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**FDI IN ORGANIZED RETAIL SECTOR: A COMPARATIVE STUDY BETWEEN INDIA AND CHINA**

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**ABSTRACT**

FDI is an important tool in the process of globalization and plays a key role in the development of the economies of the developing countries. The share of developing countries at over 50 per cent in total FDI inflows may increase further with well-built growth prospects in organized retail sector. The present papers attempts to study the FDI policies and FDI inflow in organized retail sector in both India and China. From the analysis it is clear, there is no significant difference in the FDI inflow in organized retail sector between India and China. Even though China has given 100 percent FDI provision in organized retail sector in 2004. Compared to China, India has high market potential with increase in GDP growth rate, higher disposable income, rapid urbanization, participation of youth in retail expenditure and more brand loyalty. India's changing FDI climate provides an interesting dynamic to several international retailers entry and expansion plans in Indian organized retail sector.

**KEYWORDS**

Brand loyalty, Disposable income, FDI, organized retail Tier II, III&IV cities.

**INTRODUCTION**

FDI is an important tool in the process of globalization and plays a key role in the development of the economies in the developing countries. FDI refers to capital inflows from abroad that is invested to enhance the production capacity of the economy. Retailing acts as the interface between producer and individual consumer buying for final consumption. It prohibit direct interface between the manufacturer and institutional buyers such as the government and other bulk customers. Retailing is the last bond that connects the individual consumer with the manufacturing and distribution chain. The retail sector has been divided into organized and unorganized sector. Organized retailing refers to trading activities undertaken by licensed retailers, that is, those who are registered for sales tax, income tax, etc. These include the corporate-backed hypermarkets and retail chains, and also the privately owned large retail businesses. Unorganized retailing, on the other hand, refers to the traditional formats of low-cost retailing, for example, the local kirana shops, owner managed general stores, paan/beedi shops, convenience stores, hand cart and pavement vendors, etc.

Retail sector has played a major role in the global economy. In today's developed market retailing is one of the most outstanding industries. In 2008, the US retail sector contributed 31% to the GDP at current market prices. When compared to developing countries, the developed countries has 75-80% share in total organized retail sector. In developing economies the unorganized retail sector has a dominant share compare to organized retail sector. Global retail sales was estimated to be around US\$ 12 trillion in 2007; where as in 2008, due to the financial crisis in US (United States), consumer expenditure was reduced in retail market. Till 2007 global level retail sector performed vigorously well, but the impact of US crisis extend over to Europe and also in the Asia-Pacific region in 2008. In 2010 the global FDI flows remained stagnant at US \$ 1.1 trillion since uncertain and weak in the world economic recovery.<sup>1</sup>

According to UNCTAD's Global Investment Trends Monitor (January 17, 2011), although global FDI flows at aggregate level remained stagnant, they showed an uneven pattern across regions – while it contracted further in advanced economies by about 7 per cent, FDI flows recovered by almost 10 per cent in case of developing economies as a group driven by strong rebound in FDI flows in many countries of Latin America and Asia. Rebound in FDI flows to developing countries has been on the back of improved corporate profitability and some improvement in Mergers & Acquisition activities with improved valuations of assets in the stock markets and increased financial capability of potential buyers.<sup>1</sup> In emerging economies macroeconomic conditions improved and led to the changes in FDI policies, resulting in enhanced corporate profits attached with improvement in stock market valuations, which boosted mounting business confidence in global FDI scenario.

According to UNCTAD, these favorable developments may help translate Multi National Corporation's record level of cash holdings (estimated to be in the range of US\$ 4-5 trillion among developed countries' firms alone) into new investments during 2011.<sup>1</sup> The share of developing countries at over 50 per cent in total FDI inflows may increase further with well-built growth prospects in organized retail sector.

Being leaders of developing countries China and India both have more attractive market in retail sector. The GRDI report – 2012 ranks China in 3<sup>rd</sup> and India in 5<sup>th</sup> place. The present paper emphasis the trends in FDI of India and China in organized retail sector, and also changing FDI policies in both the economy.

**THEORETICAL UNDERPINNINGS**

**Capital market theory** is one of the oldest theories of FDI (1960s). According to this FDI is determined by interest rates. **Dynamic macroeconomic FDI theory:** FDI are a long term function of Trans National Company strategies. The timing of the investment depends on the changes in the macroeconomic environment "hysteresis effect". FDI theory based on exchange rates analyses the relationship of FDI flows and exchange rate changes and FDI as a tool of exchange rate risk reduction. FDI theory based on economic geography explores the factors influencing the creation of international production clusters and Innovation as a determinant of FDI – **Greta Garbo effect.** **Gravity approach** to FDI informs that closer two countries are (geographically, economically, culturally ...) the higher will be the FDI flows between these countries. FDI theories based on institutional analysis explores the importance of the institutional framework on the FDI flows with **Political stability** being key factor.

**Product Life cycle theory:** (Raymond Vernon & Lewis T. Well – 1966) explains macroeconomic phenomenon, which investigates the relationship between FDI and technology. According to this product life-cycle can be divided into three stages as new product stage, matured product stage and standardized product stage. In the early new product stage, firms place factories in the home country since the demand for a new product is too small elsewhere. As the expansion of production in the home country becomes too expensive, the mature oligopolistic invests in a host country with high income elasticity of demand and similar

<sup>1</sup>Arpita Mukherjee, Nitisha Patel (2005), 'FDI in Retail Sector: India', *Academic foundation*, pp-2.

consumption patterns to the home country. Therefore it develops into the second stage of matured product. As the product turns into increasingly standardized and its competition is based on price, the product is manufactured in less developed countries (LDCs) for export.

The **internalization theory**, was developed by Buckley and Casson (1983), Rugman (1981) and Hennart (1982), it is primarily concerned with the transactions cost approach. The basic hypothesis of this theory is that MNEs emerge when it is more beneficial to internalize the use of such intermediate goods as technology than externalize them through the market. The core prediction of the theory is that, given a particular distribution of factor endowments, MNE activity will be positively related to the costs of organizing cross-border markets in intermediate products.

**Eclectic FDI theory or OLI approach** by John Dunning(1981) ( O-ownership advantage, L- localization advantage, I- internalization factors) suggests that the greater the O and I advantages possessed by firms, more the L advantages of creating, acquiring (or augmenting) and exploiting these advantages from a location outside its home country. This leads to creation of more FDI. Where firms possess substantial O and I advantages but the L advantages favor the home country, then domestic investment will be preferred to FDI and foreign markets will be supplied by exports.

**Economic Conditions:** like Market Size, potential market size, Rate of return, Urbanization/Industrialization, Labour cost, Human capital, Physical Infrastructure known to influence FDI along with Macroeconomic fundamentals like inflation, financial health, tax regime and macroeconomic stability. **Host Country Policies:** Promotion of private ownership, efficient financial market, trade policies/regional trade agreements, FDI policies/investment incentives, legal framework, quality of beaurocracy and openness attracts more FDI into a country.

## OBJECTIVES

- To study FDI policies in organized retail sector both in India and China.
- To analyze trend in FDI inflow in organized retail sector between India and China.

## HYPOTHESIS

- There is no significant difference in FDI inflow in organized retail sector between India and China.

## METHODOLOGY

The study is based on secondary data like GRDI reports, FICCI reports, research article and journals. For data analysis FDI inflow in retail sector both China and India have been taken from 2006-2011 and for analysis the appropriate statistical tools like regression, simple table, line graph and flow charts have been used.

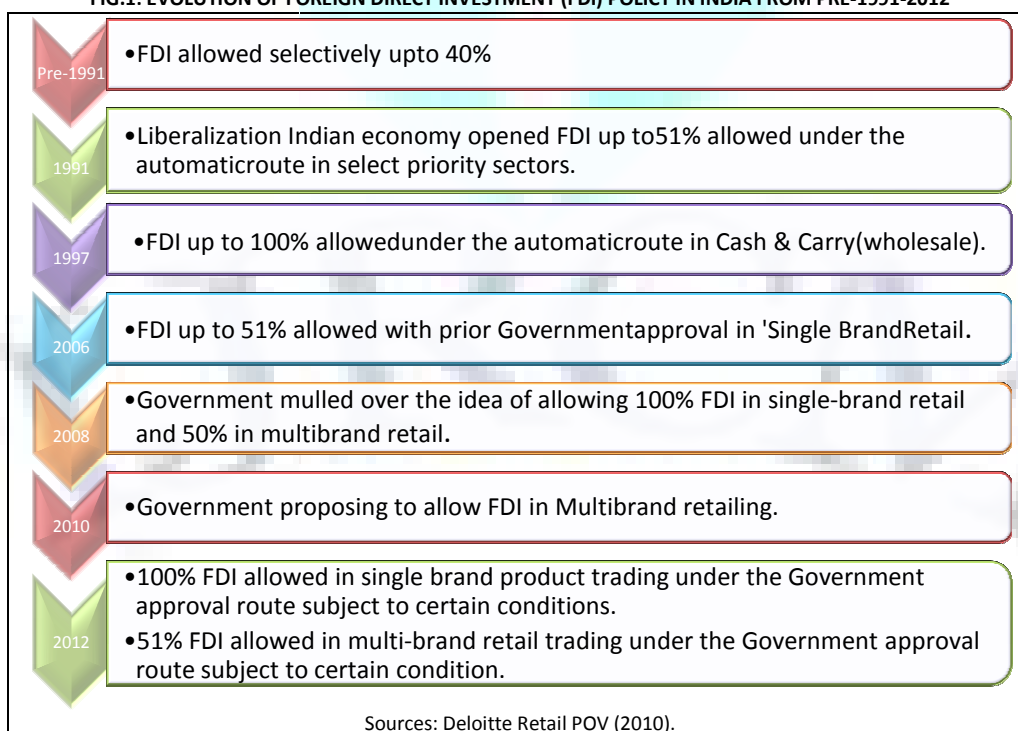
## SCOPE OF THE STUDY

This paper highlights the global retail scenario, trends in FDI policy over a period of both India and China. It also attempts to study the difference between the FDI inflow between India and china (2006-2011).

## EVOLUTION OF FOREIGN DIRECT INVESTMENT (FDI) POLICY IN INDIA

India ranks 5<sup>th</sup> in GRDI report 2012, with accelerated retail growth of 15 to 20 percent. In next five years an average annual retail growth can be expected around 6-7 percent with rise in GDP, higher disposable income and rapid urbanization. Overall retail market contributes to 14 percent of India's GDP; organized retail growth is low at 5 to 6 percent. The retail sector employs approximately 8 percent of India's population with demand for skilled workers expected to rise. Even though, India has delayed to open up its economy, it has given a provision to private as well as foreign investment in last two decades. The foreign investment is directed by government through the FDI policy which control industries open to foreign investment, and also the percentage that can be held by the foreign companies. Globalization and liberalization have immensely influenced Indian economy and have gone a long way in making it a profitable consumer market. The government in a series of moves has opened up the retail sector slowly to FDI. There were initial reservations towards opening up of retail sector arising from fear of job losses, procurement from international market, competition and loss of entrepreneurial opportunities. In 1997, FDI in cash and carry (wholesale) with 100 percent ownership was allowed. In 2006, 51 percent investment in a single brand retail outlet was permitted. Since then retailing through franchisee route has been explored by several global brands.

FIG.1: EVOLUTION OF FOREIGN DIRECT INVESTMENT (FDI) POLICY IN INDIA FROM PRE-1991-2012



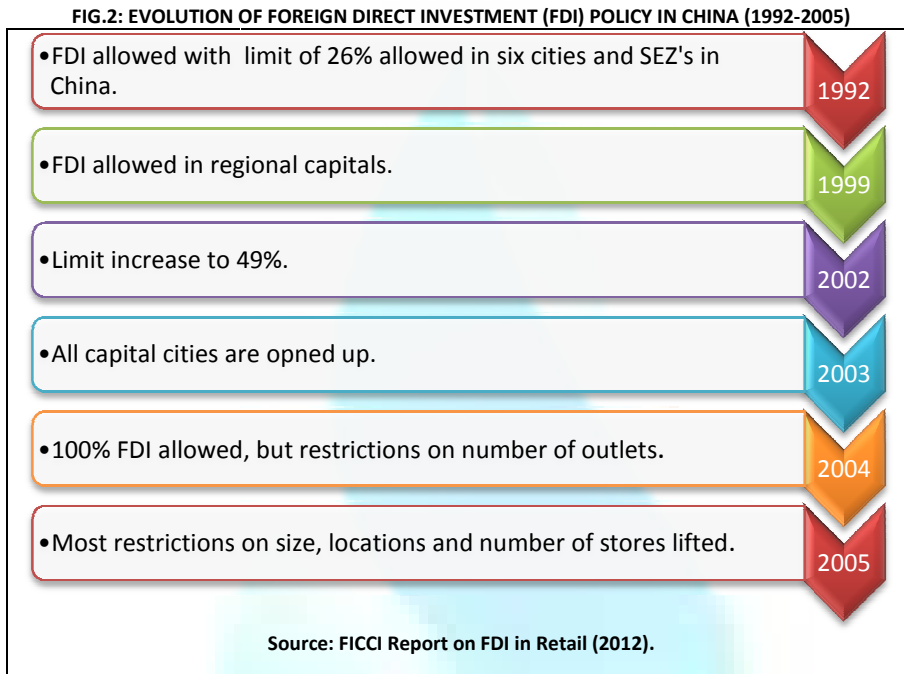
Today about 1.0 million people are employed directly by organized retail. Without FDI, this number is expected to increase to 2 million by 2016 (plus \$ million opportunities via indirect employment). FDI in retail can potentially add another 1.5 million jobs by 2016 (additional direct and indirect job creation). Over 80% of



this employment opportunity will be for people with minimum qualification. Also, these jobs offer higher salaries, defined career paths and a better work environment compared to unorganized retail.

**EVALUATION OF FOREIGN DIRECT INVESTMENT (FDI) IN CHINA**

China rose to third place in the GRDI- 2012. The country’s future retail growth remains positive, with a double-digit rise in annual sales expected. Inflationary pressures are driving up rent rates up to 30 percent and labour costs are by 15 percent per year. While domestic players still dominate the Chinese market major international retailers are expanding rapidly with a focus on tier II, III, and IV cities. China has become the world’s largest luxury goods market with \$ 12 billion in sales. More than 100 percent brands are active in the country fast experiencing on an average growth rate of 30 percent for the past few years. China has received over Rs. 1.5 lakh crore grow at an extremely fast pace. In fact the amount of sourcing from China has grown at a much higher rate compared to the increase in revenues of foreign retail players. China started the journey of FDI in retail back in 1992 and is now almost fully open to FDI since 2005. FDI in retail is now outpacing overall FDI in China at an overall growth rate of 42%.

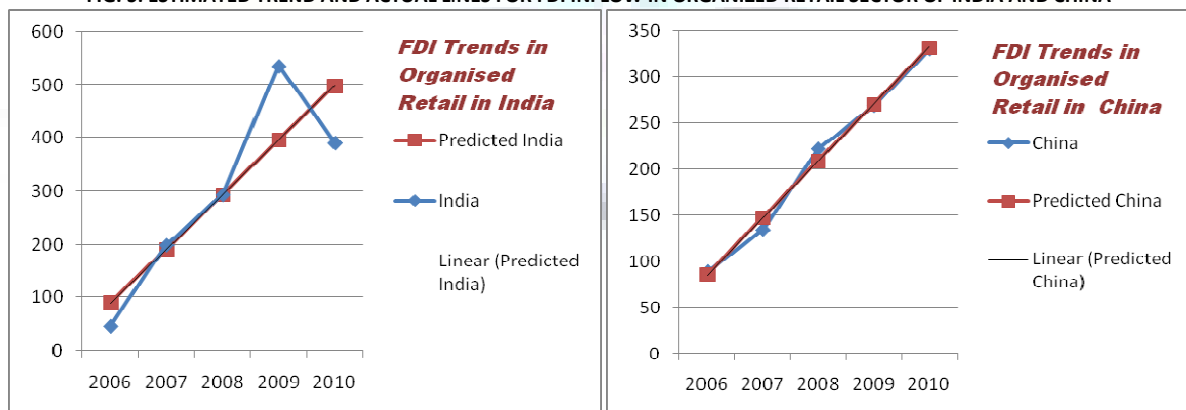


**TABLE 1: FDI INFLOW IN ORGANIZED RETAIL SECTOR OF INDIA AND CHINA FROM 2006-2011**

Year	India		China	
	Actual	Predicted	Actual	Predicted
2006-07	47	88.8	89	85.4
2007-08	200	191.2	134	147.1
2008-09	294	298.6	222	208.8
2009-10	536	396	269	270.5
2010-11	391	498.4	330	332.2

Sources: RBI annual Report 2011-12<sup>4</sup> & FICCI Report on FDI in Retail (2012).

**FIG. 3: ESTIMATED TREND AND ACTUAL LINES FOR FDI INFLOW IN ORGANIZED RETAIL SECTOR OF INDIA AND CHINA**



$FDI_{retailing} = b_0 + b_1 t$   
 $FDI_{retailing India} = -205326 + 102.4t$   
 $Se (66557.06387) (33.14593992)$   
 $t (-3.084955797) (3.089367815)$   
 $(0.053926) (0.05374)$   
 $FDI_{retailing China} = -123685 + 61.7t$   
 $Se (7012.686003) (3.492372641)$   
 $t (-17.63729332) (17.66707231)$

(0.000397) (0.000395)

The trend equations indicate that there is difference in the trend coefficients of India and China. India's trend coefficient with 102.4 is greater than China's trend coefficient 61.7 reflecting greater flows for India in organized retailing with each passing year when compared to China.

## ANALYSIS AND INTERPRETATION

$$Y = \beta_0 + \beta_1 D_1$$

Where Y= FDI in retailing,  $\beta_0$ = intercept,  $\beta_1$ =co efficient,  $D_1$ =FDI inflow, 1=China, 0=India.

$H_0$ : there is no significant difference in the FDI inflow in organized retail sector between India and China.

$H_1$ : there is a significant difference in the FDI inflow in organized retail sector between India and China.

$$Y = \beta_0 + \beta_1 D_1$$

$$= 293.6 - 84.8D_1$$

Se (66.37996686) (93.8754494)

t (4.42302119) (0.90332457)

(0.00221754) (0.392740838)

As the regression shows that the mean of the FDI inflow in India is about US \$293.6 million and China is about US \$208.8. The estimated slope of coefficient for dummy variable (-84.8) is not statistically significant (p-value is 39%). Therefore there is no significant difference in the FDI inflow in organized retail sector between India and China. Even though China has given 100 percent FDI provision in organized retail sector in 2004, Chinese retail market still remains as a battle field for some foreign investors and retailers as they struggle with domestic retailers, more price sensitiveness of consumers and lack of brand loyalty restrictions on number of outlets, locations, suppliers and regulations. India is opened up its retail market for global retailing in late 2006; still it maintained same status FDI inflows like China. The changes in FDI policy that is 100% provision in Single brand and 51% in Multi-brand retailing is attracting the global retailers towards Indian retail market. Along with increase in GDP growth rate, higher disposable income, rapid urbanization, participation of youth in retail expenditure and more brand loyalty are the major factors attracting the masters of globalization that is four major retailers of world investors namely Wal- Mart, Carrefour, Tesco and Metro groups to have their future projects in India retail sector.

## CONCLUSION

The FDI policy of organized retail sectors in India is changing over a period of time. It was only 40% (wholesale market) in pre liberalization. In 2006 government approved FDI to allow only 51% in single brand in retail sector and in 2012 it increased up to 100% in single brand and 51% in multi-brand. Whereas China allowed only 26% FDI in retail sector in 1992 and it went up to 49% in 2002. It reached 100% in 2004 with restrictions on number of outlets, locations, suppliers and regulations. The trend equations indicate that there is difference in the trend coefficients of India and China. India's trend coefficient with 102.4 is greater than China's trend coefficient 61.7 reflecting greater flows for India in organized retailing with each passing year when compared to China.

The dummy regression shows that the mean of the FDI inflow in India is about US \$293.6 million and China is about US \$208.8. The estimated slope of coefficient for dummy variable (-84.8) is not statistically significant. Therefore there is no significant difference in the FDI inflow in organized retail sector between India and China. Though the overall FDI inflows for China are higher than India, the trend equations for the two countries indicate greater FDI inflows for India when compared to China in the organized retail sector. This is because of Chinese retail market being a battle field for some foreign investors and retailers as they struggle with domestic retailers, more price sensitiveness of consumers and lack of brand loyalty restrictions on number of outlets, locations, suppliers and regulations as mentioned earlier.

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