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Liberalization on The Foreign Direct Investment Policy for The Retail Sector in India

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ABSTRACT

Economic Liberalization as the outcome of New Economic Policy 1991 was a major landmark in India's economic growth trajectory. Since then, the country witnessed capital inflows in the form of FDIs and FIIs in almost all spheres of economic activity. The retail sector itself grabbed much out of this inflow across the nation. As per the latest IBEF Report, India's retail sector is worth a whopping US $1200 billion. It is projected to reach US $1300 billion by 2024. India was ranked, first in the Global Retail Destination Index of 2017 and is ranked 63rd in the Ease of Doing Business Rankings. The Indian industry recorded a net direct sale of US$ 2.47 billion in 2019. The transformation of the Indian retail sector has been consistent in bringing in investment. This metamorphosis of the retail sector is the consequence of various policy decisions.

Keywords: Economic Liberalization; FDI; MNC; Capital inflows; Retail Sector; Multi-brand retailing.

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1. INTRODUCTION

Since the introduction of the liberalised Foreign Direct Policies ('FDI') in the early 1990s, the Indian economy has been a haven of investment for many multi-national corporations ('MNCs'). This trend was expected to span across decades bringing in huge amounts of investment in the Indian economy. It will be seen that the retail sector has particularly benefitted from the introduction of the liberalised economic policies; India's retail sector is worth a whopping US $1200 billion [1]. It is projected to reach US $1300 billion by 2024. India was ranked, first in the Global Retail Destination Index of 2017 and is ranked 63rd in the Ease of Doing Business Rankings. The Indian industry recorded a net direct sale of US$ 2.47 billion in 2019 [2].

The transformation of the Indian retail sector has been consistent in bringing investment. India was ranked sixteenth in the FDI Confidence Index, 2019. The cumulative FDI inflows in the retail sector stood at US $3.44 billion between April 2000 and December 2020 [3]. The retail sector brought in US$ 6.2 billion from various private equity and venture capital funds in 2020. Swedish furniture maker Ike a recently opened its second establishment in India at Navi Mumbai and in February 2021, Greyweave, a handmade carpets and rugs brand, announced an investment of Rs.75 lakhs as a part of its offline expansion programme in India [4]. This paper is an attempt at analysing the various policy decisions following the liberalization of the Indian economy in 1991 and the consequent impact on the inflow of FDI into the retail sector.

2. MATERIALS AND METHODS

The paper is based on secondary data, of which are collected from reports, articles and online sources.

3. RESULTS, ANALYSIS AND DISCUSSION

3.1. Organised retail sector: The retail sector can be broadly classified into the organised and unorganised sectors, where the former refers to establishments such as supermarkets, retail chains, and other franchises, while the latter refers to street vendors, street markets, and 'hole-in-the-wall' shops. Nearly, 92% of India's retail sector belongs to the unorganised category. Prior to the initiation of the liberalised FDI policy, the organised sector experienced a snail-like growth owing to the strict restrictions on consumer behaviour [4]. The existence of high tax rates and expensive licences were certainly not an encouragement for foreign investment in the sector. With the introduction of the liberalised policy, the evolution of the retail sector witnessed a rise in consumerism within a short span. This significant trend in consumer behaviour was an impetus for global giants such as Samsung, Sony, and Kellogg's to break into the Indian consumer market. The government ushered in the MNC's with reduced taxes and other policy benefits, which in turn ensured that domestic enterprises competed in terms of retail innovation, better technology, and management practices [5]. In 1991, the Indian government had approved 100% FDI in the wholesale cash-and-carry market with automatic approval. Later in 2006, the government allowed FDI of up to 51% in single-brand retail subject to prior approval. Between 2006 and 2010, 94 proposals were recorded, out of which 57

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were accepted and implemented for single-brand retailing [5].The organised sector of the retail industry can be broadly classified into two: (a) multi-brand retail and the (b) single-brand retail sector.

3.1.1. Multi Brand Retail: Multi-brand retail refers to a system where foreign investors are willing to sell multiple brands under one roof. Examples would include supermarket chains such as Walmart, Tesco, and Cosco. In 2012, the government had implemented the 51% cap on the FDI in the multi-brand retail sector, the investment route being the approval by the Department of Promotion of Industry and Internal Trade ('DPIIT'). The policy places a minimum investment cap of US $100. 30% of the procurement of manufactured or processed products must be from small and medium-sized enterprises. It also requires a minimum of 50% of the FDI to be invested in backend infrastructure such as logistics, cold labs, and agro testing units, to ensure overall development. Such a structure would exclude the middlemen, thereby allowing farmers to obtain significantly better prices. The benefit also extends to the improvement and development of the retail supply chains [6].

The new policy also mandates that 50% of the jobs in the retail outlets be reserved for the local workforce, and a part of the supply be procured from poor producers. To ensure the continued functioning of the Public Distribution System and the Food Security System, the government reserves the right to procure a certain proportion of the food grains. This ensures that the prices of food and commodities are secure. Additionally, the development of the backend infrastructure allows consumers to purchase high-quality goods at lower prices with the guarantee of better services [7].

The restrictive policy does not allow multi-brand retail traders to engage in e-commerce trading as opposed to single-brand retail traders. The opening of retail stores and outlets has been restricted to cities with more than ten lakhs or any other city or metropolitan area notified by the State government. The policy also states that the fresh agricultural and meat products for sale in these stores do not have to be branded. Nevertheless, the policy amendment has been received with a generally positive outlook as per various consulting agencies such as Ernst & Young, Technova and KPMG. The DPIIT has recently approved three FDI policies, Mountain Trailer Food, Koehler India Corporation, and Merlin Entertainments in single-brand retail [8]. The department has also approved two proposals worth more than Rs. 400 crore within the retail sector.

3.1.2. Single Brand Retail: Single brand retail refers to the products sold under the same brand on an international scale. This does not involve the sale of multi-brand goods; even if such goods have been produced by the same manufacturer. Examples of single-brand retailers include global smart phone giants Apple and Samsung. The FDI was initially restricted to 49% through the automatic route. In 2012, the government announced up to 100% FDI in the single-brand retail under the government-approved route, wherein permission was required from the DPIIT. This policy had a 30% local sourcing requirement which was perceived as detrimental to the expansion plans of many companies [9].

An example would be the French Sports retail store Decathalon, which received a 100% FDI approval in 2013 and currently operates 75 retail stores in the country. However, in 2018, the need for governmental approval was scrapped, and now the 100% FDI is done through the automatic route

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[10]. Under this new policy, single-brand retail entities ('SBRT') would be permitted to set off their incremental sourcing of goods from India for global operations during the initial five years. The period of five years shall be calculated, with the reference point being the 1st of April of the year of opening the first source. This is in opposition to the compulsory sourcing requirement of 30% of purchases from India. After completion of a five-year period, the SBRT entity will be required to meet the 30% sourcing norms directly towards India's operation on an annual basis. The liberalised take on the policy would now permit the sourcing done for global operations via third parties such as contract manufacturers to be recognised as fulfilling the domestic sourcing obligation [11].

Additionally, all procurements made in India, either by domestic purchase or export, would be accounted for as local sourcing. In 2019, the FDI policy was further amended to allow single-brand retail stores to open first with online stores, though a brick and mortar store must be opened within two years of the online platform being set up. The investor-friendly amendments to the single-brand FDI policy have seen a response from companies. For instance, Apple opened its e-store in late 2020 and its first physical retail store in 2021.The fact that Apple boasts a market share of nearly 75% in the premium smart phones range, the amendment to this policy has undoubtedly paved the way for future investment. A similar example is that of Swedish furniture brand Ike a, which following the policy amendment, opened its first retail store in Hyderabad in 2020. In March 2021, MI India announced an Rs.100 crore support plan for its retail partners over the next two years [12].

The removal of the 30% local sourcing requirement has been criticised as detrimental to the MSME structure in India. Despite the policy changes, many investors still tend to view the Indian retail sector as 'murky'. Such an outtake has led to companies such as Marks & Spencer and Zara have opted for partnerships with Indian retail giants over the FDI system [13]. Nevertheless, the 2018 and 2019 amendments to policy are significant contributing factors to an improved Ease of Doing Business ranking.

3.2. FDI and E-commerce: India's e-commerce sector has exploded in recent years and continues to thrive. In recent years, e-commerce businesses have been incorporated under the companies act, 2013. FDI in India's e-commerce start-up ecosystem can result in a cash infusion and increase the ecosystem's development potential. In recent years, e-commerce firms that use the marketplace model have seen substantial development. The inventory-based e-commerce firms, on the other hand, have not reaped the benefits of the FDI policy reforms in India [14].

The DPIIT has outlined the FDI policy for e-commerce activities in India in the "Consolidated FDI Policy Circular 2020", which came into effect on the 15th of October 2020. The policy allows for a 100% FDI in e-commerce activities through the automatic route. However, this is contingent on the e-commerce start-ups and entities engaging in the Business – to- Business (B2B) model and not the Business–to–Consumer (B2C) model. As inferred from the terminology, B2B refers to a system of transaction where both the parties are businesses as opposed to the B2C system, where one of the parties is an individual consumer. Furthermore, the 100% FDI via the automatic route is restricted only to the marketplace model of e-commerce activities and does not extend to the inventory-based model [15]. The marketplace model refers to a system where the e-commerce entity provides an online platform facilitating transactions between the buyer and the seller. On the other hand, the

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inventory-based model refers to a system where the e-commerce entity owns the inventory of goods is services listed on the online platform. The role of facilitation is replaced by that of direct engagement in the transaction.

This classified application of the 100% FDI policy in e-commerce activities can be seen as an attempt to alleviate the concerns that the increased reliance on FDI will not bode well for the local markets and traditional businesses. By restricting the application to the market place model, the government has allowed small businesses to remain in the mix and benefit from the vast potential that the e-commerce industry holds [20]. The interest of not leaving out the small businesses is further evident in other guidelines which allow e-commerce entities to provide support centres to the local sellers concerning logistics, warehouse management, payment, delivery services, etc. The policy also bars the entity from directly or indirectly influencing the prices and mandates the entity to provide a level playing field. In furtherance of maintaining the distinction between the e-commerce entity and the vendors, the policy also bars entities with equity participation by the e-commerce entity or their group companies or having control over its inventory by e-commerce entities or their group companies from engaging in transactions on the e-commerce platform [16]. Thus, the policy is designed on the fundamental premise that the benefit of the liberalised foreign investment policy is to percolate down into all levels of the retail sector.

100% FDI is allowed through the automatic route for the single-brand entities with the condition that they open brick and mortar stores in two years from the opening of the online platform. FDI in e-commerce for the multi-brand sector is not allowed in any form or stage. Existing and prospective investors have well received the changes in the FDI policy with respect to e-commerce entities [19]. In April 2020, Amazon India announced an investment of Rs.10 crore to energise its pilot “Local Shop on Amazon” programme, which added more than 5000 retailers onto the platform in more than 100 cities.

3.3. Implications for the Unorganised Sector: Over 98% of the retail market currently belongs to the unorganised bracket. India’s relatively late entry into the contemporary organised retail sector market is attributed to the government’s restrictions on foreign investment. Following liberalization, changes in FDI regulations have significantly impacted unorganised retailing, as prominent players have now been granted access to the retail market. Furthermore, the policy changes have been a catalyst for changes in factors such as income and employment levels in the unorganised market [18]. In 2005, it was noted that foreign retailers agreed with the local producers for in-house labelling and delivering new technologies. This practice of local sourcing was a significant contributor to increasing the efficiency of the retail supply chain management system. On a cost-benefit analysis, it is argued that the potential benefits of bringing a major retailer into the Indian retail sector may exceed the costs. As evidenced by the data from the United States, FDI from the organised sector aids in the management of rising inflation, particularly in wholesale prices [17]. It also enhances India’s technical expertise and supply chain infrastructure, particularly for perishable items such as agricultural products.

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4. CONCLUSION

It is evident that the liberalisation of the FDI policy has allowed the Indian economy to tap into and glimpse the massive potential of its retail sector. The retail sector alone contributed to an FDI flow of US$ 1.8 billion between 2000 and 2010. The most notable FDI policy changes in the Indian retail sector are the 100% FDI via automatic route in single-brand retail and the 51% FDI through the government route in the multi-brand retail sector. These policies have been efficient in the promotion of investment in this sector, but observers warn of the hazards such policies pose to traditional businesses and the local producers. It is argued that the FDI in retail would lead to a more comprehensive integration of India into the worldwide market, despite the fact that FDI in the energetic Indian retail sector should not just be freely allowed and encouraged. Innovative government measures could further mitigate adverse effects on small retailers and traders. It would be unfair to state that the government has been ignorant of these threats, as the recent policy change with regard to e-commerce indicates otherwise. The policies allow for farmers to get the skylight of direct marketing and consequently be better remunerated. However, this would require affirmative action and the creation of adequate safety nets. With a proactive interaction of various laws, it is possible for the Indian economy to secure a bright future for FDI in the retail sector.

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