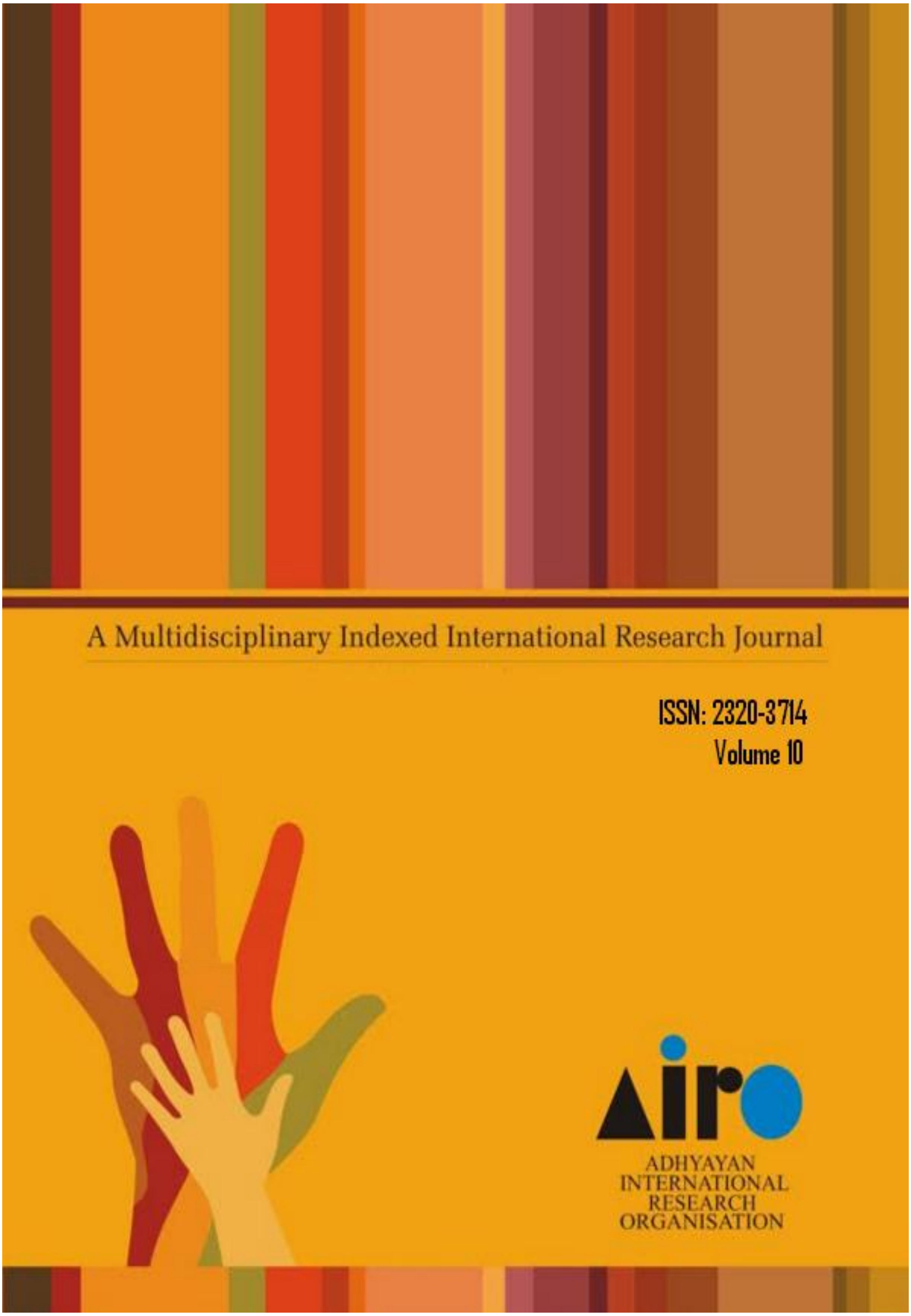
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Impact of Foreign Direct Investment on Indian Economic growth (Special reference to Retail Sector)

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ABSTRACT

Foreign direct investment (FDI) plays an important role in Indian economic growth dynamics. There are several examples of the benefits of FDI in India. FDI in the retail sector can expand markets by reducing transaction and transformation costs of business through adoption of advanced supply chain and benefit to the consumers and suppliers (farmers). The result is also net gains in employment at the aggregate level. Author has been given forth a few conceptual issues and analysis of qualitative information, data and stylized facts. Author takes following methods - Foreign direct investment in India, surveys retail sector growth forecasts in India, highlights components raised by opponents of liberalising FDI in retail trade, provides arguments in favour of allowing foreign competition in this sector, and outlines challenges for organised retail in India.

Key words: FDI in India, retail sector growth, liberalising FDI in retail trade, DIPP of the Government of India, challenges in retail sector.

INTRODUCTION

India is now the last major frontier for globalise retail. In the 21years since the economic liberalisation of 1991, India's middle class has greatly expanded and so has its purchasing power. But over the years, unlike other major emerging economies, India has been slow to open its retail sector to foreign investment. Recent signals from the government however suggest that this may be about to change global supermarket chain stores such as Wal-Mart (United States), Carrefour (France), Marks and Spencer and Tesco (UK) and Shoprite (South Africa) may finally be allowed to set up shop in India.

Foreign direct investment (FDI) in the retail sector in India is restricted in 2006, the government eased retail policy for the first time, allowing up to 51 Percent FDI through the single-brand retail route (see Section 2 for a classification of organised retail in India). Since then, there has been a steady increase in FDI in the retail sector, and the cumulative FDI in single-brand retail stood at $195 million by the middle of 2010 (DIPP Report, 2010) Foreign investment in the single-brand retail sector in India has been resilient to the global economic crisis of 2007–08. Given India’s large population and rapidly expanding middle class, there is robust and growing demand to rapidly expanding market.

LITERATURE REVIEW

It is universally acknowledged that FDI inflow offers many benefits to an economy. UNCTAD (1999) reported that Transactional Corporations (TNCs) can complement local development efforts by (i) increasing financial resources for development; (ii) boost export competitiveness; (iii) generate employment and strengthening the skill base; (iv) protecting the environment to fulfil commitment towards social responsibility; and (v) enhancing technological capabilities through transfer, diffusion and generation. However has rightly reported that in the absence of pro-active government policies.

OBJECTIVES OF THE STUDY

The present study has been undertaken with a conduct empirical analysis of impact of FDI in India growth and made some recommendation to flow of FDI in retail sector. Thus the objectives of the study can be enumerated as follows:

1. To analyze the pattern and direction of FDI flow in India.
2. To review FDI policy of India
3. To make policy recommendation to improve the level of FDI.
4. Retail sector growth forecasts in India
5. Highlights liberalising FDI in retail trade and point out its positive and negative effect on retail sector.

SURVEYS OF RETAIL SECTOR GROWTH FORECASTS IN INDIA

The retail sector in India is organised into three categories. According to the Department of Industrial Policy and Promotion (DIPP) of the Government of India, single-brand retail comprises those retailers selling products ‘of a “single Brand “only, such that products should be sold under the same brand internationally. Single-brand product retailing covers only products that are branded during manufacturing. In this category, FDI is allowed to the extent of 51 Percent from 2006 to March 2010, around 94 foreign firms applied to invest through the single-brand route of which 57 were approved. Consequently, the percentage increase in FDI flows in the retail sector between 2008 and 2010 was even higher than that in sectors such as the services sector, trading and telecommunications which have a much higher share in the country's overall FDI (DIPP Report, 2010). In contrast, no FDI is allowed in the multi-brand retail category. This includes all firms in organised retail that seek to stock and sell multiple brands, such as large international retailers like Wal-Mart and Carrefour. This is the sector that is most under dispute. The third segment, called 'cash and carry', refers to wholesale retail. The government defines this segment as the 'sale of goods and merchandise to retailers, industrial, commercial, institutional or other professional business users or to other wholesalers and related subordinated service providers. In India, FDI of 100 per cent is permitted in this segment. As per the 'cash-and-carry' structure commonly in India, the wholesale and retail entities are maintained as separate entities without any cross-shareholdings. The retail entity is owned and controlled by the Indian partner while the wholesale entity can be owned by the foreign partner up to 100 per cent. Wal-Mart, for example, has already established a successful presence in this category of wholesale operations by entering into a joint venture with Bharti Enterprises Ltd. of India. The new entity, Bharti-Wal-Mart, is in operation with stores opening around the country. The yardstick used to determine whether an operation is wholesale or not is the type of customers to whom the sale is made and not the size and volume of sales.

The data from private consulting company reports suggest that growth in the Retail market has been rapid despite major restrictions on FDI. In the third-quarter report of 2010, the BMI India Retail Report forecasts that the total retail Sales will grow from USD353 billion in 2010 to USD543.2 billion by 2014.1 An important consideration, the report suggests, is the fast-growing middle and Upper class consumer base the analysis also suggests that in the next few years, there will be major opportunities in India's smaller cities. AT Kearney, a global management consulting firm, rates India as the most attractive nation for retail investment.

HIGHLIGHTS CONCERNS RAISED BY OPPONENTS OF LIBERALISING FDI IN RETAIL TRADE

A third concern raised by domestic incumbent firms in the organised retail sector is an infant industry argument that this sector is under-developed and in a nascent stage. In this view, it is important that the domestic retail sector grow and consolidate first, before being exposed to foreign investors. Domestic firms in this sector oppose liberalising retail to FDI as they view multinational companies as direct competitors. A newspaper article describes opposition from an incumbent: 'Kishore Biyani (chief executive of the largest retailer in India) argues that the retail sector should not be given away to foreign players while it is too young to compete on a level playing field. He lacks the capital to build even average-sized Wal-Mart stores of 200,000 square feet—four times larger than his flagship Big Bazaar' (India Daily, 2005). In the Indian policy debate, a contrasting view is that growth in organised retail is expected to benefit producers, without (significantly) hurting smaller traders, and that they may preserve their smaller domains without being swallowed up by large retailers. However, the experience of organised retail in other parts of the world does not always bear this out. With respect to the impact of entry by big-box stores such as Wal-Mart on retail employment and earnings evidence from the United States is mixed. Using county-level data, a recent study finds that Wal-Mart entry increases retail employment in the year of entry (Basker, 2005) while contrasting evidence indicates that each Wal-Mart worker replaces approximately 1.4 retail workers representing a 2.7 per cent reduction in average retail employment (Neumark 2008).

BENEFITS OF FDI AND COMPETITION IN ORGANISED RETAIL IN INDIA

The changing structure and scale of retail can critically impact several industries in the short term – the retail industry itself, manufacturing, and real-estate, to name a few. And in the long term, spill-over effects can be felt in other industries. The growth of retailing has the potential to impact the performance of interlinked sectors such as manufacturing of consumer goods and agriculture- based industries. We begin by discussing the potential benefits of allowing entry by large foreign discount retail chains on lowering inflation, improving distribution and warehousing technologies. We do so by comparing findings from US studies that examine the effects of Wal-Mart and other large chains entering the US retail sector and the upheaval in the retail landscape brought about in the United States beginning in the early 1990s. The section concludes by describing a couple of policy recommendations made in the Indian Government's recent discussion paper on opening up the retail sector with a view to protecting domestic firms and increasing employment in the retail sector.

- **Lowering Inflation and Food Prices: -** Evidence from the United States suggests that FDI in organised retail could help tackle inflation, particularly with wholesale prices. Inflation is a politically sensitive subject, particularly for incumbent governments in a democratic country such as India, in particular because rising food prices tend to be regressive in their impact. This is underscored by the fact that the weight of food in rural and agricultural household consumption baskets is approximately 65–70 percent. Recent studies quantify the price impact of entry by low cost entrants. For example, using average city-level prices of various consumer goods, price dynamics in 165 US cities before and after Wal-Mart entry suggest robust reduction in prices for several products while magnitudes vary by product and specification, but generally range from 1.5 to 3 percent in the short run to four times as much in the long run with significant increases in consumer surplus especially for lower income households Taking into account demographics, store characteristics and market conditions, corroborating evidence suggests that Wal-Mart decreases prices by 6–7 per cent for national brand goods and by 3–8 per cent for private label goods. Price decreases are most significant in the dry grocery and dairy departments. Moreover, Wal-Mart sets grocery prices significantly lower than its competitors would lead to a continuously updated expenditure weighted average price calculation in comparison with the official Bureau of Labour Statistics approach. Estimates using their new approach would lower food at home inflation by about 0.32–0.42 percentage points, in turn lowering the estimated inflation rate by about 15 per cent per year. In India, food accounts for nearly 50 percent of the consumption basket and the impact on inflation reduction could therefore be significant.

- **Improving distribution and Warehousing**. It is expected that technical know-how from foreign firms, such as warehousing technologies and distribution systems, for example, will lend itself to improving the supply chain in India, especially for agricultural produce. Here, there are multiple inefficiencies in the supply chain that leads from farm to the dinner table. While the Indian government is the largest purchaser of food crops for many farmers, the consequence of a poor distribution system is that much of the stockpile fails to reach consumers and ends up rotting or as waste. India is the world's second largest producer of fruits and vegetables in the world after China, producing around 180 million tonnes per year. Official estimates are that about 25–30 per cent of this produce goes waste between harvest and consumption. Encouraging wholesale trading can create demand throughout the supply chain. In this spirit, the recent discussion paper talks of earmarking 50 percent of FDI inflows for building up of back-end infrastructure, logistics and agro-processing (DIPP Report, 2010). In theory, if fresh produce is collected efficiently at the farm-gate, and end-to-end cold-chain is maintained in storage and transportation until it reaches supermarket shelves as in developed countries, this wastage can be eliminated, translating into better prices for farmers and lower prices for consumers besides greater availability of the produce for processing, export and other value addition.

- **Employment Effects and Small Domestic Firms: -** The Indian Government recommends that retail firms source a percentage of manufactured products from the small and medium domestic enterprises (DIPP Report, 2010). With a restriction of this sort, the opening up of the retail sector to FDI could therefore provide a boost to small and medium enterprises. Moreover, expansion in the retail sector could also generate significant employment potential, especially among rural and semi-urban youth. The discussion paper considers the possibility of reserving 50 per cent of jobs in FDI-funded retail outlets for rural youth. Other issues up for debate include identifying possible locations for such outlets. The current thinking is that these stores could initially be allowed in cities with populations of over one million, particularly on the outskirts.

CHALLENGES FOR FOREIGN FIRMS IN ORGANISED RETAIL

The first challenge is competition from the unorganised sector. Traditional retailing has been established in India for many centuries and is characterised 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 labour costs. Moreover, they also pay little by way of taxes. Consumer familiarity that runs from generation to generation is one big advantage for the traditional retailing sector. It is often said that the mom-and-pop store in India is more like a father-and-son enterprise. Such small shops develop strong networks with local neighbourhoods. The informal system of credit adds to their attractiveness, with many houses 'running up a tab' with their neighbourhood kirana store, paying it off every fortnight or month. Moreover, low labour 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 organised 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 neighbourhood 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. Anecdotal evidence of consumers who return from such shops suggests that the wholesale model provides for major bargains – something Indian consumers are always on the lookout for. The other major challenge for retailers in India, as opposed to the US, is the storage set-up of households. For the large-scale retail model to work, consumers visit such large stores and return with supplies likely to last them for a few weeks.

CONCLUSION

India's retail sector remains off-limits to large international chains especially in multi-brand retailing. A number of concerns have been raised about opening up the retail sector to FDI in India. The first concern is the potential impact of large foreign firms on employment in the retail sector. A second related concern raised in the DIPP report is that opening up FDI would lead to unfair competition and ultimately result in large-scale exit of incumbent domestic retailers, especially the small family-owned business. A third concern raised by domestic incumbent firms in the organised retail sector is that this sector is under-developed and in a nascent stage. In this paper, we argue that the potential benefits from allowing large retailers to enter the Indian retail market may outweigh the costs. Evidence from the United States suggests that FDI in organised retail could help tackle inflation, particularly with wholesale prices. It is also expected that technical know-how from foreign firms, such as warehousing technologies and distribution systems, for example, will lend itself to improving the supply chain in India, especially for agricultural produce. Creating better linkages between demand and supply also has the potential to improve the price signals that farmers receive. By eliminating both waste and middlemen also increase the fraction of the final sales prices that is paid to farmers. An added benefit of improved distribution and warehousing channels may also come from enhanced exports. India's experience between 1990–2010, particularly in the telecommunications and IT industries, showcases the various benefits of opening the door to large-scale investments in these sectors. Arguably, it is now the turn of retail.

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