Research Paper Commerce

FDI in Retail Sector and its impact on MSMEs in India

Dr. Sudhansu Sekhar Nayak — Lecturer in Commerce, R.N.College, Dura, Berhampur-10, Ganjam (Odisha)

Mr. Prasanta Mahapatra — Chairman , Gurukul International, Berhampur (Odisha)

ABSTRACT

Small and medium enterprises play a very important role in the development process of the country since independence. It is the 2nd largest employer in the country after agriculture at the same time contributes nearly 6% in the GDP of the country in 2011. Indian retail sector today is valued at $450 billion, and is increasing day by day due to its increasing middle class population and their spending power. Small and medium enterprises dominate the Indian retail sector.

Foreign Direct Investment, in India, has to be dealt cautiously before it is allowed to enter our country as this is going to have a direct impact on a very large population of the country. If proper regulation is not conferred on them and they are left alone to profit it will result in deepening the gap between the rich and the poor. Therefore it is required to canalize foreign capital in retail sector before it is allowed to enter Indian markets in such away that it benefits Indian economy more. This can be done by making proper rules and regulations to control the operations of multinationals in the country so that they do not act in a monopolistic manner and treat India as a milk cow.

KEYWORDS MSMEs, FDI, FEMA, DIPP, FIPB , FICCI, SIA

INTRODUCTION:

Small and medium enterprises play a very important role in the development process of the country since independence. The sector is more labour intensive than large enterprises. In an agricultural based economy like India, it provides simple Livelihood and employment opportunities to the people. It also helps in the development of entrepreneurial skill and helps in the equitable distribution of income through decentralization of economic activities. The MSME sector is the 2nd largest employer in the country after agriculture at the same time contributes nearly 6% in the GDP of the country in 2011. As per the Third All India Census of Small Scale industries conducted in 2004, the SME's have increased from about 80,000 units in the 1940's to more than 100 lakh units till 2011. Their total employment is about 25 million and they produce about 7500 products including high technology products. In the sports goods and garments sector their contribution to exports is as high as 90% to 100%. They constitute 90% of the industrial units in the country and also contribute to about 35% of India's exports.

Government of India, in its policy regulations and in different five year plans, recognized the importance of MSME sector and gave a special status and protection in its policies. It reserved 842 items to be exclusively manufactured by small industries, i.e., large corporations were not allowed to enter in the reserved category. Further, Government policies to counter regional imbalances (1977) promote ancillarisation (1980), encourage exports and dispersal in rural areas (1990) and then to promote Small, Tiny and Village Industries (1991) were some of the measures to promote micro and small and medium enterprises. The Micro, Small and Medium Enterprises Development (MSMED) Act, 2006 was passed to facilitate the development of these enterprises as also enhance their competitiveness. It provides the first ever legal framework for recognition of the concept of enterprise which comprises both manufacturing and service entities. It defines medium enterprises for the first time and seeks to integrate the three tiers of these enterprises namely micro, small and medium.

Globalization and Industrial Policy, 1991 brought a massive change in the economic scenario in the country. India became the member of World Trade Organization in 1995 which forced its member countries, including India, to bring economic reforms in the country. It forced its member countries to drastically scale down quantitative and non-quantitative restrictions on imports and pave the way for foreign direct investment in their country. As a result, restrictions were removed from many reserved categories including wholesale and retail business in India. As a result, de-reservation took place in the name of technological upgradation and higher productivity and the number of reserved items reduced from 842 in 1950-51 to 21 at present.

Retail sector in India :

Retailing can be said to be the interface between the producer and the individual consumer buying for personal consumption. This excludes direct interface between the manufacturer and institutional buyers such as the government and other bulk customers. Retailing is the last link that connects the individual consumer with the manufacturing and distribution chain. A retailer is involved in the act of selling goods to the individual consumer at a margin of profit.

With strong fundamentals developing in the economy with changes in income levels, lifestyles, taste & habits reflecting in strong consumerism with preference for superior quality and branded products, vast domestic market with a very competitive manufacturing base, India also observed a major retail boom in recent years.

Being encouraged by India's growing retail boom many multinational companies also started making beeline to enter India's retail market. Indian Industry, by and large, has also hailed investment from abroad which has been considered to be very vital for adding to domestic investment, addition to capacity, higher growth in manufacturing, trade, business, employment, demand, consumption and income with multiplier effects.

Government has also taken a number of policy measures, in recent times, for encouraging growth of retail business and other allied activities like creation of the required infrastructure facilities, centers of manufacturing excellence, providing for a good network of production, marketing, storages, distribution and cold chain facilities for spreading the effects of develop-

ISSN - 2250-1991 | IF : 5.215 | IC Value : 77.65

ment to downstream level for inclusive growth.

Indian retail sector today is valued at $450 billion, and is increasing day by day due to its increasing middle class population and their spending power. Small and medium enterprises dominate the Indian retail sector. The retail industry can be divided into three categories (i) organized large, (ii) unorganized and (iii) informal sector enterprises.

(i) Organized retailing refers to trading activities undertaken by licensed retailers who are registered with sales tax/ VAT etc. Such enterprises are super markets, hypermarkets, retail chains, and also the privately-owned large retail businesses. Their presence on scene, though of a recent origin, is gradually gaining in importance, and slowly eating in to the business of other two categories of retailers.

(ii) Unorganized retail trade enterprises refers to the traditional formats of low cost retailing, for example, local kirana shops, owner manned general stores, etc. Their number is very large and this category of enterprises dominate Indian scenario with a whopping 98 per cent estimated share in the total establishments. They are providing tough competition to large retail outlets.

(iii) The third category of retailers, which includes small shops such as tiny grocery and vegetable shops run from a room of a house, paan/beedi shops (often selling a variety of items, like small toothpaste tubes, tooth brushes, soaps, pouches of shampoo, etc), way-side vendors, and hand carts operating without any licenses.

Retail industry is India is much different from developed countries. In developed countries, organized sector plays a very important role in the distribution of goods and services and forms nearly 20-30% of the total retail business. In India, only 6% of retailing is done through organized sector rest of retailing is done by unorganized and informal sector. Till recent years, it was mostly restricted to big cities.

FDI policy in India :
FDI means investment in a foreign country through the acquisition of a local company or the establishment there of an operation on a new site. In simple words, FDI refers to capital inflows from other country 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 monitoring and reviewing the FDI policy on continued basis. 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 in retail sector in India :
DIPP and consolidated FDI Policy issued in October 2010 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.

Till recently, Government of India allowed 51% FDI in single brand retail. FDI in multi brand retail has not yet been allowed. The decision is yet to be taken. In order to encourage organized trading in retail sector, government has announced 51% FDI in . multi brand retail and 100% in single brand retail in Nov 2011. The main driver for this policy may be to remove the inefficiency and defects prevalent in the distribution system, especially food related chain stores. There is a lot of post harvest loss suffered by the farmers when the are forced to sell their produce to the middlemen at cheaper rates. Intermediaries obtain a disproportionate share and farmers receive only 15% of the end consumer price.

According to the global consultancy firms AC Neilsen and KSA Technopak India has the highest shop density in the world. In 2001 they estimated there were 11 outlets for every 1,000 people. Further, a report prepared by Confederation of Indian Industry (CII) predicted that global retail giants such as Tesco, Kingfisher, Walmart, etc, are waiting to enter the retail sector in India. This report also states that the Indian retail market holds a lot of potential to grow provided the sector is opened up significantly. It does not talk about creating additional jobs however, which should be the prime concern of the policy maker.

Benefits of FDI in retail sector in India :
According to the Federation of Indian Chambers of Commerce and Industry (FICCI), the current size of the Indian retail market is $450 billion which is expected to increase to $850 billion in the next 10 years. At present, 35 per cent of products are sourced from SMEs. The projections are that by 2020, more than $298-billion worth products would be sourced from SMEs. International retailers see India as a huge market for investment of their capital as opportunities in developed countries has come to a saturation. They are in need of new and potential markets for their capital investment and India provides it all for them.

A. Benefits to Customers :
Customers are always benefitted by competition. Products are available to them at lower price. Consumer will get variety of products at low prices compared to market rates, and will have more choice to get international brands at one place. This is very much evident when we visit a mall where variety of offers is given to lure customers to buy.

B. Benefits to Consumers :
Consumers will get variety of products at low prices compared to market rates, and will have more choice to get international brands at one place. It will improve the quality of products at the same time reduce wastages, They will get best products and services at reasonable price also.

C. Development of Infrastructure :
Lack of infrastructure is one of the major problem faced by the retail sector in India. It has led the process to an incompetency. Inadequate storage facilities cause heavy losses to farmers. 25%-30% of F&V and 5%-7% of food grain in India are wasted. An 11th plan working group has estimated a total investment of Rs 64312 crore in agriculture infrastructures. FDI in retail will bring investment, technology, management know how etc. Food inflation and fluctuation in food prices can also be controlled.

D. Better Realization for Farmers :
There tail business in India is dominated by intermediaries. They act as an interface between the manufacturers or producers and the consumers. Hence the farmers and manufacturers lose their actual share of profit margin as the lion's share is eaten up by the middle men. Indian farmers realize only l/3rd of the total price paid by the final consumer against 2/3rd by farmers in nations with a higher share of organized retail. This issue can be resolved by FDI, as farmers might get contract farming where they will supply to a retailer based

upon demand and will get good cash for that, they need not search for buyers.

E. Economic Growth :
Entry of foreign companies in India will help in building up the infrastructure in the country. This will also help in the growth of real estate sector consequently banking sector will also grow as money is required to build infrastructure would be provided by banks. FDI in retail sector will help in the expansion of stores and operations which leads to employment generation. India can also become shopping destination for the world. Sectors like Textile and handicraft will get a significant boost. Sourcing from India will increase. Exports to get significant boost.

F. Competition :
Opening up of retail sector to foreign investment is definitely going to induce competition and innovation in the sector. It is a general rule that good and healthy competition increases the efficiency of all the units operating in the market. It ensures highly efficient-low margin business model in the country.

G. Creation of Foreign Exchange :
Foreign Direct Investment helps, to a great extent, in solving the problem of foreign exchange in the country. To meet its foreign trade deficits, foreign currency is required which is ensured by FDI in different sectors in the country and retail sector may be one among them.

Disadvantages of FDI :
A number of issues are to be concerned before making partial opening of the retail sector in India. Some of them are as follows:

1. Unemployment :
Retail industry in India is the second largest employer after agriculture. Any game changing situation can lead to heavy job losses particularly in rural areas and small cities. Entry of large global retailers such as Wal-Mart would kill local shops and millions of jobs, as the unorganized retail sector employ an enormous percentage of Indian population after the agriculture sector.

It would lead to unfair competition and ultimately result in large-scale exit of domestic retailers, especially the small family managed outlets, leading to large scale displacement of persons employed in the retail sector. Further, as the manufacturing sector has not been growing fast enough, the persons displaced from the retail sector would not be absorbed there.

2. Nascent stage of organized retail sector in India :
Another concern is that the Indian retail sector, particularly organized retail, is still under-developed and in a nascent stage. The domestic organized sector may not be able to compete with international players and may lose their market share. Therefore, it is important that the domestic retail sector is allowed to grow and consolidate first, before opening this sector to foreign investors.

3. Evils of monopoly :
Unfair competition and abilities of big retailers to sustain losses can lead to large scale exit of domestic retailers, especially the small family managed outlets. It would lead to monopoly. One monopolistic tendency is created in the country, the global retailers would conspire and exercise monopolistic power to raise prices and monopolistic power to reduce the prices received by the suppliers. Once the competitors are eliminated from the market and fanners are left with no other options than to sell their produce only to them, they may be forced by these multinationals to sell at a very low price and at the same time may charge huge amount from customers.

4. Impact on the economy :
FDI, no doubt, in the beginning would bring foreign capital that may act as an accelerator of economic growth but ultimately it would drain away the country's share of revenue to foreign countries that would have a negative impact on Indian economy in the long run.

5. Regional Disparity :
It would lead to asymmetrical growth in cities, causing discontent and social tension. Multinationals and private companies are always interested in making profit and would open their centers in big cities only. Remote areas would be left out that would add to their backwardness. Hence, both the consumers and the suppliers would lose, while the profit margins of such retail chains would go up.

6. Infrastructure :
There is a lack of proper infrastructure facility in the country which is prevalent in retail sector also. For example, India is second largest producer of fruits and vegetables but has a very limited integrated cold-chain infrastructure. Due to this it becomes very difficult to market such perishable commodities in distant markets. Lack of storage facilities cause huge loss to the fanners. They are forced to sell their produce at lower price to middlemen in post harvest season, in order to prevent further losses due to perishable nature of their products.

7. Domination of intermediaries :
Intermediaries often dominate market norms and their pricing lacks transparency. Wholesale regulated markets, governed by State APMC Acts, have developed a monopolistic and non-transparent character. According to some reports, Indian farmers realize only I/3rd of the total price paid by the final consumers.

8. Improper Public Distribution System :
In recent years, we have witnessed a lot of controversy as regards public procurement and public distribution system. Despite heavy subsidies, overall food based inflation is rising which is a matter of great concern. The absence of a proper retail supply system has led to the ultimate customers paying a premium for shortages and a charge for wastages.

9. No Global Reach :
The Micro Small & Medium Enterprises (MSME) sector in India has also suffered due to lack of branding and lack of avenues to reach out to the vast world markets. While India has continued to provide emphasis on the development of MSME sector, the share of unorganized sector in overall manufacturing has declined from 34.5% in 1999-2000 to 33.2% in 2008-09. This has largely been due to the inability of this sector to access latest technology and improve its marketing interface.

Suggestions :
In order to safeguard the interests of Indian retailers, consumers, farmers and all other parties affected directly or indirectly by FDI in retail sector in India, following recommendations may be considered:

1. Proper rules and regulations must be framed in order to ensure that large retailers are not able to dislocate small retailers by unfair means.
2. To improve the efficiency of small retailers they must be provided with institutional credit, at lower rates, by public sector banks
3. Formulation of a Model Central Law regarding FDI in retail sector
4. Formulation of proper regulations for big shopping malls in the country to regulate the fiscal and social aspects of the entire retail sector,
5. Clear guidelines on investment in Infrastructure and Export commitments for International Retailers would help all stakeholders to benefit.
6. Investments in Infrastructure, especially Transportation, Cold Storage, Roads for efficient movement of goods

Conclusion :
Developed economies have come to the saturation point.

Now, further investment of capital does not bring adequate returns to the capital invested. They are looking towards developing countries for investment of capital and for earning good profits. At the same time, it cannot be denied that opening up the sector in the era of globalization is the need of the hour. If foreign investment is going to benefit multinationals then it is also likely to benefit Indian economy by bringing foreign capital which will act as a stimulus for the development of the economy as a whole. The only pre-requisite is formulation of proper rules and regulations to monitor it. Government has already added an element of social benefit. Multi brand retail sector is allowed to enter the Indian market only in collaboration with a domestic company. This will benefit both the MNC as well as the domestic company. MNCs can teach their expertise to domestic companies and in turn get the entry in the Indian market. Further, only those foreign retailers are allowed to enter the Indian markets who first invest in the back-end supply chain and infrastructure.

Therefore, it is necessary that the Government must consider the various pros and cons related to the entry of foreign players into the Indian market, and then come to take a firm decision.

References :

1. dipp. (2010). Discussion paper on foreign direct investment (FDI) in multi-brand retail trading. New Delhi: Department of Industrial Policy and investment Promotion
2. Government of India (2002).India Vision 202.Planning Commission, India.
3. World Bank, Global Economic Prospects and the Developing Countries, 1994
4. UNCTAD, World Investment Report 2004
5. Guruswami, M., Sharma, K., Mohanty,]., & Korah, T. FDI in India's Retail Sector: More Bad than Good? New Delhi: Centre for Policy Alternatives.
6. India's Retail Sector (Dec 21, 2010) http://www.cci.in/pdf/ surveys reports/ Indias retail sector.pdf
7. Agarwal and Tyagi, Foreign Direct Investment in Indian Retail Sector-An Analysis
8. Mukherjee, Distribution Services: India and the GATS 2000. http://www \FDI\fdi in retail --imp.htm
9. Federation of Indian Chamber of Commerce and Industry (FICCI) http://b.scorecardresearch.com/
10. Discussion Paper on FDI in Multi Brand Retail Trading, http:// dipp.nic.in/DiscussionPapers/ DP_FDI_Multi-BrandRetailTrading
11. The Economic Times. (2010, July 8). BJP opposes FDI in multi-brand retail. Retrieved july 13, 2010, from http://economictimes.com:
12. MITRA, S. (2010, May 31). Private labels shine in retail. Retrieved July 13,2010, from The Telegraph:
13. Prasad, V. N. (2009, July). Indian MSEs: Trading and other Enterprises Need a Common Policy Treatmen. Retrieved July 17,2010, from GSME News:
14. A Lokhande, Madhavi, Evolution of the MSMEs in India, Journal of Social and Development Sciences Vol. 1, No. 2, pp. 79-90, Mar 2011
15. Bodla, B. S. and Verma, S. R. (2008). An analysis of the performance of SSIs in the era of globalization. The Icfai Journal of Managerial Economics, 6(3): 40-53.
16. Dodge, H. R. and Robbins, J. E. (1992). An empirical investigation of the organizational life cycle model for small business development and survival. Journal of Small Business Management, 30(1): 27-37.