ENTRY ROUTES OF FOREIGN RETAILERS IN INDIA

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ABSTRACT

The retailing sector in India has undergone significant transformation in the past 10 years. Traditionally, Indian retail sector has been characterized by the presence of a large number of small-unorganized retailers. However, in the past decade there has been development of organized retailing, which has encouraged large private sector player to invest in this sector. Many foreign players have also entered India through different routes .With high GDP growth, increased consumerism and liberalisation of the manufacturing sector, India is being portrayed as an attractive destination for foreign direct investment (FDI) in retailing. However, at present this is one of the few sectors, which is closed to FDI. Within the country, there has been significant protest from trading associations and other stakeholders against allowing FDI in retailing, yet foreign retailers are entering India through various routes. The present paper exmanies the entry routes of foreign retailers to India.

Key Words : ***Retailing, Test marketing, Franchising***

1.1 FDI IN RETAILING IN INDIA : ENTRY ROUTES

In India, till recently, FDI is not allowed in retailing but the union cabinet on January 24, 2006 nationalized and simplified the FDI policy and allowed the contentious issue of foreign investment in retail sector by allowing FDI up to 51 percent with prior government approval for retail trade in single brand products. This world imply that foreign companies would be allowed to sell goods sold internationally under a single brand viz. Reebok, Nokia, Adidas, retailing of goods of multiple brands, even if such products are produced by same manufactures would not be allowed.

Although FDI is not allowed in retailing, many international players are operating in the country(table1.1). They have adopted various routes to enter India Some of these entry routes are discussed in detail below.

a) MANUFACTURING AND LOCAL SOURCING

Companies that set up manufacturing facilities are allowed to sell the products in the domestic market. Consumer durable companies such as Sony and Samsung have entered the retail sector through this route. Due to high labour cost in their domestic market, many international brands are setting up manufacturing bases in developing countries such as India and China and/or are sourcing products from local manufacturers. For example, Levi's and Tommy Hilfiger are sourcing products from Indian manufacturer like Arvind Mills. Benetton has a manufacturing unit in India. Other international brands like GIVO from Italy have set up export-oriented manufacturing facilities. These companies are allowed to sell products to Indian consumers through franchising, local distributors, existing Indian retailers, own outlets etc.

TABLE 1.1

SOME EXISTING FOREIGN PLAYERS AND PROSPECTIVE ENTRANTS

Retailers	Type	Status
7-Eleven	Supermarket	Already in
Amway	Direct Selling	Already in
Auchan	Hypermarket	Evaluating
Carrefour	Multi-format retailer	Postponed entry
Dairy Farm	Multi-format retailer	Tied up with RPG
J C Penny	Product sourcing	Already in
Landmark	Department store	Already in
Lee Cooper	Product sourcing	Already in
Levi's	Product sourcing	Already in
Mango	Apparel retailer	Already in
Marks & Spencer	Department store	Already in
Metro	Cash & carry	Already in
Oriflame	Direct selling	Already in
Reebok	Joint venture	Already in
Shoprite	Wholesale cash-and-carry	Already in

Retailers	Type	Status
	and franchising	
Sony	Manufacturer retailer	Already in
Wal-Mart	Hypermarket	Recently tied with Bharti Reatil

Source : "FDI in Retail sector", Department of Consumer Affairs, Government of India,p.115

Companies which have set up manufacturing bases or are sourcing products from India would continue to do so if FDI is allowed in retailing. However, some companies such as Sony have closed down certain production units in India and are sourcing their products from abroad. With increased globalization, companies are and in future would source their products from countries where they have efficient and cost advantages

B) FRANCHISING

Franchising is the most preferred mode through which foreign players have entered the Indian market. Franchising is often used as a mode to expand the market of a particular retail enterprise outside domestic economy since it allows firms to expand without investing their own capital, is based on local expertise and endless firms to curb local oppositions and regulations. This is the most common mode for entry of fast food chains across the world. Apart from fast food chains like Pizza Hut, players such as Lacoste, Mango, Nike and Marks and Spencer, have entered the Indian market through this route.

For setting up franchising operations, the foreign players are required to take permission from the Reserve Bank of India (RBI). RBI often imposes the condition that franchisers have to bring in foreign investment and set up a base for carrying on operational activities. A foreign franchiser not wishing to make a direct investment would have to render technical assistance to the franchisee. Some franchises such as Pizza Hot have made significant investment in the supply chain. Others like Mango entered India through the franchising route but did not make much investment and has got a special approval from RBI to import from Spain. Although Mango maintains the full range of textiles abroad,in India it is allowed to operate only in

woman wears. Marks and Spencer have also entered the market through the franchising route but the company is importing all product ranges.

The arrangements between franchisee and franchiser are found to be extremely flexible and are based as negotiation between the two. Some Indian franchisees have complained about high franchising fees together with high real estate costs, high import duties and other costs escalate the prices. For instance, the cost of a Marks and Spencer product is higher than not only the brands produced domestically but also in comparison to the price of the product in the UK. The high prices restrict the ability of the foreign players to penetrate the market but they have entered the country to make their brands visible to the huge Indian Market.

If FDI is allowed in retailing, franchisees are not very sure whether they would hold the retailing rights for the brands. According to industry representatives, since franchisees largely constitute of domestic traders who have made significant investment in infrastructure, government through legislation must ensure that they do not loose cut their franchising rights if FDI is allowed in retailing and the franchisers decide to change the mode of operation. The existing franchises have also expressed an interest in entering into joint venture with the franchisers if FDI is allowed in retailing.

c) TEST MARKETING

Test marketing is another route which many foreign players have entered the Indian market. Foreign Investment Promotion Boards (FIPB) allows foreign companies to test market products for a two-period by the end of which they are required to set up manufacturing facilities in India. Direct selling companies like Amway and Oriflame entered the Indian Market through this route. Initially, Amway got an approval for test marketing for a period of two yeas but they managed to secure an extension of one more year. At the end of the third year, they set up contract manufacturing facilities and brought in foreign investment and technical know-how. Oriflame too extended its test marketing licence for a third year and at the end of which had set up a manufacturing facility in Noida (UP) for producing certain specific products. Other products are imported and would continue to be imported from abroad.

Nokia came to India through the test marketing route in Mid-1990s. Initially they got a license for two years to test their products in the Mumbai circle. After three months of their entry they tied up with the service providers to provide integrated services to their customers. Due to pressure from the FIPB, Nokia had tied up with the HCL Infotech as a strategic partner for all India distribution of Nokia products. After the success of its products in the country, Nokia had opened up an office but had not set up a manufacturing facility and continued to import all products. After another two years they divided the country into four zones and entered into a strategic alliance for distribution with Supreme for East and West India while HCL continued with North and Southern Zone. Nokia had also applied for the cash and carry license from the FIPB and has recently got the license. Nokia is aggressively targeting the Indian consumers and plan to capture 75 percent of the mobile market in the next seven years. The company, which currently operates as a wholesale cash-and-carry, recently announced that it would get up manufacturing facilities by 2006.

The test marketing route allows foreign players to test the demand for their products in Indian market before undertaking investment. Even if FDI is allowed in retailing, many foreign players would like to enter the Indian market through this route. The Entry strategies of existing foreign players is Exhibited in Table :1.2

TABLE 1.2

THE ENTRY STRATEGIES OF EXISTING RETAILERS

Entry Strategy	Companies
Franchisee (International retailers provide brands and technology to the local partners to get Royalty in return)	✓ Pizza Hut ✓ Domino Pizza ✓ Marks and Spencer ✓ Nike, Tommy Hilfiger
Cash & Carry Wholesale trading (FDI in wholesale business is allowed hence players like "Metro cash and carry' have entered Indi and they supply the producers to the retailers here to sell)	✓ Metro ✓ ShopRite

Entry Strategy	Companies
Joint Ventures (International brands provide equity and support to the Indian entity)	✓ Mc Donald ✓ Reebok
Distribution (The international company sets up a distribution office in India and they supply the products to the retailers here to sell)	✓ Huge Boss ✓ Mango Swarovski
Manufacturing (The company sets up an Indian Company to undertake manufacturing of their products in India)	✓ Bata ✓ United Colors of Benetton
Test marketing (Foreign Investment Promotion Boards (FIPB) allows foreign companies to test market products for a two-period by the end of which they are required to set up manufacturing facilities in India)	✓ Amway ✓ Ori Flame

Source: Technopak Analysis

d) WHOLE SALE CASH-AND-CARRY OPERATIONS

This is the route through which large international retailers such as Germany's Metro cash and carry GMGH and Shoprite Checkers of South Africa have entered the Indian Market. The whole sale cash and carry operation is defined as any trading outlets where goods are sold at the wholesale rate for retailers and businesses to buy. The transactions are only for business purposes and not for personal consumption as in the case of retailing.

Metro GmbH was the first company to bring to bring in 100 percent FDI through this route. The company has been given license to supply to distributors, wholesalers and retailers having valid trade licenses/sales registration, Metro, which is one of the top five global retailers, had initially set up two outlets in the suburbs of the city of

Bangalore. Subsequently,it issued over 2.50 lakh purchase access to these outlets. Customers of Metro include retailers,hotels,commercial organizations and organization of professionals like doctors, Lawyers,I nfotech companies,etc. Metro GmbH have been given an APMC license by Karnataka Govt for wholesale trading in agricultural products.

The Indian retailer organizations have raised significant protests against the entry of Metro and Shoprite. The campaign is led by Federation of Association of Maharashtra, supported by other state Trading Corporations. The protests have allegedly received political patronage. The protesters have pointed out that there is no means to verify that products sold by these cash- and –carry operators are for resale, commercial or industrial use and not for personal consumption. They have cited examples where Metro consumers bought products in small quantity or products which are not relevant for their business. For example, a jewellery company purchasing footwear or confectionery. they have raised concerns that a large global retailers like Metro can resort to unfair trade practices such as predatory pricing which would eliminate the local players. Wholesale cash–and- carry operation can be used as a backdoor entry route by global retailers since FDI is not allowed in Retailing.

While there is protest at one end, different state government departments such as Punjab Agro-Industries Corporation are trying to tie-up with Metro for sourcing therir products. Metro has made substantial investment, is trying to set up asupply chain and is in the process of training up Indian farmers, fisherman, etc. in the state-of-the art technology. Uncertainties and protest is affecting its future expansion and investment plans. In order to safeguard against the protest Shoprite, which has acash and carry license has also entered into a franchising agreement with Godrej Group and acquired over 60,000 square feet of space in Nirmal Lifestyle Mall in Mulund , Mumbai, for a Hypermarket.

e) DISTRIBUTOR

Companies such as Swarovski and Hugo Boss have set up distribution offices in India and these offices supply the products to local Indian retailers. All products of Hugo Boss are imported and distributed through the company's distributor.

f) SPECIAL CASES

The Sri Lankan retailers have entered the Indian market through the initiatives of Export Development Board of Sri Lanka (EDB) which obtained special permission from the RBI to set up retail operations in India. The EDB has leased 17 retail outlets in Spencer plaza in Chennai in which Sri Lankan retailers are showcasing and selling their products. The Sri Lankan products showcased in these stores are mostly at the higher end of the quality spectrum and can be brought into the country free duty. This gives an advantage to large Sri Lankan retailers like Hameedia not only to establish a global presence but also to access the large customer base of India at competitive prices. The EDB is also exploring the possibilities of setting up similar trade centres in other cities like Delhi and Mumbai. Although this mode has allowed retailers from Sri Lanka to enter the Indian market without domestic manufacturing and sourcing conditions and some products sold by these traders are similar to those sold by Indian retailers, EDB did not face any opposition from chambers, retailers and the trading houses.

1.2 CONCLUSION

Although the official policy is that as yet FDI is not allowed in retailing, but it has not acted as any entry barrier. Foreign players have a substantial presence in the country and have used different routes to enter Indian Trading Sector.

These Foreign players have worked around the regulation in their own way for entry purposes. For example, Metro Cash and Carry GmbH has pointed out that there is no proper definition of retailing or retail formats in India. Although whole sale cash-and-carry is meant for purchases in bulk, the policy on bulk trading does not clearly state the minimum quantity requirement. Metro admitted that around 2percent of its retail sales since it is very difficult for the company to track whether the purchase is for personal use or for resale and commercial use. A number of international players have shown interest in entering the Indian market through this route and hence there is

need for greater clarity in the definition of wholesale cash-and-carry operation. The case studies also show that foreign players have used the test marketing entry route differently. Many of them have got extension over the stipulated timeframe for test marketing and their future expansion plans and modes of operation in India depend on their ability to convince the FIPB and other concerned authorities. Even when foreign players are required to set up manufacturing facilities, it is not restricting them from sourcing from abroad. The foreign Players like Shoprite are simultaneously using alternative routes to circumvent political protest and other barriers. The restrictions on FDI and protest against allowing FDI in Retailing has resulted in an uncertain and non-transparent policy environment leading to undesirable discretion and scope for Corruption.

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