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## FDI in Retail: A Global Perspective

**Srikant Gokhale**  
**Piyush Kumar Sinha**

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## **FDI in Retail: A Global Perspective**

**Srikant Gokhale**

Adjunct Faculty, Indian Institute of Management Ahmedabad

**Piyush Kumar Sinha**

Professor, Indian Institute of Management Ahmedabad

Email: pksinha@iimahd.ernet.in

### **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. When India is the only country in the world where the top five business houses with market caps running into trillions are into retail business, this issue becomes much more interesting. Most retailers in other countries do not feature even in the top 10 large firms. Also 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. The experiences in other emerging economies have shown that 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.

## FDI in Retail: A Global Perspective

In last 8 years lot of action has happened in Indian retailing landscape with large corporate and foreign players dominating the organised retailing in top 15 cities. What they are trying to do now is to build a profitable and scalable business model based on local customer experience in each of the catchment. They have learnt hard ways about the formats, size and merchandising mix based on the catchment and customers they serve. Croma, Relaince Digital and other have worked on 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. Most of the organised retailers unlike their counterpart in west operate with inverse pyramid organization structure with top 20% representing 80% of salary which needs to undergo sea change as retailer cannot sustain such high Salary cost. Many of them have undergone restructuring recently to reduce the overhead costs.

The organized retail in India have faced many challenges and realized 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. For example which format will work on Golf course road, in Gurgaon may not work on the other side on Gurgaon in Sector -14 market within 10 kilometer of each other. They need to come to terms with the fact that the consumer needs and buying behaviour are very different for each catchment within cities. Different formats serve different market need, but in case of India it is difficult to find critical mass of similar catchments within the same cities forget across the countries this has been the case of India based on the learning of organized players operating in India for last 8 years.

### **Advent of Foreign retailers in India:**

Many global retailers whosoever wanted to come to India are already here leveraging on the policy of 100% in cash and carry wholesales route for multi-brand retailing like Walmart, Metro, Woolworth, Staples or 51% for single brand retailing like Zara, Mark & Spencer, Hamleys, Debanham, Espirit, Nokia and many more. 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.

Many online global retailers like Amazon are operating in India. Recently many global players taking advantage of online retailing 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. For example Crate and Barrel has launched India specific website to attract Indian consumer to buy their products online. Similar efforts are expected by other leading global retailers to target Indian consumer leveraging on spread on internet, 3G and smart phone apps and social networking especially the youth segment.

### **Retailing is Local:**

Retail has been local industry driven by understanding of local customers, catchments and providing merchandising needed by the target segments. Hence, scalability is dependent on developing understanding of catchments with similar shopping behaviour and dominant presence of the target segment in these catchments. Since the advent of modern retailing in the 19<sup>th</sup> century, it has largely remained local. It is only after 1990 the retailers started to venture out of their own countries especially in Europe due to saturation in their home markets and local regulations which prevented

them to expand and grow. In all the major economies, emerging or mature, the market share of local retailers across categories is higher than foreign retailers.

### **Experiences of Retailers beyond home country:**

Most retailers have grown concentrically. Initially most of these expansions by few Transnational Retailers (TNR) were in neighboring countries mainly in Europe and America. The acceleration of retail FDI in the late 1990s primarily involved European and US retailers (mostly grocery/general merchandise operators) exporting capital, formats and expertise to, and developing store networks in, the emerging economies of East Asia, Latin America and Central/Eastern Europe. There were also some significant flows of retail FDI between 'mature' economies during the same period, such as Wal-Mart's acquisition-led entry into the UK and Germany. The international expansion has taken places in waves as per **Table -1**. This FDI acceleration was driven by a number of forces:

- (a) Longer-term growth opportunities perceived to be offered by emerging economies with previously largely 'traditional' retail systems;
- (b) by the consolidating, and often increasingly tightly regulated, home markets of these firms;
- (c) 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).<sup>1</sup>

**Table – 1: Phases of Globalisation of TNRs**

Wave	1st	2nd	3rd	4th
	Early 1990s	Mid-late 1990s	Early 2000s	Late 2000s
Countries	South America East Asia (outside China and Japan). Parts of South East Asia (e.g Thailand, Philippines). northern-Central Europe (e.g. Poland & Baltic countries) South Africa	Mexico & Central America Much of Southeast Asia (e.g. Indonesia) south -Central Europe South Africa	China Eastern Europe Russia Other parts of Central America & S.E.Asia India	South Asia (outside India)  Sub-Saharan Africa outside countries impacted in 2nd and 3rd waves.  Poorer countries in South East Asia (e.g. Cambodia) South America (eg. Bolivia).
'Modern' retail market share mid 2000s	50-60%	30-50%	1-20%	

Source: The globalization of Trade retail services, OECD Report, Nov, 2010

A study of top 250 global retailers (**Table – 2**) reveals that 110 of them operate in single local home country. 175 retailers operate in less than 5 countries, mainly neighboring countries. Only 50 retailers operate in more than 10 countries. Only 36 of them have entered into China since the opening up of retail sector in late 1990s. Out of these, 17 retailers are already present in India. Therefore the scope for entry of global retailer entry into India is limited.

**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. It is difficult to assume that all these efforts were successful as there are more cases of failure and exit rather than success in terms of creating scale in emerging economy. The recent case of exit of Best Buy from China and in the past Wal-Mart from Germany and Carrefour from Korea are demonstrative of incapability of TNR to fight local competition due to lack of understanding of local consumer taste, preferences and culture, local regulations and necessary conditions for retailing to be successful.

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.<sup>3</sup>

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.

Table – 2:

## 2010 Top 250 Global Retailers present in China and India

SR. No.	Retail Sales Rank	Company	Country of Origin	2009 retail sales (US \$mil)	Number of Countries of	China	India
1	1	Wal-Mart Stores, Inc.	US	\$405,046	16	Y	Y
2	2	Carrefour S.A.	France	\$119,887	36	Y	N
3	3	Metro AG	Germany	\$90,850	33	Y	Y
4	4	Tesco plc	UK	\$90,435	13	N	Y
5	15	Groupe Auchan SA	France	\$54,057	14	Y	N
6	16	Seven & i Holdings Co.,	Japan	\$52,508	18	Y	N
7	17	Best Buy Co., Inc.	US	\$49,694	15	Y	N
8	18	Aeon Co., Ltd.	Japan	\$49,021	9	Y	N
9	30	The IKEA Group (INGKA)	Sweden	\$29,100	38	Y	N
10	44	PPR S.A.	France	\$18,714	84	Y	Y
11	48	Alimentation Couche-Tard	Canada	\$16,440	9	Y	N
12	50	Inditex S.A.	Spain	\$15,424	74	Y	Y
13	52	Kingfisher plc	UK	\$15,381	8	Y	N
14	53	Marks & Spencer	UK	\$15,224	39	Y	Y
15	55	AS Watson & Company, Ltd.	Hong Kong SAR	\$14,977	34	Y	N
16	57	Staples, Inc.	US	\$14,635	23	Y	Y
17	60	Groupe Adeo SA	France	\$13,807	9	Y	N
18	61	Isetan Mitsukoshi	Japan	\$13,575	11	Y	N
19	62	Toys "R" Us, Inc.	US	\$13,568	35	Y	N
20	64	H & M Hennes & Mauritz AB	Sweden	\$13,218	36	Y	N
21	67	LVMH Moët Hennessy-	France	\$12,843	79	Y	Y
22	73	Dell Inc.	US	\$12,054	177	Y	Y
23	96	Lotte Shopping Co.,	S. Korea	\$8,823	5	Y	N
24	101	Office Depot, Inc.	US	\$8,661	33	Y	N
25	102	Limited Brands, Inc.	US	\$8,632	45	Y	Y
26	116	Oxylane Groupe	France	\$7,587	14	Y	Y
27	124	Fast Retailing Co., Ltd.	Japan	\$7,118	19	Y	N
28	125	Dairy Farm International	Hong Kong SAR	\$7,029	10	Y	Y
29	133	Apple Inc. / Apple Stores	US	\$6,574	9	Y	Y
30	158	Next plc	UK	\$5,074	32	Y	Y
31	179	Luxottica Group S.p.A.	Italy	\$4,378	25	Y	Y
32	193	Groupe Vivarte	France	\$4,020	66	Y	N
33	223	Compagnie Financière Lagardère	Switzerland	\$3,372	51	Y	Y
34	230	Services SA	France	\$3,226	30	Y	N
35	238	Coach, Inc.	US	\$3,156	6	Y	N
36	248	Woolworths Holdings	S. Africa	\$3,093	18	N	Y

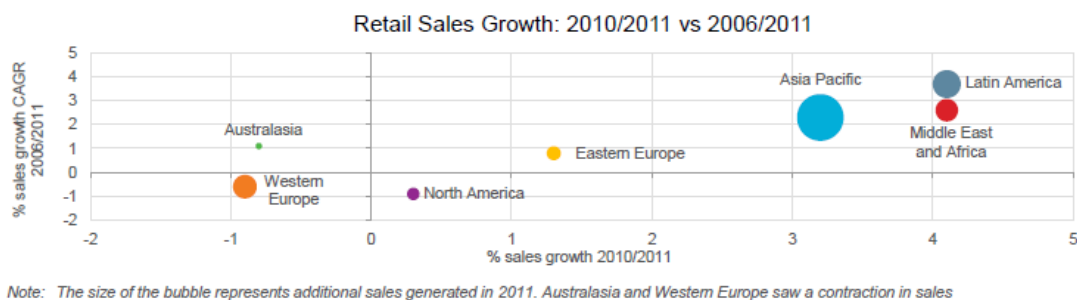
Source: Store Magazine, January, 2011

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.

As initial retail FDI in those markets began to mature, market scale and sustainable advantage became increasingly vital issues. In particular, the critical nature of market leadership to profitability became an increasingly important criterion for TNRs and their home country financial markets. 'Flag planting' investment via start-up expansion or via minority share acquisition, which was very successful in the late 1990s, started losing its impact during 2000s. As a result, achieving sufficient market scale in a country against better placed TNR rivals or leading local retail chains, became difficult and many TNR retailers either divested or exited the markets. For example, Wal-Mart and Carrefour both divested their South Korean stores in 2006 leaving Tesco as the only retail TNR in that market. Additionally Carrefour also divested its Japanese stores to local operator Aeon in 2005."<sup>1</sup>

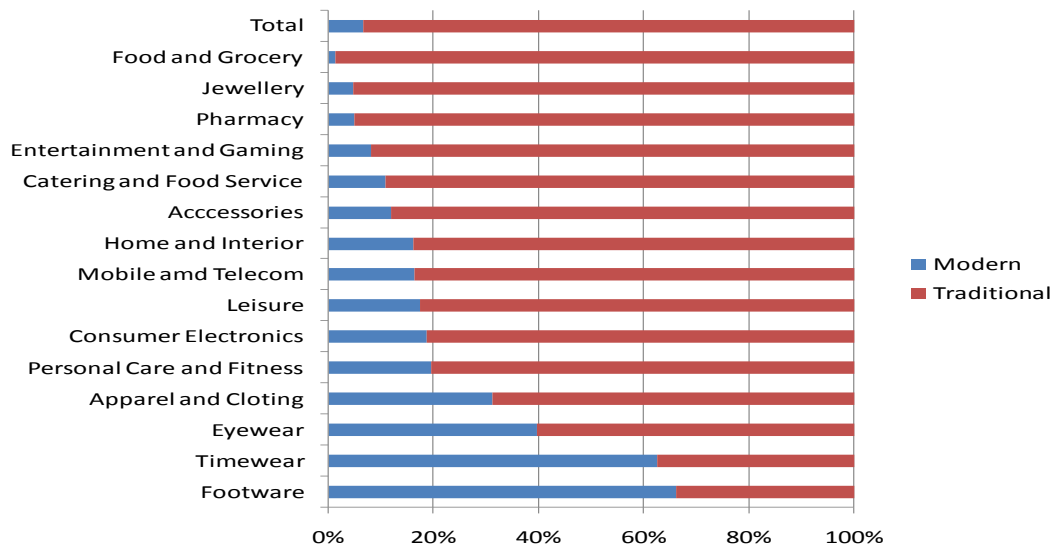
### **Changing Indian retail landscape:**

Modern Retail has seen a significant growth in the past few years with large scale investments made by Indian corporate houses primarily in Food and Grocery retailing in a bid to capture the large potential of the USD 400 Billion market. Foreign apparel brands including luxury brands have set up shop in India through Franchisee/Joint Venture route and have expanded rapidly in the last few years. Multi-brand retailing is being opened for foreign investment. For global retailers who have not been seeing large organic growth, India provides a lucrative market for them to grow their topline and profitability. Some global retailers are currently operating in India in the cash and carry (wholesale) format. Few retailers have been designing plans to start their Cash & Carry business to have a market presence and create brand awareness.<sup>4</sup> 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.



Source: Euromonitor International

No doubt it is big retail market with over \$400 Bn in 2010 growing at 10% each year but 90% of it is unorganized or small mom and pop shop selling to end customers. The highly diverse nature of Indian customer favours local retailers to succeed moreover 70% of India is still rural lacking proper infrastructure to facilitate retail development. The top cities are overcrowded lacking shopping centres, high street and mall spaces for organized retailing to take shape. New urban areas are coming up in cities without proper planning to create adequate space for shopping. 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)



Source: India Retail Report, 2011

The big corporate taking advantage of retail regulation in 2003 (not allowing FDI) invested heavily billions of dollars and today the scenario is very different. All large corporate Tatas, Reliance, Aditya Birla, Biyani's, Raheja's, Essar, and many more have setup retail formats in each of the major categories and the share of organized retail has grown significantly in top 15 cities in last five years. The growth rate of organized retailers is over 40-50% per annum compared to overall growth of 10% in retailing. Even though each of these corporations have set up scalable model after trial and error, many of them are still struggling to find a sustainable, scalable and profitable business model. Casualties like Subhiskha and Vishal Mega mart and many other retailers could not sustain due to the gear change in their businesses because of growth. Many of these had financed projects through heavy debts and found tough to service them in the regime of high interest rates.

#### **What new FDI policy in multi-brand retailing will do:**

As per policy makers, the FDI in multi brand retail is expected to bring retail Know how and best practice, shopping experience, foreign capital, generate huge employment, investment in supply chain and backend operation mainly in food and grocery segment. The new FDI policy has been designed to attract the large Food and Grocery and Hypermarket retailers like Walmart, Carrefour and Tesco who already have presence in India in various ways and are furthering their expansion plan through their Indian retail partners. In India, no foreign retailers would be investing in the backend operation other than the food and grocery and in categories where retailers either manufacture or import their own merchandise like in case of Apparel other than these products most of the products sold by retailers (FMCG) are manufactured in India and distributed in a seamless way for example in Consumer electronics and Mobile phones Industry; all the key brands like Nokia, Samsung, LG and Whirlpool, Hitachi, Sony and others have invested heavily and developed capabilities in supply chain to serve the market demand in an efficient way so that they can replenish the orders within 24 hours in top 20 cities due to fragmented nature of markets. The same is the case with other FMCG brands manufacturers like P&G, Unilever, ITC, Tata etc.

Based on the experience elsewhere of the TNR, they have been very cautious and have long term approach to market. They will first try to understand the market before investing the single dollar not only in terms of attractiveness based on micro economic data but also based on changing consumer demographics as they have realised based on 20 years of international expansion especially in emerging market that slow and steady approach is prudent way to enter market rather than carpet bombing.



The opening will allow the existing organized retailers to have joint ventures with many global players to bring different retail formats to the market similar to what has happened in the Middle Eastern countries. It is the local corporate who have brought foreign players rather than the other way round using licensing, franchise or joint venture route.

The responses of Indian organized players to FDI in Multi brand retailing are positive. "Apart from opening up doors for the likes of [Wal-Mart](#) and Carrefour, which have been waiting in the wings for years, it would eventually also benefit small and marginalized farmers as well. According to Thomas Varghese, chairman, CII National Retail Committee and CEO, Aditya Birla Retail, "The move will bring in the required funds from all kinds of foreign investors into modern retail which was till date stymied for funds." Varghese said that once the funds come into [India](#) through the FDI route, it will usher in a phase of expansions. Once cleared, the move would offer Indian companies the option of selling a part of their stake to foreign companies enabling them to become debt-free. "For us as a company, the option to sell a stake comes into play in order to make ourselves debt-free. The FDI will throw open opportunities which will enable us to sell a stake and raise funds," said Kishore Biyani, founder & chairman, Future Group, India's largest retailer which operates stores like Big Bazaar and Food Bazaar. Not everyone is impressed though. Arvind Singhal, chairman, Technopak Advisors, a retail consultancy firm, however, said that there are too many riders attached to this proposed policy which do not make much sense. "After so many years of debate and discussion, the government came up with this confused proposal, it is disappointing," said Singhal.<sup>5</sup>

Govind Shrikhande, managing director of Shoppers Stop, has a question for the Walmarts and the Carrefours: Why aren't they going the whole hog in the cash-and-carry segment where 100% FDI is allowed? (Carrefour opened its first cash & carry store in India last December; Walmart has five such stores in India in a tie-up with telecom major the Bharti Group.) "At Reliance, we are okay with FDI not coming in," says Bijou Kurien, president and chief executive (lifestyle) of Reliance Retail, a Mukesh Ambani venture. "We have partnerships only in the specialty and luxury space with marquee brands [like Marks & Spencer, Office Depot, Hamleys] and not in the big-ticket hypermarket or grocery space. We have run the distance long enough by ourselves. After having burnt our fingers during this learning phase we don't want to get into partnerships now and share our topline and bottomline."<sup>6</sup>

As evidenced from above, It is the Indian large corporates who have invested in organized retail are waiting eagerly for opening up as it will allow them to find much needed funding to create scale and to multiply their investment and also to go public whosoever has reached the critical mass and have a profitable business model at operating level. Opening up will attract both foreign funds (FII) and PEs who will invest into these companies with opening up of multi brand retailing. There will be increase and M&A activity in retail due to this opening up.

Many of these global retailers are driven by Wall Street expectation of growth as the valuations in developed and mature markets are much lower than the emerging markets like India. The table below shows the attractiveness of Indian market compared to US market in terms of market valuation which may prompt many global retailers and investor to come to India. With the opening up of FDI in multi brand retailing very few new global retailers are expected to be attracted to India as the India is very fragmented, complex, with lot of bottleneck both in managing supply chain and state taxation which does not allow the proper management of movement of goods across the different states.

	sales Bn \$	Market Cap Bn \$	Price to sales ratio
Best Buy	50	9	0.18
Target	68	34	0.5
Walmart	431	183	0.42
Home Depot	69	53	0.77
Gap	15	8	0.59

	sales Rs Cr	Market cap Rs Cr.	Price to sales ratio
Trent	686	2123	3.09
Pantaloon	6316	6078	0.96
Shopper Stop	1929	3082	1.60
Titan	6661	17898	2.69

Source: Yahoo finance and Rediff.com

Therefore, rather than pinning hope on FDI, Govt. should focus on removing bottleneck and fast tracking projects related to improving infrastructure like roads, special incentives in economic zone to set up warehousing, early implementation of GST, streamlining labour laws for retail trade, planned urbanization with proper spaces (malls, high street, shopping centres) to facilitate retail activities with adequate parking, availability of adequate power to run the shops.

### **Conclusion:**

In the end, based on evidence and experiences of TNR in other emerging economy of limited success, and considering the bottlenecks in India, diverse customer demographics, and fragmented industry we feel that this opening up will attract very few global retailers particularly in food and grocery segment. Out of top 250 retailers, the 36 retailers who are successful in China are most likely to enter into India as 17 retailers out of this have already entered India, hence scope for many global players to enter is very limited. At best, the global players already present in India will expand faster due to opening up.

As retailing still is very local industry (over 90%), the FDI in multibrand retailing will only benefit existing organized players in terms of attracting foreign capital and will not change significantly the retail landscape in terms of formats proliferations benefiting customers, generating huge employment or investment in supply chain or back end investment as has been envisaged in the policy. Many TNRs will use online route to attract Indian consumer to start with before setting up physical presence to test the market.

With global uncertainties, slow down of growth and cash flow issues, the TNR will be cautious in terms of expansion into unchartered territories in near to medium term. Instead of paying too much attention to FDI and banking on it as game changer, Indian Government should fast track infrastructure especially road development, set up economic zones for warehousing facility, streamline labour laws, planned urbanisation to ensure adequate availability of quality real estate, high street and implement GST to facilitate modern organized retail to takeoff in India.

At the end of the day, 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 benefits 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.

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