The entry of foreign direct investment economics essay

Economics

Abstract

Allowing FDI in multi brand retailing has recently generated tremendous euphoria for some and fear for others. It is based on the notion that it will open floodgates for foreign retailers to invest and will change the retail landscape forever in India. The evidence of last 20 years of globalization by retailers shows that there is no such case of domination of foreign retailers wherever markets for global retailers have opened up. Only limited numbers of retailer have entered into these markets that too with lot of caution as they have realised that retail thrives on local knowledge rather than transplanting global retail concepts, strategy and formats. This paper analyzes the experiences in other emerging economies where fewer foreign retailers have been successful while several failed as they could not comprehend local nuances, customer insights and fight local competition. In fact, in many countries the local retailers have better market shares, sizes and performances. The factors that attracted investment in India are stable economic policies, availability of cheap and quality human resources, and opportunities of new unexplored markets. Besides these factors, there are a number of macroeconomic factors that are expected to affect FDI in India. The research findings have important implications for policy makers and foreign investors. Policy makers need to push reform agenda in domestic market so as to attract more FDI in the Indian economy.

II. Introduction

The entry of Foreign Direct Investment (FDI) in the retail sector seems to have become the next frontier f or conquest by the pro-MNC forces of

liberalisation. Paul Etgart a former director of the giant UK retailer TESCO has said, " Indian retail business should not be fooled by partnership offers by global retail giants because they want 100 per cent control and eventual ownership". He also told the audience to " urge your government to retain your strict FDI regulations, (for) global retail giants are very smart and clever to tackle local cultural and political obstacles. India must beware." Of late, the retail industry in India has often been hailed as one of the sunrise sectors in the economy. AT Kearney, the well known international management consultancy, recently identified India as the 'second most attractive retail destination' globally from among 30 emergent markets. It has made India the cause of a good deal of excitement and the cynosure of many foreign eyes. With a contribution of 14 percent to the national GDP and employing 7 per cent of the total workforce in the country, the retail industry is definitely one of the pillars of the Indian economy. Indian retail industry is one of the sunrise sectors with huge growth potential. According to the Investment Commission of India, the retail sector is expected to grow almost three times its current levels to $660 billion by 2015. However, in spite of the recent developments in retailing and its immense contribution to the economy, retailing continues to be the least evolved industries and the growth of organised retailing in India has been much slower as compared to rest of the world. Undoubtedly, there exists dismal situation of the retail sector, despite the on-going wave of incessant liberalization and globalization stems from the absence of an FDI encouraging policy in the Indian retail sector. In this context, this dissertation attempts to analyse the strategic issues concerning the influx of foreign direct investment in the Indian retail industry. Moreover,

with the latest move of the government to allow FDI in the multiband retailing sector, this research analyses the effects of these changes on farmers, committees, mom & pop stores and agri-food sector. The findings of the research point out that FDI in retail would undoubtedly enable India Inc. to integrate its economy with that of the global economy. Thus, as a matter of fact FDI in the buzzing Indian retail sector should not just be freely allowed but should be significantly encouraged.

FDI in Retail: A History

In India, FDI in cash and carry (wholesale) with 100% ownership was allowed in 1997 under the Government approval route. Later on in 2006, it was brought under the automatic route. Simultaneously, 51% investment in a single brand retail outlet was also permitted. But till 2013, FDI in Multi-Brand retailing was prohibited in India[1]. Traditionally, most of the Indian households have enjoyed the convenience of calling up the grocery " kirana" store, which has advantages of familiarity with their brand preferences, applies flexible conditions for product returns and exchange and also offers credit. However in most cities today, mall based shopping formats are gaining popularity but still the price-sensitive Indian shopper prefers Big box stores such as Big Bazaar specifically for the steep discounts and bulk prices. Most of the shoppers preferred the convenience and access offered by the local grocery store and hence, retail chains such as Reliance Fresh, Subhiksha and More have reportedly closed down operations in some of their locations. These retail giants will have to focus on various operations while reaching out to the Indian consumer. Firstly, they have to effectively build their expertise with cold storage technologies to attract customers with fresh

and exotic vegetables and organic produce. Secondly, they need to create a range of inspirational global foods and household brands and hence create access for the consumers. Thirdly, they have to ensure interruption free supplies of essential raw materials by supporting domestic farmers. Hence, mega foreign retailers will have to focus on engaging shoppers' and farmers interest and ultimately combine these benefits with the advantages that local " kirana" stores have always offered – ‘ familiarity, convenience and personalised shopping experiences’.

Literature review

Indian Retail Sector: An Overview

Mckinsey & Company (May 2007) studied that the Indian retail market size is estimated to be US$ 450 billion and retailing in India is one of the pillars of its economy. Retailing accounts for 14 to 15% of its GDP and constitutes as one of the top five retail markets in the world by economic value. Also with 1. 2 billion people, India is one of the fastest growing retail markets in the world. Dikshit (2011) examined that India's retail and logistics industry employs about 40 million Indians. Owner manned small shops constitute India's retailing industry. In 2010, about 4% of the industry was constituted by larger format convenience stores and supermarkets with their presence only in large urban centers. Indian central government denied foreign direct investment (FDI) until 2011in multibrand retail, thus not allowing any foreign groups from any ownership in convenience stores, supermarkets, or any retail outlets. According to the regulation, single-brand retail was limited to 51% ownership and had to undergo a bureaucratic processing. Agarwal and Bahree (2011) examined that since announcement on retail reforms sparked

intense activism, Indian government placed the retail reforms on hold before it being reaching a consensus. According to Economist (2012), market reforms in November 2011, paved the way for retail innovation and competition with multi-brand retailers. Multi-brand retailers such as Walmart, Carrefour and Tesco and single brand giants such as IKEA, Nike, and Apple are not planning strategic entry into India. Sharma and Sahu (2012) investigated that in January 2012; India approved reforms for single-brand stores imposed the requirement that the single brand retailer source 30% of its goods from India. However they welcomed anyone in the world to innovate in Indian retail market with 100% ownership. According to The Financial Times (2012), because of the 30% requirement, IKEA announced in January that it will put on hold its plan to open stores in India. Fitch believes that this requirement will significantly delay but might not prevent brand majors from Europe, USA and Japan to open up stores in India. There are many past studies which have emphasized the role of GDP growth, wage rate, trade rate, real interest rates, inflation, and stock of FDI, domestic investment in attracting FDI into a country. Burak Camurdan and Ismail Cevis (2009) developed an empirical framework to estimate the economic determinants of FDI inflows by employing for the period of 1989-2006, a panel data set of 17 transition economies and developing countries. Seven independent variables are taken for this research namely, the previous period FDI, GDP growth rate, wage, trade openness rate, the real interest rates, inflation rate in form CPI index, and domestic investment. The results conclude that the previous period FDI is important as an economic determinant. Besides, it is also understood that the main determinants of FDI

inflows according to such empirical analysis are the inflation rate, the interest rate, the growth rate and the trade (openness) rate.

Growth drivers in India for retail sector

The pace of growth in retail in India is very fast as it is expected that it will grow up to US$ 833 billion by the year 2013 and US$ 1. 3 trillion by 2018 (at a CAGR of 10%). Simultaneously, the consumer spending has also gone up as in the last four years, the consumer spending in India surged to 75%. Also, the organized sector is promising to grow at a CAGR of 40% by the year 2013. 2

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Following are the key factors driving growth in retail industry: growing middle class income, improving demand from rural markets, young demographic profile (Average age of an Indian homeowner has fallen to 27 from 40 years in the last decade), increasing consumer aspirations, housing boom, rising incomes and improvements in infrastructure. Other factors are increase in per capita income, liberalization of the Indian economy and the advent of double income families. Consumer preferences are also improving and they are becoming quality conscious and shifting their purchase behaviour from the traditional retail stores to malls. Encouraging accessibility to the growing influences of domestic and foreign retail chains is the internet revolution. Rohilla and Bansal (2012) examined that many online stores are highly accessible and hence, also help in creating awareness about global products for local markets. For example, TV channels promoting products-HomeShop18, India Today, etc. are increasing in number. About

47% of the Indian population is under the age of 20; and this may be increase up to 55% by 2015. This young population is highly tech-savvy compared to past generations and also watch more than 150 satellite TV channels, and show very high propensity to spend. This factor will immensely contribute to the growth of the retail sector in the near future. Some other factors are increase in number of working women, change in the outlook and tastes due to emergence of dual income households growth of nuclear families set up leading to shift in preference of home decoration, increase in urbanization and changing fashion concepts,.

Organised Retail in India

In the past 8 years, Indian retailing landscape has completely changed as a result of large corporate and foreign players dominating the organised retailing in top 15 cities. They aim to build a profitable and scalable business model based on local customer experience in each of the catchment. They have analysed many strategic ways about the formats, size and merchandising mix based on the catchment and customers they serve. Many Indian retail giants like Croma, Reliance Digital, etc. have worked on creating reduced size and smaller formats like Croma Zip to reach various target segments in a profitable ways as assumptions of big box being profitable in Indian scenario has proven wrong. The organized retail faces many challenges in Indian and have examined that India is very complex and challenging country from a scalability perspective to serve the need of diverse mix of customers based on demographic variations. Since the consumer needs and buying behaviour are very different for each catchment within cities, various formats need to be stitched to serve different markets.

But again in India, it is difficult to find critical mass of similar catchments within the same cities which has been the learning of organized players operating in India for last 8 years.

Advent of Foreign retailers in India

Many global retailers like Walmart, Metro, Woolworth, Staples which wanted to establish and capture some market in India are now trying to leverage on the policy of 100% in cash and carry wholesales route for multi-brand retailing. Similarly retailers like Debanham, Espirit, Nokia, Zara, Mark & Spencer, Hamleys etc. are leveraging policies based on 51% for single brand retailing. Significant foreign retailers' presence is seen in Apparel, Fashion, Luxury and food retailing using either the franchise or licensing route. Table 2 list the category wise presence of 17 foreign retailers out of Top 250 retailers in the world. Recently many global players like Amazon are taking advantage of online retailing and hence are targeting Indian consumer by setting up relationship with supply chain companies to deliver products to end customer therefore bypassing the need to create physical retail stores. To attract Indian consumer to buy their products online, Crate and Barrel has launched India specific website. To target Indian consumer, identical efforts are expected by other leading global retailing giants leveraging on 3G and smart phone apps, spread on internet, and social networking.

Retailing is Local

Retailing has largely remained local since its advent in the 19th century. It has been local industry driven by understanding of catchments, local customers and providing merchandising to the target segments. Achieving

economies of scale has been the priority of retailers since then which has been determined by developing understanding of catchments with similar shopping behaviour and dominant presence of the target segment. During 1990s due to saturation in their home markets, retailers started venturing out of their own countries mostly Europe. Local regulations which prevented them to expand and grow were another factor in expanding in the foreign lands. As per empirical data, the market share of local retailers across categories is higher than foreign retailers in all the major economies, emerging or mature.

Experiences of Retailers beyond home country

Most retailers have grown concentrically because initially most of these expansions by a few Transnational Retailers (TNR) were in neighbouring countries mainly in Europe and America. In the 1990s, the retail acceleration primarily (involving European and US retailers) comprised developing store networks in, the emerging economies of Latin America, East Asia and Central/Eastern Europe along with exporting capital, formats and expertise. Wal-Mart’s acquisition-led entry into the UK and Germany is an example of significant flows of retail FDI between ‘ mature’ economies while this time 3. The international expansion has taken places in accordance to Table -1. This FDI inflow was determined by: Longer-term growth opportunities perceived to be offered by emerging economies with previously largely ‘ traditional’ retail systems; by the consolidating, and often increasingly tightly regulated, home markets of these firms; by the capacity of the largest of these firms ‘ to leverage their increasing core-market scale and free cash flow for

expansionary investment in order to secure the longer-term higher growth opportunities offered by the emerging markets' (OECD, 2000a, 306).

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Why globalization of retailers has not succeeded

As emerging markets opened their economies for retailing in early 2000, few of these TNR ventured into these countries with mixed results. Many of these retailers exited after unsuccessful stints. Empirical analysis also shows that there are more cases of failure and exit rather than success in terms of creating economies of scale in emerging economy. Recent examples like the exit of Best Buy from China and Wal-Mart from Germany and Carrefour from Korea demonstrate of inefficiency and incapability of these giant retailers to get substantial amount of market share from the local competition.

According to Deloitte (2008), retailing is a uniquely complicated business. It is the industry that maintains the closest and most personal relationship with consumers, often intersecting their lives on a weekly and even daily basis. Achieving a successful personal relationship is far more challenging when doing it in an alien culture. In addition, successful global retailing entails undertaking a wide range of tasks. These include managing diverse human resources who must engage in personal interaction with customers, managing foreign human resources from afar, managing complex and differing supply chains, managing relationships with thousands of suppliers and other vendors in multiple business and regulatory environments, meeting the requirements of multiple regulatory regimes, and all the while understanding the changing needs of diverse consumers. In particular, they fail to deal with the resistance shown by two parts of the existing retail

structures of those markets. First, by indigenous retailers who rapidly and successfully emulated the organizational innovations and best practices of the TNR that had entered their home markets and who, because of their local institutional knowledge and social/political-networks, were able to anticipate and respond to the TNRs' sources of competitive advantage. Indeed, prior to the main ' waves' of entry of 12 TNRs into their home markets some of these indigenous ' modern' retail chains had already developed the basis of a protectable market scale – i. e. sufficient to ensure that they were well positioned to resist that entry. Several examples of this type of resistance have been documented, including the case of Chile (Bianchi & Mena 2004 and Bianchi and Ostale 2006) in the late 1990s/early 2000s, where Ahold, Carrefour and Home Depot all failed to establish themselves against sustained defense by the largest indigenous chains at the time (D&S and Cencosud in grocery retailing, and Sodimac in home improvement retailing). This demonstrates the fallacy of any easy or inevitable route to domination of emerging markets by multinational retailing. Secondly, strong resistance has also been shown by the ' informal' retail channels. Indeed, it is widely acknowledged that the TNRs have faced persistent difficulties in fresh food retailing where ' wet' and/or ' street' market formats retain their popularity and market share in emerging markets. Humphrey (2007) suggests that significant question marks exist over the capacity of multinational retailing to mount a sustained challenge in this area.

Changing Indian retail landscape

According to India Retail Report 2013, modern Retail has seen a significant growth in the past few years with large scale investments made by Indian corporate houses mostly in food sector retailing. The market size has been estimated to be USD 400 Billion market. Through Franchisee/Joint Venture route, foreign retailer giants and apparel brands including luxury brands have entrenched themselves in India in the last few years. For global retailers who have not been seeing large organic growth, India provides a lucrative market for them to grow their topline and profitability after multi-brand retailing being opened for foreign investment. Few retailers have been designing plans to start their Cash & Carry business to have a market presence and create brand awareness. Indian retail landscape has changed since 2004 since the time world woke up to the potential of retailing in India in a significant way. The market is still fragmented dominated by small shops, the largest network of retailers in the world from street Hawkers to Luxury malls. The market size is growing at 10% each year but 90% of it is unorganized. The highly diverse nature of Indian customer favours local retailers to succeed. However, 70% of India is still rural and lacks proper infrastructure. For any organized retailing to flourish, metro cities are too overcrowded and lack adequately built shopping centres, high street and mall spaces. New urban areas are coming up in cities without proper planning to create adequate space for shopping. The Mall sizes in India are half in terms of area occupied as per the International standards of building any mall. The suppliers and manufactures help in ensuring that retailing remain fragmented as this ensures the bargaining power with them rather

than with retailers as has been case with dominant retailers. (Wal-Mart, Tesco, Carrefour, Best Buy and others)

Qualitative Analysis

Effects of FDI on various Stakeholders

Impact on Farming Communities

Since the early 1990s, a supermarket revolution has been observed in developing countries. In order to reach the mass market, supermarkets have now developed beyond the middle- and upper-class clientele. This process affects both traditional retailers, and the wholesale, processing, and farm sectors within the food system. With respect to quality, costs, volume, consistency and commercial practices, supermarkets require more from suppliers when they modernize their procurement systems. Supermarkets affect suppliers in a biggest way and earliest for food processing and food-manufacturing enterprises, since some 80% of contents sold by supermarkets comprise processed, staple, or semi-processed products. So supermarkets indirectly affect farmers by affecting processors as processors pass on the demands placed on them by their retail clients. Sometimes supermarkets thus help farmers with training, credit, equipment, etc when they cannot source from medium- or large-scale farmers, and small farmers lack the much needed assets4. Empirical analysis shows that farmers tend to earn from 20 to 50% more in net terms when they enter supermarket channels. For example, net profit is 33–39% higher among supermarket channel participants compared to traditional markets participants among tomato farmers in Indonesia along with helping the farm labour to gain. However this requires more up-front investments on the part of farmers and

meet greater demands for quality, consistency, and volume compared with marketing to traditional markets.

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Support for retail reforms

During December 2011, a pan-Indian survey was conducted and a majority of consumers and farmers participated across ten major cities in the country to support the retail reforms. According to 90 per cent of consumers, FDI in retail will offer a wider choice of goods and also bring down prices. About 78 per cent of farmers said through multi-format stores, they will get better prices for their output. Marketing resources will be needed to push sales through multiple channels, as they may have to accept lower margins for greater volumes. This fact was accepted by nearly 75 per cent of the traders 4.

Farmer groups

Announcing their support for reforms in retail, Indian farmer associations have the following opinion: Shriram Gadhve of All India Vegetable Growers Association (AIVGA) lends his support because currently, middlemen commission agents benefit at the cost of farmers and the retail reform should be focusing on rural areas so that farmers are benefited5. Bharat Krishak Samaj, a farmer association having more than 75, 000 members also lends it support to retail reform. They examined that a monopoly exists between various groups such as middlemen, commission agents available at the sabzi mandis and the small grocery retailers.

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The group has requested the government to make it mandatory for organized retailers to buy 75% of their produce directly from farmers, bypassing the middlemen monopoly and India's sabzi mandi auction system6. According to Prakash Thakur, the chairman of the People for Environment Horticulture & Livelihood of Himachal Pradesh, FDI will help build storage centers that will reduce the number of middlemen, increase market access, and enhance returns to farmers[6]. He lends his support to FDI by further establishing the fact that highly perishable fruits have a high demand but because of lack of cold storage and transport infrastructure, are not able to tap the market.

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Sharad Joshi, founder of Shetkari Sangathana, also lend his support to retail reforms. According to him, FDI will help the farm sector improve critical infrastructure and integrate farmer-consumer relationship. Due to null investment in backward integration, current retail has not been able to supply fresh vegetables to the consumers. Suryamurthy, in an article in The Telegraph, claims that with the current retail system the farmer is being exploited and their groups across India do not support present status and seek retail reforms. According to him:[8]One of the major issue is that farmers get only one third of the price consumers pay for food staples, the rest is taken as commissions and mark-ups by middlemen and shopkeepers. For perishable horticulture produce, average price farmers receive is barely 12 to 15% of the final price consumer pays. Also potato farmers sell their

crop for Rs. 2 to 3 a kilogram, while the Indian consumer buys the same potato for Rs. 12 to 20 a kilogram[9]

Impact on Traditional Mom and Pop Stores

With the advent of major organized retail players in India, the existence of traditional mom and pop stores is in question. The answer could be a co-existence. The major advantage for the smaller players in India is the size, complexity and diversity of Indian Markets. However most of organised retailers have opened shop in the Metros, Tier 1 and Tier 2 towns. There is a gamut of reasons being floated to prevent the liberalisation of the FDI norms for Indian retail: A big concern regarding the kirana stores and locally operated Mom and Pop stores is that they being adversely affected by the entry of global retail giants such as Walmart, Carrefour and Tesco. Since these retailers have advanced capabilities of scale and infrastructure along with being cash rich, this may result in the loss of jobs for people in the Indian unorganised sector. Prices of products may also be lowered due to better operational efficiencies of the organised players and this will affect the profit margins of the unorganised players. Multi-brand retail, if allowed, is expected to transform the retail landscape in a significant way: Firstly, the organised players would bring in the much needed investment which will help the domestic retailers that don‘ t have the resources to ride out the storm during an economic slump such as the case with Vishal, Subhiksha and Koutons. Also rising inflation rates have crippled India. Major reasons for this are the vastly avoidable supply chain costs in the Indian food and grocery sales. Hence it is expected that the infrastructure support extended to improve the backend processes would enable to eliminate such extreme

wastages and enhance the supply chain operational efficiency. FDI in multi-brand retail would not endanger the jobs of people employed in the unorganised retail sector. On the contrary, it would lead to the creation of millions of jobs as massive infrastructure capabilities would be needed to cater to the changing lifestyle needs of the urban Indian who is keen on allocating the disposable income towards organised retailing in addition to the local kirana stores. Also, these would be more prominent in the Tier-II and Tier-III cities where the organised supermarkets would find it harder to establish themselves. FDI in multi-brand retail is therefore a necessary and significant step to propel further growth in the sector. This will help integrate the Indian retail sector with the global retail market in a strategic manner leading to better long term results.

Case Studies of how various MNC' s are helping Farmers

Case 1: PepsiCo India

PepsiCo India helped farmers improve yield and income to create a cost-effective, localized agro-supply chain for its business by[10]: Building company's stature as a development partner by helping farmers grow more and earn more. Introducing new high-yielding varieties of potato and other edibles. Introducing sustainable farming methods and practising contract farming. Providing to farmers world-class agricultural practices and thus increasing farm productivity. Today PepsiCo India's potato farming programme is able to reach out to more than 12, 000 farmer families across six states. Following were the benefits: Providing superior seeds, and agricultural implements supply free of charge. Pre-fixed rate buy-back mechanism with farmers. Tie-up with State Bank of India and providing credit

at a lower rate of interest to farmers. ICICI Lombard tie-up for weather insurance. In 2010, Pepsico's contract farmers in West Bengal registered a phenomenal 100% growth in crop output, creating in a huge increase in farm income. The remarkable growth has provided to farmers a profit between Rs. 20, 000– 40, 000 per acre, as compared to Rs. 10000–20, 000 per acre in 2009.

Case 2: Bharti Walmart

Bharti Walmart initiative through Direct Farm Project[11]: In Bharti Walmart, Corporate Social Responsibility (CSR) initiatives foster inclusive growth through empowerment of the community. Through their philanthropic programs and partnerships, Bharti walmart have supported initiatives regarding women empowerment, skills training , enhancing opportunities for imparting education, generating local employment, and community development. Bharti Walmart implemented community-building activities in village, Haider Nagar in Punjab. They have worked on the following aspects to improve community's living style: Education: 100% children enrolled in formal education program. Children' s group had been formed to discuss children issues. They constructed a sanitation block, installed hand pumps, distributed uniforms etc. Health and Hygiene: They also started a dispensary in Haider Nagar to help people avail medical facilities in the village itself. Sanitation and Biogas: Gave provisions for sanitation, installed eighty Bio Gas plants to conserve gas energy and utilize the waste generated from their cattle. Waste Management: Installed twenty Community Dustbins to improve the living conditions of the people and to provide them garbage free. This and many other cases suggest that opening of Indian retail sector to FDI is a

win-win situation for farmers. Farmers would benefit significantly from the option of direct sales to organized retailers. Global majors such as Wal-mart, Carrefour and Tesco are expected to bring a global scale in their negotiations with the MNCs such as Unilever, Nestlé, P&G, Pepsi, Coke, etc. The improved cold chain and storage infrastructure will no doubt lead to a reduction in losses of agriculture produce. It may also lead to removal of intermediaries in the retail value chain and curtail other inefficiencies. And this may, result in higher income for a farmer.

Contrary View:

For many centuries, traditional retailing has been established in India, and is characterized by small, family-owned operations. Hence these ownerships are usually very low-margin, are owner operated, and pay low taxes and have very low real estate and labour costs. These businesses also develop strong networks with local neighbourhoods. Their attractiveness is increase manyfold due to informal system of credit. Apart from this, low labour costs also allow shops to employ delivery boys. These advantages are non-quantifiable but highly significant.[12]Congested urban living conditions force few Indian households to equip themselves with adequate storage facilities since real estate rents are very high. Thus opportunities are limited for big box retailers in this sector and they will have to fight stiffly with the local sources of groceries and Kirana stores to attract consumers.[13]

Policy Implication of FDI in Single Brand Retail[14]

100% FDI in single brand retail trading is permitted. Products to be sold should be of a particular Single Brand only. 30% sourcing is to be done from

micro and small industries (investment in Plant and Machinery not exceeding US $ 1mm). This will ensure that SME sector is benefited to a larger extent.

Policy Implication of FDI in Multi Brand Retail[15]

Individual state governments to take decision of allowing foreign supermarket chains. Foreign retailers to source almost a third of their processed goods and manufactured from industries with a total plant and machinery investment of less than $1 million. Foreign retailers to invest a minimum of $100 million, and put at least 50% of their total investment into 'back-end' infrastructure, such as warehousing and cold storage facilities. Foreign retailers will only be allowed to set up shop in cities with a population of more than 1 million. Individual state governments can choose where to allow foreign chains to open in states where there are no cities with such a big population.

Analysis of Impact of FDI in Retail on Macroeconomic factors for other countries

The nations analysed below are similar to India in terms of demographics and various macro-economic factors. A comprehensive study has been done to analyse the impact of FDI particularly in retail in following countries.

China

China developed its open door policy in the aspect of FDI in order to take a transition from a planning to a market economy as Deng Xiaoping once said, reform in China is like " crossing the river by feeling the stones on the riverbed". Simultaneously, china has undoubtedly made the single largest contribution to global poverty reduction of any country in the past 20 years.

[16]Following has been the series of events with respect to FDI in retail in china: FDI in retailing was permitted in China for the first time in 1992. Foreign ownership was initially restricted to 49%. In December 2004 the government lifted up all the restrictions on FDI in Retail. Regarding employment in the retail and wholesale trade, it increased from about 4% of the total labour force in 1992 to about 7% in 2001. Between 1996 and 2001, number of traditional retailers also increased by around 30%. After liberalization of its retail sector, following changes took place (CII-PwC, 2008): Over 600 hypermarkets were opened between 1996 and 2001The number of small outlets (equivalent to kiranas) increased from 1. 9 million to over 2. 5 millionFrom 28 million people to 54 million people, employment in the retail and wholesale sectors increased during 1992 to 2001. GDP growth has been at 8% on an average after the introduction of FDI in RetailChina’s inflation rate decreased to -0. 8% and -1. 4% in 1998 and 1999 respectively. Now after 20 years, inflation rate is at 2% rather than 14. 6% and 24. 2% in 1993 and 1994. The value of imports and exports has increased minutely since the introduction of FDI in retail. Also the Chinese Yuan started depreciating with respect to dollar after 1992. The total FDI inflow & outflow has also increased significantly after the introduction of FDI in retail leading to increased trade openness.

Thailand

Following is the sequence of events with respect to FDI in retail in Thailand: FDI in Retail was introduced in 1997 in Thailand. However, many adverse effects of FDI in retail were observed. It permits 100% foreign equity, with no limit on the number of outlets. According to the Report of ICRIER: Wet

market and small family owned grocery stores dominated the Thai Retail industry. After the Asian crisis in 1997, the entry ban on foreign players was removed. Soon, the foreign players increased and developed their operations significantly. Eventually, most of the local players had to close down their business. However, there were certain positive effects as well: Expansion of organized retailing and a new shopping destination called Thailand; Encouraged agro-food processing industry and enhanced the exportsImpact on macroeconomic factors: GDP growth rate of Thailand plummeted to -10. 5% in 1998 due to the shutting down of local retailers. Unemployment rate remained low. Inflation rate also remained at 0. 3%The openness indicator reached its maximum in. FDI inflows increased to 7, 314, 804, 931 in 1998.

Indonesia

Modern retail was introduced in Indonesia in the 1990s and mostly involved domestic chains. FDI led to the multi-nationalization and rapid consolidation of the supermarket sectors in such developing countries.[17]Currently, Indonesia permits 100% foreign equity in retail business, with absolutely no limit on the number of outlets. In 1958, the leading chain Matahari started as a small shop, expanded into a chain of department stores, and was then bought by a giant banking and real estate conglomerate, Lippo Group, in 1997. Between 2002 and 2006, Matahari doubled its sales, becoming a billion-dollar chain. Impact on macroeconomic factorsA deep economic recession in 1997-98 leading to inflation of 80% during the mid 1997. The GDP growth too plunged to -13%Introduced a wide range of institutional reforms and redirected monetary policy towards maintaining price and exchange rate stability. Eventually, price stability was reinstated. Also,

exports & imports & the real exchange rate remained consistent. There was an increasing effect of FDI in retail on the total FDI inflows. However, FDI outflows dropped after 1994.

Brazil

Of the top-seven chains with sales of $24 billion in 2006—including Casino (the leader), Carrefour, Wal-Mart, and Makro—all are foreign owned. [18]Empirical analysis shows that since its opening up to the foreign investment in 1994, the traditional small retailers managed to increase their market shares by 27% (according to the report by CUTS International). The annual GDP growth remained stable and positive. The unemployment rate increased after 1994 after its maximum at 9. 6. After 1994, the Brazilian Real appreciated with respect to U. S Dollar. The value of exports and imports too increased after 1994. In 1998, the total FDI inflows reached their peak.

Russia

The Russian supermarket revolution has occurred only in the 2000s. In 2002, sales by the top-15 chains totaled $2. 7 billion; by 2006, sales by those chains had soared to $19. 2 billion. The share of the top-3 chains was about 40 percent in 2002 and 54 percent in 2006. The foreign share of sales was 33 percent in 2002 and 35 percent in 2006—only inching up and spreading over 8 foreign chains among the top 15. Since the introduction of FDI in retail, the GDP growth has been positiveSince 2000, the unemployment rate too has decreased. After 2002, a sharp increase was observed in FDI inflows and outflows.

Mexico

The Mexican case of supermarket development is quite similar to that of Brazil. In the early 1990s, nearly all the supermarket sales were by domestic chains.[19]By 2002, 48 percent of the $24 billion dollars in sales by the top-seven chains in 2002 were by foreign chains (primarily Wal-Mart). By 2006, the sales of those chains had nearly doubled to $38 billion, and now 53 percent are by foreigners. With the influx of foreign retailers in 1991, a handful of major chains came to dominate the market, and many of the smaller retailers were forced to shut down. By 2001, only 4 chains dominated the market: Wal-Mart de Mexico(Walmex) with almost half (45. 6 percent), Comerical Mexicana with a little over a fifth (20. 6 percent), Gigante (15. 5 percent) andSoriana (14 percent). By 2002, Walmex’s total sales had grown to 10. 1billion (Tegel 2003), and by 2006 to 18. 3 billion (Wal-Mart de Mexico 2006)The GDP rate has been consistent except in 1995 when it reached -6. 2. Wal-Mart took over nearly half of Mexico's retail business with just over 200, 000 employees (the country's population is 112 million). Undoubtedly the unemployment rate increased to 6. 9 in 1995. Though the value of exports and imports was consistent throughout but the exchange rate was seen fluctuating after 1991. There was an increase in the total FDI inflows.

Research Methodology

Objectives

Examining the relationship between FDI and macro-economic factors has important implications for policy makers and foreign investors. Policy makers need to push reform agenda in domestic market so as to attract more FDI in

the Indian economy. Hence various macroeconomic factors have been analysed vis-a-vis FDI in retail using quarterly data for the period starting from January 2000 to December 2011 for six countries – Russia, Brazil, China, Mexico, Indonesia and Thailand. It is important to analyse the impact of FDI on macro-economic factors over a period of time. Simultaneously, it is important to examine the role played by macro-economic factors in attracting FDI in any country. Hence, policies should be formulated in accordance to the macro-economic factors which work best for the country. If the economy of the country indicates high probability for the country to accept FDI in a particular sector, the policies should be formulated accordingly to open barriers in order to invite FDI in the country in the respective country.

Methodology Undertaken for Analysis

Dynamic relationship between FDI and macro-economic factors

According to Ernst and Young's 2010 European Attractiveness Survey, India is ranked as the fourth most attractive foreign direct investment destination in 2010. In their research paper " On Dynamic relationship between FDI and Macro-economic factors: The India Experience", Tripathi, Seth and Bhandari (2011) discuss that the factors that attracted investment in India are stable economic policies, availability of cheap and quality human resources, and opportunities of new unexplored markets. Besides these factors, there are a number of macroeconomic factors that are expected to affect FDI in India. This research considers the following macroeconomic factors/determinants affecting FDI: Market Size: To tap the domestic market is the aim of FDI in

emerging developing countries, and thus market size is important for domestic market oriented FDI. Market size is generally measured by GDP or per capita income. Thus, an economy with a large market size (along with other factors) should attract more FDI. Pfefferman and Madarassy (1992) examine that as it provides potential for local sales, greater profitability of local sales to export sales and relatively diverse resources, market size is important for FDI which make local sourcing more feasible. Thus, a large market size provides more opportunities for sales and also profits to foreign firms, and therefore attracts FDI (Wang and Swain, 1995: Moore, 1993; Schneider and Frey, 1985; Frey, 1984). Here it's given by (Real GDPi, t- Real GDPi, t-1)/Real GDPi, t-1. This data has been taken for 7 countries from 2000 to 2012 on quarterly basis from Bloomberg. Exchange Rate: The appreciation and depreciation of currency does have an impact on the price of exports and imports making their comparative position and competitiveness in international markets fluctuate sometimes towards advantage to the home country and sometimes disadvantage. It was argued by Aliber (1970) that while firms coming from countries that have strong currency are better able to financially support their foreign direct investments than firms coming from countries that have a inherently weak currency. This data has been taken for 7 countries from 2000 to 2012 on quarterly basis from Oanda. com. Trade Openness: Trade Openness refers to the degrees to which countries or economies permit or have trade with other countries or economies. It is calculated as export plus import as percentage of GDP. It is also considered to be one of the key determinants of FDI. The FDI activities of the firms are constrained when there is protectionist policy followed; therefore these

activities are encouraged when the country embarks on the path of liberalization. Scaperlanda (1992) analyzes that when capital controls are relaxed, the flow of capital between countries easier and faster. In an economy that is export oriented, the management skills of marketing products internationally, innovations, technology advancements and knowledge of external operations become unrestricted. The exports plus imports level of a country is taken as a variable to represent this degree of economies openness i. e. (Exportsi, t + Importsi, t)/GDPi, t. This data has been taken for 7 countries from 2000 to 2012 on quarterly basis from Bloomberg. Unemployment Rate: FDI have helped India to attain a financial stability and economic growth with the help of investments in different sectors. FDI has boosted the economic life of India and on the other hand there are critics who have blamed the government for ousting the domestic inflows. As a common understanding, Foreign direct investments generates employment to the unemployed, provides revenues in the form of tax and incomes, gives financial stability to the government, provides development of infrastructure, forms backward and forward linkages. This data has been taken for 7 countries from 2000 to 2012 on quarterly basis from Bloomberg. IIP: Index of Industrial Production: Investors can use the IIP of various industries to examine the growth in the respective industry. If this index is growing month-over-month for a particular industry, then the companies in the industry are performing well. This data has been taken for 7 countries from 2000 to 2012 on quarterly basis from Bloomberg. Inflation: Bengoa and Sachez-Robles (2003) suggested that higher rates of return is required by countries with high inflation generally to compensate for the higher risk

associated with inflation. FDI is motivated by investment efficiency and this is generally affected by the condition in degree of inflation. Inflation needs to be stable in order to encourage greater FDI. Here we have taken inflation as (CPIi, t-CPIi, t-1)/CPIi, t-1 where CPI is the consumer price index in period t for country i. This data has been taken for 7 countries from 2000 to 2012 on quarterly basis from Bloomberg.

Total FDI flows: (FDI inflowsi, t + FDI outflowsi, t)/GDPi, t

Tax Revenue Indicator: Tax revenues in country i at time t in local currency unit (LCU) divided by GDP in current LCU i. e. Tax revenuei, t/GDPi, t. This data has been taken for 7 countries from 2000 to 2012 on quarterly basis from Bloomberg. Methodology 1:

Panel Data Regression:

A panel dataset contains observations on multiple entities (individuals), where each entity is observed at two or more points in time. With panel data we can control for factors that:• Vary across entities (states) but do not vary over time• Could cause omitted variable bias if they are omitted• are unobserved or unmeasured – and therefore cannot be included in the regression using multiple regressionPanel Data regression has been applied in this research to carry out regression for 6 countries – China, Indonesia, Mexico, Brazil, Thailand and Russia simultaneously and observe the results and eventually, apply them in the Indian scenario. Since FDI in retail sector data is not explicitly available for any country, the data about its presence or not has been taken. Hence, FDI in retail in its binary format is taken. A 1 indicates FDI in retail was present in a particular country while a 0 indicates

it was not present. Hence various macroeconomic factors have been analysed vis-a-vis FDI in retail using quarterly data for the period starting from January 2000 to December 2011 for five countries – Brazil, Russia, China, Mexico, Indonesia and Thailand. It is important to analyse the impact of FDI on macro-economic factors over a period of time. Hence all the seven macro-economic factors have been analysed with respect to FDI in retail and other significant factors individually. Simultaneously, it is important to examine the role played by macro-economic factors in attracting FDI in any country. Thus, Logit-Probit model has been applied to understand the significance of macro-economic factors in attracting FDI in retail in any country.

Multicollinearity Tests

VIF Approach: For each dependent variable Xi, calculate the variance inflation factors: Y= ao +a1 X1+ a2X2 + a3X3X2= b0 + b1X1+b2X3VIFi = 1/(1-Ri2)where Ri2 is the coefficient of determination of the model that includes all predictors except the ith predictor. If VIF > 5, then there is a problem with multicollinearity. Correlation Matrix: Construct a correlation matrix and look for high values. If any value exceeds 0. 8, a correlation exists between the two variables. Reject one of the variable and analyse the regression including one of the correlated variables only. Logit-Probit Model: In dummy regression variable models, it is assumed implicitly that the dependent variable Y is quantitative whereas the explanatory variables are either quantitative or qualitative. There are certain type of regression models in which the dependent or response variable is dichotomous in nature, taking a 1 or 0 value. The dependent variable is of the type which elicits a yes or no

response. There are special estimation / inference problems associated with such models. The most commonly used approaches to estimating such models are the Linear Probability model, the Logit model and the Probit model.

The Logit Model

Logit regression (logit) analysis is a uni/multivariate technique which allows for estimating the probability that an event occurs or not, by predicting a binary dependent outcome from a set of independent variables. The logit of a number p between 0 and 1 is given by the formula: Logit (Pi)= ln[Pi/(1-Pi)] = Zi = a0 + a1XiIn this equation, Pi is the probability of FDI in retail being brought to India while (1-Pi) is the probability of FDI in retail being not brought to India. Hence the hypothesis behind constructing Pi is that what should be the policy of India compared to other countries where FDI in retail has already been allowed to a certain extent. The base of the logarithm function is the natural logarithm e. Negative logits represent probabilities below 0. 5 and positive logits correspond to probabilities above 0. 5. The logit transformation is one-to-one. The inverse transformation is sometimes called the antilogit, and allows us to calculate probability.

The Probit Model

A probit model is a popular specification for an ordinal or a binary response model that employs a probit link function. As such it treats the same set of problems as does logistic regression using similar techniques. The probit model is most often estimated using the standard maximum likelihood procedure, such an estimation being called a probit regression. Probit Model

assumes that the function follows a normal (cumulative) distribution, and latent variable probit can be derived from the following model: Probit = bo +b1X1 +b2X2 +error

Conclusion

Small retailers will strengthen market positions by becoming and growing innovative. The factors that will compensate for the loss of market share of the unorganized sector retailers will be growing economy and increasing purchasing power. Iniitially there will be a displacement of middlemen involved in the supply chain which is quite desirable as well, but they will be mostly absorbed by increase in the food processing sector induced by organized retailing. In order to mitigate adverse effects on small retailers and traders, innovative government measures could be taken further. Farmers will be able to directly access the market and hence get better remuneration. Regarding consumers, they will certainly gain from assured weights and cash memos, enhanced competition and better quality of produce. Due to enhanced operational efficiency, elimination of intermediaries and control on post harvest wastage, the government revenues will rise but competition in the market would ultimately be beneficial for consumer. Finally the government has added many constraints for the incoming retailers which reflect social benefit and has initiated a calibrated opening of the multi-brand retail sector to foreign direct investment (FDI). The 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. These firms hence must have already created jobs for rural India before entering 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. Moreover, in the fierce battle between the advocators and antagonist of unrestrained FDI flows in the Indian retail sector, the interests of the consumers have been blatantly and utterly disregarded. The empirical research has shown that FDI in retail significantly impacts GDP growth rate, unemployment rate, exchange rate (INR/USD), and Trade Openness and Tax collection. Simultaneously, FDI in retail (binary) is also attracted by factors like IIP, exchange rate, tax as a % of GDP, unemployment rate change and GDP growth rate. The research findings have important implications for policy makers and foreign investors. Policy makers need to push reform agenda in domestic market so as to attract more FDI in the Indian economy. The FDI in multibrand retailing will mostly benefit existing organized players in terms of attracting foreign capital because retailing still is very local industry (over 90%), and will not change significantly the retail landscape. Many transnational companies will use online marketing route to attract Indian consumer before setting up physical presence to test the market. Thus instead of relying too much on FDI in retail to change the retail landscape, Indian Government should streamline labour laws, implement GST to facilitate modern organized, fast

track infrastructure especially road development and set up economic zones for warehousing facility using planned urbanisation to ensure adequate availability of quality real estate. Current analysis of macr-economic factors vis-a-vis other developing countries also shows that it is the right time in India to have policies in place so as to invite FDI in retail in accordance to the analysis done in other 5 countries where FDI in retail has already entered. Finally, it does not matter whether it the local or foreign retail players leading this next wave of retail revolution in India as long as Indian consumer is getting benefitted in terms of access to innovative retails formats, best practices and availability of goods and services from all over the world along with great shopping experience.