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RESEARCH ARTICLE
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A Critical Analysis of Foreign Direct Investment (FDI) in India

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ABSTRACT

Foreign Direct Investment (FDI) is considered to be a vital resource for development by the developing nations all over the world. However, the economic effects of FDI are very difficult, if not impossible, to measure accurately. Foreign Direct investment plays a very important role in the development of the nation. Sometimes domestically available capital is inadequate for the purpose of overall development of the country. Foreign capital is seen as a way of filling in gaps between domestic savings and investment. India can attract much larger foreign investments than it has done in the past. The present study has focused upon the trends of FDI Flow in India and various issues and challenges associated with it with a particular focus upon the retail sector. We know that India is a signatory to the World Trade Organization's General Agreement on Trade in Services. We had to open up the retail trade sector to foreign investment. Given that 95% of the sector constitutes unorganized retail consisting largely of "mom and pop" stores, the Government has treaded cautiously by building adequate safeguards for the domestic stakeholders in the unorganized sector. 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. It can be said that the advantages of allowing unrestrained FDI in the retail sector evidently outweigh the disadvantages attached to it and the same can be deduced from the examples of successful experiments in countries like Thailand and China where too the issue of allowing FDI in the retail sector was first met with incessant protests, but later turned out to be one of the most promising political and economical decisions of their governments and led not only to the commendable rise in the level of employment but also led to the enormous development of their country's GDP.

Key Words : Foreign Direct Investment, Inflows, Multi Brand Retailing, Single Brand Retailing

INTRODUCTION

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 per cent ownership was allowed under the Government approval route. It was brought under the automatic route in 2006. 51 per cent investment in a single brand retail outlet was also permitted in 2006.

Foreign Direct Investment:

FDI stands for Foreign Direct Investment, a component of a country's national financial accounts. Foreign direct investment is investment of foreign assets into domestic structures, equipment, and organizations. It does not include foreign investment into the stock markets. Foreign direct investment is thought to be more useful to a country than investments in the equity of its companies because equity investments are potentially hot

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money which can leave at the first sign of trouble, whereas FDI is durable and generally useful whether things go well or badly. A foreign direct investment (FDI) is a controlling ownership in a business enterprise in one country by an entity based in another country.

Foreign direct investment is distinguished from portfolio foreign investment, a passive investment in the securities of another country such as public stocks and bonds, by the element of "control". According to the *Financial Times*, "Standard definitions of control use the internationally agreed 10 per cent threshold of voting shares, but this is a grey area as often a smaller block of shares will give control in widely held companies. Moreover, control of technology, management, even crucial inputs can confer de facto control."

The origin of the investment does not impact the definition as an FDI, *i.e.*, the investment may be made either "inorganically" by buying a company in the target country or "organically" by expanding operations of an existing business in that country.

Defining the term:

Broadly, foreign direct investment includes "mergers and acquisitions, building new facilities, reinvesting profits earned from overseas operations and intra company loans". In a narrow sense, foreign direct investment refers just to building new facilities. The numerical FDI figures based on varied definitions are not easily comparable. As a part of the national accounts of a country, and in regard to the GDP equation Y=C+I+G+(X-M)[Consumption + gross Investment + Government spending +(exports - imports)], where I is domestic investment plus foreign investment, FDI is defined as the net inflows of investment (inflow minus outflow) 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. FDI is the sum of equity capital, other long-term capital, and short-term capital as shown the balance of payments. FDI usually involves participation in management, joint-venture, transfer of technology and expertise. *Stock* of FDI is the *net* (*i.e.*, inward FDI minus outward FDI) cumulative FDI for any given period. Direct investment excludes investment through purchase of shares. FDI is one example of international factor movements.

Types:

1. Horizontal FDI arises when a firm duplicates its home country-based activities at the same value chain stage in a host country through FDI.

2. Platform FDI Foreign direct investment from a source country into a destination country for the purpose of exporting to a third country.

3. Vertical FDI takes place when a firm through FDI moves upstream or downstream in different value chains *i.e.*, when firms perform value-adding activities stage by stage in a vertical fashion in a host country.

FDI Policy in India:

India has already marked its presence as one of the fastest growing economies of the world. It has been ranked among the top 3 attractive destinations for inbound investments. Since 1991, the regulatory environment in terms of foreign investment has been consistently eased to make it investor-friendly.

– 100% FDI allowed in the telecom sector.

– 100% FDI in single-brand retail.

– FDI in commodity exchanges, stock exchanges and depositories, power exchanges, petroleum refining by PSUs, courier services under the government route has now been brought under the automatic route.

– Removal of restriction in tea plantation sector.

– FDI limit raised to 74% in credit information and 100% in asset reconstruction companies.

– FDI limit of 26% in defence sector raised to 49% under Government approval route. Foreign Portfolio Investment up to 24% permitted under automatic route. FDI beyond 49% is also allowed on a case to case basis with the approval of Cabinet Committee on Security.

– Construction, operation and maintenance of specified activities of Railway sector opened to 100% foreign direct investment under automatic route.

FDI as defined in Dictionary of Economics (Graham Bannock et.al) is in-vestment 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 in-vested 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 Pro-motion Board ('FIPB') would be required. Foreign investment was introduced in 1991 under Foreign Exchange Management Act (FEMA), driven by then finance minister Manmohan Singh. As Singh subsequently became the prime minister, this has been one of his top political problems, even in the current times. India disallowed overseas corporate bodies (OCB) to invest in India. India imposes cap on equity holding by foreign investors in various sectors, current FDI in aviation and insurance sectors is limited to a maximum of 49%.

Starting from a baseline of less than $1 billion in 1990, a 2012 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 that attracted higher inflows were services, telecommunication, construction activities and computer software and hardware. Mauritius, Singapore, US and UK were among the leading sources of FDI. Based on UNCTAD data FDI flows were $10.4 billion, a drop of 43% from the first half of the last year.

Nine from 10 largest foreign companies investing in India (from April 2000- January 2011) are based in Mauritius. List of the ten largest foreign companies investing in India (from April 2000- January 2011) are as follows:

1. TMI Mauritius Ltd. ->Rs. 7294 crore/$1600 million
2. Cairn UK Holding -> Rs. 6663 crores/$1492 million
3. Oracle Global (Mauritius) Ltd. -> Rs. 4805 crore/ $1083 million
4. Mauritius Debt Management Ltd.-> Rs. 3800 crore/$956 million
5. Vodafone Mauritius Ltd. – Rs. 3268 crore/$801 million
6. Etisalat Mauritius Ltd. – Rs. 3228 crore
7. CMP Asia Ltd. – Rs. 2638.25 crore/$653.74 million
8. Oracle Global Mauritius Ltd. – Rs. 2578.88 crore / $563.94 million
9. Merrill Lynch(Mauritius) Ltd. – Rs. 2230.02 crore / $483.55 million
10. Name of the company not given (but the Indian company which got the FDI is Dhabol Power Company Ltd.)

Objectives of the study:

1. To study the emerging challenges in FDI in Indian Retail Sector.
2. To study the opportunities in FDI in Indian Retail Sector.
3. To recommend certain suggestions for growth of FDI in Indian retail sector.

METHODOLOGY

This study is descriptive in nature. The study is based on secondary data which has been taken from case studies, books, journals, newspapers and online databases and websites of DIPP (Department of Industrial Policy and Promotion), RBI (Reserve Bank of India) and FICCI (Federation of Indian Chambers of Commerce and Industry) and UNCTAD (United Nations Conference on Trade and Development). The main focus of the study is to highlight the emerging challenges and opportunities of FDI in retail sector.

Benefits/Opportunities of FDI:

FDI in retail would have been an opportunity to attract inflow of funds which would have resulted in major benefits for the Indian economy:

- ***Growth in allied industries:*** The inflow of funds into retailing would have simultaneously led to the growth of allied industries as happened in the case of automobiles, which led to the growth of auto components sector. Likewise FDI in retail would assist growth in supplier industries such as food-processing and textiles moreover; growing demand for retail space, construction of real estate would have also taken place.
- ***Improvement of Government Revenues:*** Another significant advantage of organized retailing is its contribution to government revenues. Organized retailers, by virtue of their being corporate entities need to file tax returns periodically whereas in the unorganized sectors there have been leakages in the collection of central and state taxes.
- ***Supports the growth of Indian small***

industries: If the consumers in India buy goods at foreign single-brand outlets, established in India and enjoy the shopping experience, in reality, they would be actively contributing towards significant money transfer to a multinational based out of the USA, which after retaining profits, would end up sending majority of this money to China, where most goods are being manufactured. The government appears to be cognizant of this very issue, which is why they proposed that at least 30 per cent of the procurement of manufactured / processed products shall be from "small industries" (presumably this refers to "small industries" in India). This aspect will lead to support the growth of the small industries in the country.

- ***Supports Improved Standard of Living***: Allowing FDI in Indian Single-Brand Retail will certainly bring in more sophisticated and luxurious goods and services to the country. Availability of such goods backed with good promotional support will definitely motivate / induce the Indian buyers to buy and consume them. It will be certain that the standard of living of the consumers will be improved. In addition to the above, the people who shall be employed in the multi-national retail enterprises will be paid attractive salaries and wages that will also stand for their increased affordability. The organized retail also provides other add-on services along with the products sold. All these new changes, that shall be resulted by allowing FDI in single-brand retail will surely support improved standard of living.

- ***Enhanced Competition and Reduced Prices:*** Entry of the many other multi-national corporations will obviously promise intensive competition between the different companies offering their brands in a particular product market. When the manufacturing companies will take efforts to increase their market share or to accomplish their other marketing objectives, competition among them will be activated. Such a competition will result in the availability of many varieties, reduced prices, and convenient distribution of the marketing offers.

- ***Enhanced Shopping Environment and Experience:*** Consumers in India mostly suffer from unhygienic experiences, erratic price and irregular availability in daily food and FMCG products. Many established foreign retail giants that are known for low pricing, creation of pleasant shopping environment, maintenance of hygienist, better customer care, effective inventory management and storage facilities shall efficiently contribute for eradicating the said problems and make the shopping very productive and a happy experience to the customers in India.

- ***Efficient Enforcement of Laws:*** The presence of International companies in Indian Retail will facilitate effective enforcement of Tax Laws and increase in tax revenue. Tax evasion could be stopped when more of the retail is in organised format.

- ***Overall Growth of The Country:*** FDI in Indian retail will obviously result in the growth and expansion of the market and change in consumer spending pattern and also increase in their spending that eventually lead to higher GDP in the country.

- *Efficient Supply Chain Systems:* The Government believes that FDI in retail is the silver bullet solution to all issues regarding the inefficient supply chain system in India. This belief rests on the premise that a component of the capital inflow into the retail sector will go into developing an extremely efficient and organized supply and logistic system that will take care of collection, storage and transportation of food produce, seamlessly. The government cannot expect the Wal-Mart's and the Tesco's to build good roads, without which the supply systems cannot be optimized. This is one of the constraints that Indian retail players are already struggling with. Globally, logistics account for around five per cent of total cost retail players incur, while it is as high as ten per cent in India, thus making a dent in its attractiveness.

- ***Higher Profits for Farmers:*** The section in the Indian Government that supports foreign investments in retail, believes that such a move has the potential to boost up the lives of our farmers. The underlying rationale is that with the giant retailers setting up shops and investing in fully integrated supply chain from farm gates to supermarket shelves, middlemen in the chain will be cut out. Without the intermediaries, food producers would get higher prices for their produce.

- ***Large-Scale Employment Generation:*** Proponents of FDI in retail have declared that there will be large-scale job creation in the economy. Union Minister for Commerce and Industry Anand Sharma went one step further by quoting a figure of 10 million as the number of new jobs to be created, with bulk of that supposedly coming from the logistics sector. For example, the Wal-Mart, whose global turnover is close to size of India's entire retail industry, employs only 2.1 million people. Assuming that the Wal- Mart and other retailer giants will extend their highly profitable model in the Indian retail sector as well, it is highly unlikely that 10 million jobs will be created. On the other hand, there is a possibility of loss of employment for several small retailers once foreign retailers establish themselves in the market, as seen in developed nations. In the Indian context, a study conducted by the Indian Council for Research on International Economic Relations in 2008 observed that unorganized retailers operating in and around organised retailers have witnessed a drop in business turnover and profits after the entry of large organised retailers. The entry of foreign players into the Indian retail market may or may not result in huge loss of jobs, but income reduction of marginal retailers and intermediaries is highly likely.

- ***Elimination of Food Wastage:*** Presently the highly unorganised and inadequate supply chain in India is considered responsible for the wastage of about a quarter of the total produce between the harvest and the consumption stages. In theory, development of an efficient end-to-end cold chain will make it possible to eliminate this wastage during the collection, storage and transportation of fresh produce from farms to supermarket shelves. The increase in supply base of food items due to elimination of waste will supposedly translate into higher income for farmers and lower prices for consumers. However, data from countries where retail is highly organised convey a different story. In the US and UK, anywhere between 20 and 30 per cent food is wasted by retail giants between the stages of production and consumption. A huge quantity of fresh produce is thrown away by the supermarkets during the sorting process since they have a policy of accepting products that conform to strict standards in shape, size and appearance. Hence, fresh fruits and vegetables which are otherwise edible are thrown away from supermarket shelves for their unappealing looks. The Environment Agency estimates that the total UK retail food waste is 1.6 million tonnes per year.

Benefits to consumers:

- Consumers have increased the competitiveness of domestic players;
- The growth in the sector assisted the development of the auto component industry which not only produces products of global standards but has also resulted in increased employment;
- The productivity levels within the sector have improved as a result of following globally recognized models of manufacturing;
- The technological capability of Indian firms has also seen improvements over the years;
- FDI bought the required capital into the sector which assisted players in scaling up their supply thereby assisting their overall efficiency and growth;
- Consumer choices have increased by many folds both in terms of product range within a price range as well as across price range;
- The Indian consumer today has access to global brands;
- The quality of products in terms of customer experience as well as other parameters such as safety, accessories have improved tremendously.

Over the years there have been new product categories that have been created keeping in mind the change in customer preferences. The recent surge in demand for luxury and high end automobiles has been noticed by various international brands which have now started looking at India as a future growth driver.

Challenges:

The first challenge is competition from the unorganized sector. 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. 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 neighborhoods. The informal system of credit adds to their attractiveness, with many houses 'running up a tab' with their neighborhood kirana store, paying it off every fortnight or month. 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.

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 setup 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. Having such easy access to neighborhood stores with whom, as discussed above, it is possible to have a line of credit and easy delivery service, congested urban living conditions imply that few Indian households might be equipped with adequate storage facilities.

Suggestions:

FDI since 1991 has proved to be game changer for wide segments of Indian industry. FDI has changed quality, productivity, and production in areas where it has been allowed.

1. India needs to invest in infrastructure development because India is lacking only in this which will affect our Retail Industry;
2. India should increase the investment absorption capacity;
3. India should make FDI policies little bit more liberal so that it can face competition with other emerging economies;
4. Bureaucratic delays and various governmental approvals and clearances involving different ministries need to be fastened;
5. Restrictions on sector caps and entry route to sectors other than those of national importance need to be liberalized further and constant reviewing of policies must be done.
6. Government must ensure consistency of policy so as to improve the business and investor confidence.

Conclusion:

In light of the above, it can be safely concluded that allowing healthy FDI in the retail sector would not only lead to a substantial surge in the country's GDP and overall economic development, but would also help in integrating the Indian retail market with that of the global retail market in addition to providing not just employment but a better paying employment, which the unorganized sector (kirana and other small time retailing shops) have undoubtedly failed to provide to the masses employed in them. Thus, as a matter of fact FDI in the buzzing Indian retail sector should not just be freely allowed but should be significantly encouraged. Allowing FDI in multi brand retail can bring about Supply Chain Improvement, Investment in Technology, Manpower and Skill Development, Tourism Development, Greater Sourcing from India, Up-gradation in Agriculture, Efficient Small and Medium Scale Industries, Growth in market size and Benefits to Government through greater GDP, tax income and employment generation.

Despite the current policy and regulatory environment not being 'perfect' for foreign investors, there are clearly moves towards improving the current position and facilitating FDI inflows without having a detrimental impact on various sectors of the economy. The current policy is trying to encourage Joint Ventures in multi-brand retailing so as to boost the domestic retailer's growth in this area. However, there is also the risk that some foreign retailers will not be interested in investing unless they have 100% ownership and that the current policy will prevent them from choosing India as a Retail destination. In our view, the advantages outweigh the disadvantages of allowing unrestrained FDI in the retail sector, as successful experiments in countries like Thailand and China demonstrate. In both countries, the issue of allowing FDI in the retail sector was first met with incessant protests, but allowing such FDI led to GDP growth and a rise in the level of employment.

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