

Foreign Direct Investment (FDI) in retail and its scope in India

Simerjeet Singh Bawa

Assistant Professor in Management

Gian Jyoti Group of Institutes

Banur

Email : simer.bawa@gmail.com

Dr. Harpreet Singh

Director

A S College

Khanna

Email : harpreet7305@yahoo.co.in

ABSTRACT

India has been placed at first position in the category of countries with the best opportunity for investment in retail sector. 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 organized retailing in India has been much slower as compared to rest of the world and one of the major reason is that retailing is one of the few sector where foreign direct investment (FDI) is not fully allowed. Liberalizing flow of FDI into the retail sector has been a subject of active debate for a long time. Undoubtedly, this 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 and has stimulated the growth in different sectors. In order to create new & more jobs, FDI is the success mantra now. In this paper we study the impact of Foreign Direct Investment (FDI) with respect to Indian Retail Sector. We try to analyze merits and demerits, challenges and future scope of FDI.

Key words: Foreign Direct Investment, Retail Sector, Globalization, Liberalizing

Introduction to FDI

FDI stands for Foreign Direct Investment, which has a meaning of cross border investment made by a resident in one economy in an enterprise in another economy that as an objective of establishing a lasting interest in the investee economy. It is when a company in one country invests in a company in another country. The objectives of FDI in India are to accelerate

economic growth. The method of accelerating growth is by supplementing domestic capital, skills, and technology by promoting and attracting foreign direct investment.

In countries where they have trouble with their economy sometimes other countries will do investments in them to help boost the local economies and help them grow until they can survive on their own. In some countries, such as India, the government doesn't always approve of the FDI from outside countries because they want to be

able to grow themselves without help from another outside country. India wants to grow its economy enough that it can compete with countries like China. FDI is also described as "investment into the business of a country by a company in another country". Mostly the investment is into production by either buying a company in the target country or by expanding operations of an existing business in that country". Such investments can take place for many reasons, including to take advantage of cheaper wages, special investment privileges (e.g. tax exemptions) offered by the country.



Source : <http://www.healthandkarma.com/2013/09/foreign-direct-investment-and-indian.html>

Why Countries Seek FDI ?

- (a) Domestic capital is inadequate for purpose of economic growth;
- (b) Foreign capital is usually essential, at least as a temporary measure, during the period

when the capital market is in the process of development

- (c) Foreign capital usually brings it with other scarce productive factors like technical know how, business expertise and knowledge

Pros to FDI

- (a) Improves forex position of the country

- (b) Employment generation and increase in production
- (c) Help in capital formation by bringing fresh capital
- (d) Helps in transfer of new technologies, management skills, intellectual property
- (e) Increases competition within the local market and this brings higher efficiencies
- (f) Helps in increasing exports;
- (g) Increases tax revenues

Cons to FDI :

- (a) Domestic companies fear that they may lose their ownership to overseas company
- (b) Small enterprises fear that they may not be able to compete with world class large companies and may ultimately be edged out of business;
- (c) Large giants of the world try to monopolies and take over the highly profitable sectors;
- (d) Such foreign companies invest more in machinery and intellectual property than in wages of the local people;
- (e) Government has less control over the functioning of such companies as they usually work as wholly owned subsidiary of an overseas company;

Authorities Dealing With Foreign Investment:

- (a) **Foreign Investment Promotion Board (popularly known as FIPB) :** The Board is responsible for expeditious clearance of FDI proposals and review of the implementation of cleared proposals. It also undertake investment promotion activities and issue and review general and sectorial policy guidelines;
- (b) **Secretariat for Industrial Assistance (SIA) :** It acts as a gateway to industrial investment in India and assists the entrepreneurs and investors in setting up projects. SIA also liaison with other government bodies to ensure necessary clearances;
- (c) **Foreign Investment Implementation Authority (FIIA) :** The authority works for quick implementation of FDI approvals and resolution of operational difficulties faced by foreign investors;
- (d) **Investment Commission**
- (e) **Project Approval Board**
- (f) **Reserve Bank of India**

Advantages of FDI to Host Country

In the global economy today, we see many developing countries competing for foreign

direct investment. FDI is said to be an important factor for spurring the development of a nation. Let's take a look at some advantages of foreign direct investment to a host country:

- **Integration into global economy** - A developing country, which invites FDI, can gain a greater foothold in the world economy by getting access to a wider global market.
- **Technology advancement** - FDI can introduce world-level technology and technical know-how and processes to developing countries. Foreign expertise can be an important factor in upgrading the existing technical processes in a host country. For example, the civilian nuclear deal between India and the United States would lead to transfer of nuclear energy know-how between the two countries and allow India to upgrade its civilian nuclear facilities.
- **Increased competition** - As FDI brings in advances in technology and processes, it increases the competition in the domestic economy of the developing country, which has attracted the FDI. Other companies will also have to improve their processes and products in order to stay competitive in the market. Overall, FDI improves the quality of a products and processes in a particular sector.
- **Improved human resources** - Employees of a host country in which there is an FDI get exposure to globally valued skills. The training and skills up gradation can

enhance the value of the human resources of the host country.

The advantages of foreign direct investment to the investor includes access to a larger market in the host country, ability to tap the potential of a cheap and skilled labor, making use of resources in the host country and pursuing growth goals by diversification and optimizing costs.

Objective of the study

- 1 To understand the meaning of FDI
- 2 To verify the role of FDI in India
- 3 To describe the impact of FDI on Indian Retail Sector

Review of Literature

Dunning John H. (2004) in his study "Institutional Reform, FDI and European Transition Economics" studied the significance of institutional infrastructure and development as a determinant of FDI inflows into the European Transition Economies. The study examines the critical role of the institutional environment (comprising both institutions and the strategies and policies of organizations relating to these institutions) in reducing the transaction costs of both domestic and cross border business activity. By setting up an analytical framework the study identifies the determinants of FDI, and how these had changed over recent years.

Tomsaz Mickiewicz, Slavo Rasosevic and Urmas Varblane (2005), in their study, “The Value of Diversity: Foreign Direct Investment and Employment in Central Europe during Economic Recovery”, examine the role of FDI in job creation and job preservation as well as their role in changing the structure of employment. Their analysis refers to Czech Republic, Hungary, Slovakia and Estonia. They present descriptive stage model of FDI progression into Transition economy. They analyzed the employment aspects of the model. The study concluded that the role of FDI in employment creation/ preservation has been most successful in Hungary than in Estonia. The paper also find out that the increasing differences in sectoral distribution of FDI employment across countries are closely relates to FDI inflows per capita. The bigger diversity of types of FDI is more favorable for the host economy. There is higher likelihood that it will lead to more diverse types of spillovers and skill transfers. If policy is unable to maximize the scale of FDI inflows then policy makers should focus much more on attracting diverse types of FDI.

Vittorio Daniele and Ugo Marani (2007) in their study, “Do institutions matter for FDI? A Comparative analysis for the MENA countries” analyse the underpinning factors of foreign Direct Investments towards the

MENA countries. The main interpretative hypothesis of the study is based on the significant role of the quality of institutions to attract FDI. In MENA experience the growth of FDI flows proved to be notably inferior to that recorded in the EU or in Asian economies, such as China and India. The study suggests as institutional and legal reform are fundamental steps to improve the attractiveness of MENA in terms of FDI.

Jing Zhang (2008) in his work, “Foreign Direct Investment, Governance, and the Environment in China: Regional Dimensions” includes four empirical studies related to FDI, Governance, economic growth and the environment. The results of the thesis are, first, an intra-country pollution haven effect does exist in China. Second, FDI is attracted to regions that have made more effort on fighting against corruption and that have more efficient government. Third, government variables do not have a significant impact on environmental regulation. Fourth, economic growth has a negative effect on environmental quality at current income level in China. Lastly, foreign investment has positive effects on water pollutants and a neutral effect on air pollutants.

Samuel Adams (2009) in his paper, “Can Foreign Direct Investment help to promote

growth in Africa” provides a review of Foreign Direct Investment and economic growth literature in the context of developing countries and particularly Sub-Saharan Africa. The main findings of the study are as follows, first, FDI contribution to economic development of the host country in two main ways, augmentation of domestic capital and enhancement of efficiency through the transfer of new technology, marketing and managerial skills, innovation and best practices. Secondly, FDI has both benefits and costs and its impact is determined by the country specific conditions in general and the policy environment in particular in terms of the ability to diversify, the level of absorption capacity, targeting of FDI and opportunities for linkages between FDI and domestic investment.

Malhotra Bhavya (2014) India’s Foreign Direct Investment (FDI) policy has been gradually liberalised to make the market more investor friendly. The results have been encouraging. These days, the country is consistently ranked among the top three global investment destinations by all international bodies, including the World Bank, according to a United Nations (UN) report.

Retail Sector in India

Retailing in India is one of the pillars of its economy and accounts for 14 to 15% of its GDP. The Indian retail market is estimated to be US\$ 450 billion and one of the top five retail markets in the world by economic value. India is one of the fastest growing retail markets in the world, with 1.2 billion people. India's retailing industry is essentially owner manned small shops. As of 2013, India's retailing industry was essentially owner manned small shops. In 2010, larger format convenience stores and supermarkets accounted for about 4 percent of the industry, and these were present only in large urban centers. India's retail and logistics industry employs about 40 million Indians (3.3% of Indian population). In November 2011, India's central government announced retail reforms for both multi-brand stores and single-brand stores. These market reforms paved the way for retail innovation and competition with multi-brand retailers such as Wal-Mart, Carrefour and Tesco, as well single brand majors such as IKEA, Nike, and Apple.

In January 2012, India approved reforms for single-brand stores welcoming anyone in the world to innovate in Indian retail market with 100% ownership, but imposed the requirement that the single brand retailer source 30 percent of its goods from India. In June 2012, IKEA announced it had applied for permission to invest \$1.9 billion in India and set up 25 retail stores. On 14 September

2012, the government of India announced the opening of FDI in multi-brand retail, subject to approvals by individual states. On 7 December 2012, the Federal Government of India allowed 51% FDI in multi-brand retail in India. The government managed to get the approval of multi-brand retail in the parliament despite heavy uproar from the opposition.

FDI Policy in India

FDI as defined in Dictionary of Economics (Graham Bannock et.al) is investment in a foreign country through the acquisition of a local company or the establishment there of an operation on a new (Greenfield) site. To put in simple words, FDI refers to capital inflows from abroad that is invested in or to enhance the production capacity of the economy. Foreign Investment in India is governed by the FDI policy announced by the Government of India and the provision of the Foreign Exchange Management Act (FEMA) 1999. The Reserve Bank of India (RBI) in this regard had issued a notification, which contains the Foreign Exchange Management (Transfer or issue of security by a person resident outside India) Regulations, 2000. This notification has been amended from time to time. The Ministry of Commerce and Industry, Government of India is the nodal agency for motoring and reviewing the FDI policy on

continued basis and changes in sectorial policy/ sectorial equity cap. The FDI policy is notified through Press Notes by the Secretariat for Industrial Assistance (SIA), Department of Industrial Policy and Promotion (DIPP). The foreign investors are free to invest in India, except few sectors/activities, where prior approval from the RBI or Foreign Investment Promotion Board (FIPB) would be required.

FDI Policy with Regard to Retailing in India

It will be prudent to look into Press Note 4 of 2006 issued by DIPP and consolidated FDI Policy issued in October 2010 which provide the sector specific guidelines for FDI with regard to the conduct of trading activities.

- a) FDI up to 100% for cash and carry wholesale trading and export trading allowed under the automatic route.
- b) FDI up to 51 % with prior Government approval (i.e. FIPB) for retail trade of Single Brand products, subject to Press Note 3 (2006 Series).
- c) FDI is not permitted in Multi Brand Retailing in India.

Rationale behind Allowing FDI in Retail Sector

FDI can be a powerful catalyst to spur competition in the retail industry, due to the current scenario of low competition and poor productivity. Permitting foreign investment in food-based retailing is likely to ensure adequate flow of capital into the country, & its productive use in a manner likely to promote the welfare of all sections of society, particularly farmers and consumers. It would also help bring about improvements in farmers' income &

agricultural growth and assist in lowering consumer prices inflation.¹⁰ Apart from this, by allowing FDI in retail trade, India will significantly flourish in terms of quality standards and consumer expectations, since the inflow of FDI in retail sector is bound to pull up the quality standards and cost-competitiveness of Indian producers in all the segments. It is therefore obvious that we should not only permit but encourage FDI in retail trade.

Table 1 :Policies by Government of India regarding FDI in different years

Year	Policy	Effect
1991	The Indian government has opened the retail sector to FDI slowly through a series of steps	Almost Negative
1995	World Trade Organization's (WTO) General Agreement on Trade in Services came into existence	wholesale and retailing services came into effect
1997	FDI in cash and carry (wholesale) with government approval	100% rights allowed under the government approval route.
2006	FDI in cash and carry (wholesale) was brought under automatic approval route.	51% investment in single brand retail outlet permitted
2011	100% FDI in Single Brand Retail allowed	Positively followed
2012	On Sept. 13, Government approved the allowance of 51 percent foreign investment in multi-brand retail	Relaxation on FDI norms for civil aviation and broadcasting sectors

Present FDI Policy for Retail Sector in India

The Ministry of Commerce and Industry, Government of India is the nodal agency for motoring and reviewing the FDI policy on continued basis and changes in sectoral

policy/ sectoral equity cap. The FDI policy is notified through Press Notes by the Secretariat for Industrial Assistance (SIA), Department of Industrial Policy and Promotion (DIPP). The foreign investors are free to invest in India, except few sectors/activities, where prior approval from the RBI or Foreign Investment Promotion Board (FIPB) would be required.

1. India will allow FDI of up to 51% in multi-brand sector.

2. Single brand retailers such as Apple and Ikea, can own 100% of their Indian stores, up from previous cap of 51%.

3. FDI up to 100% for cash and carry wholesale trading and export trading allowed under the automatic route.

4. The retailers (both single and multi-brand) will have to source at least 30% of their goods from small and medium sized Indian suppliers.

5. All retail stores can open up their operations in population having over 1 million. Out of approximately 7935 towns and cities in India, 55 suffice such criteria.

6. Multi-brand retailers must bring minimum investment of US\$ 100 million. Half of this must be invested in back-end infrastructure facilities such as cold chains, refrigeration, transportation, packaging etc. to reduce post-harvest losses and provide remunerative prices to farmers.

7. The opening of retail competition (policy) will be within parameters of state laws and regulations.

Table 2 : FDI in Indian Retail Sector : A Critical Analysis

Asia : Retail sales growth by volume (% pa)

Territory	2007	2008	2009	2010	2011	2012	2013	2014	2015
Australia	5.5	0.7	1.4	-0.8	0.2	2.0	2.0	2.0	2.6
China	11.4	14.7	16.8	14.8	14.6	12.4	11.6	11.7	11.6
Hong Kong	9.0	-0.4	-2.2	5.6	1.3	1.5	2.6	2.4	2.9
India	4.6	1.7	3.4	1.5	3.9	5.6	5.6	5.8	6.3
Indonesia	11.3	7.8	2.7	4.4	4.2	4.6	4.8	4.8	4.6
Japan	-0.2	-0.5	-0.9	1.3	0.8	0.5	0.4	0.4	0.6
Malaysia	10.1	7.0	-1.5	2.3	3.3	5.0	3.7	3.8	4.1
New Zealand	2.1	-1.7	-1.3	1.3	2.3	2.4	2.5	2.4	2.7
Philippines	5.3	3.0	0.9	7.0	3.2	4.3	4.5	4.7	5.0
Singapore	7.8	1.2	-2.0	1.6	3.2	2.9	4.4	5.1	5.5
South Korea	4.8	0.5	-0.2	0.8	2.0	2.4	2.7	2.2	2.8
Taiwan	4.6	0.3	-1.4	9.4	2.3	1.5	0.6	0.6	0.9
Thailand	7.5	-2.5	-2.7	3.3	4.8	5.2	5.5	6.1	6.6
Vietnam	9.9	3.6	3.9	13.1	10.6	9.2	8.6	9.8	10.1
Source Economic Intelligence Unit					Actual		Estimate		Forecasts

Positive aspect of FDI in Retail

1. More investments in the end to end supply chain and world class cold storage facilities.
2. Low spillage and wastage of farm produce during the transportation.
3. Better options and offers to the consumer
4. Increase in economic growth by dealing in various international products
5. According to the UPA Government 1 million (10 lakh) employment will be created in next three years
6. Billion dollars will be invested in Indian retail market
7. Agriculture related people will get good price for their goods

Negative aspects of FDI in Retail

1. Will affect 50 million small merchants in India
2. Profit distribution and investment ratios are not fixed
3. An economically backward class person may suffer from price raise in future.
4. Retailer faces heavy loss of employment and profit
5. Workers safety and policies are not mentioned clearly

6. Inflation may be increased

7. Small farmers will not benefit by FDI policy

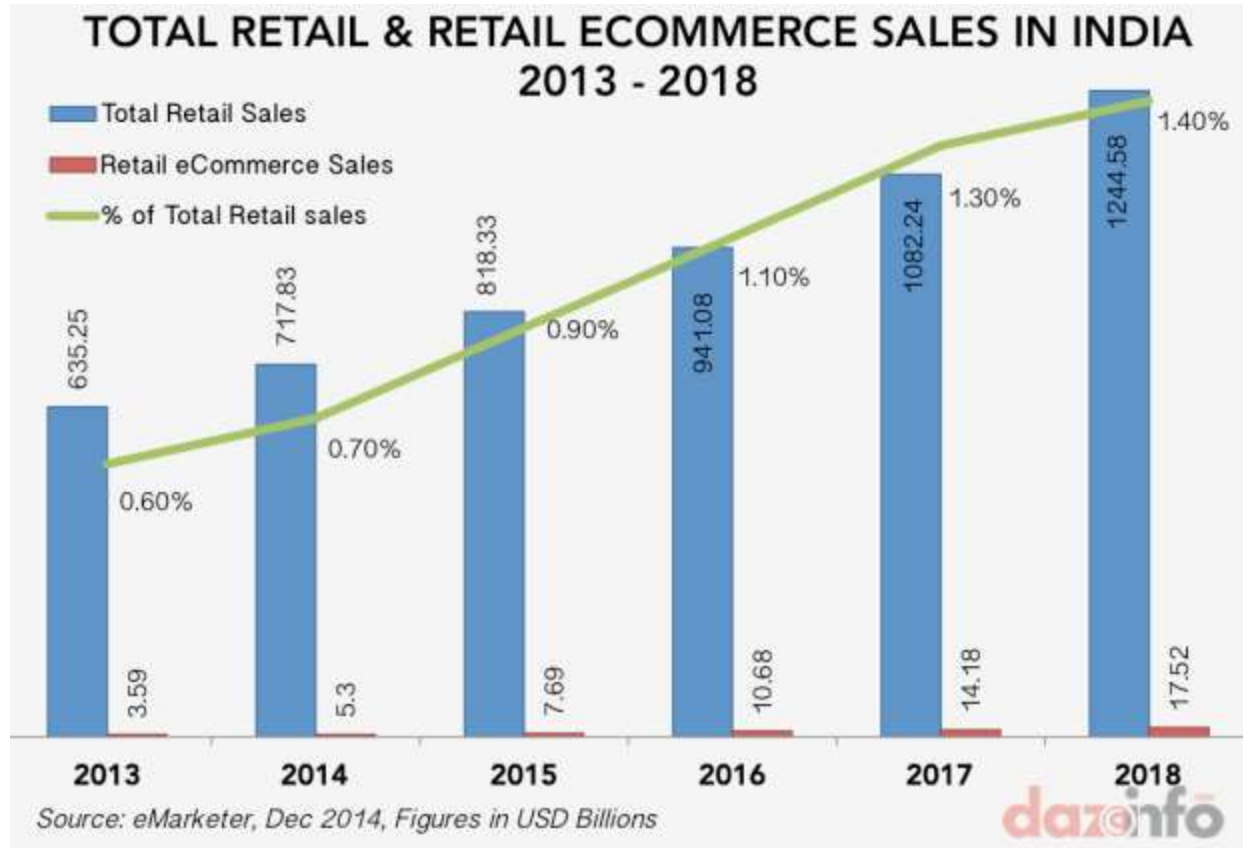
8. The rural India will remain deprived of the services of foreign players.

ECOMMERCE SALES IN INDIA: A TINY SHARE OF TOTAL RETAIL SALES

The total retail sale in India has increased from \$635.25 billion in 2013 to \$717.83 billion during the year which just ended, growing at a rate of 13%. It is expected to touch \$818.33 billion in 2015 registering a Y-O-Y growth of 14.0%. By 2018, total retail volume will grow to \$1,244.58 billion, growing steadily at 14-15% annually.

Retail Ecommerce sales in India, on the other hand, which were a meager \$3.59 billion in 2013 grew to a somewhat better \$5.30 billion in 2014, a Y-O-Y growth of 47.6% as compared to 55.6% over the previous year. In the year 2015, total online retail in India all set to touch \$7.69 billion, growing at a rate of 45.2%. By the year 2018, Ecommerce retail in the country is expected to grow to \$17.52 billion. It is shown in Figure-2

Figure-2



Now while the online retail is consistently expected to grow (and grow at a handsome rate too!) over the coming four years as well, the rate of growth of Ecommerce is seen to be slowing down. From an impressive 55% over 2012-13, it is expected to drop to a decent looking 45.2% over 2014-15 before dipping to 23.5% in 2017-18.

Talking in percentage terms, online retail sales which formed only 0.6% of the total sales volume in 2013 is expected to 'improve' and account for a 0.9% share of it in 2015 and account for 1.4% of the total sales volume in the country by 2018.

Impact of FDI on Various Stakeholders

1. **Effect on Existing Indian Organized Retail Firms-** The existing Indian organized retail firms (such as Spencer's, Food world Supermarkets

Ltd, Nilgiri's and Shop Rite) support retail reforms and consider international competition as a blessing in disguise. They expect a flurry of joint ventures with global majors for expansion capital and

opportunity to gain expertise in supply chain management.

market share (Mukherjee and Patel (2005).

2. Effect on Consumers- With liberalization, economic growth and changes in Indian consumers' demographic and economic profile and their shopping behavior, the retail sector is undergoing changes. At present, foreign retailers operate in India through both store and non-store formats. In terms of the shopping behavior of Indian consumers across different retail outlets, traditional outlets are preferred as consumers can bargain while modern outlets are preferred because they link entertainment with shopping. Those who purchase at modern outlets have reported better product quality, lower prices, one-stop shopping, choice of more brands and products, better shopping experiences with family and fresh stocks as some of the reasons for their choice of outlet. On the other hand, proximity to residence, goodwill, credit availability, possibility of bargaining, choice of loose items, convenient timings, home delivery, etc., are some of the benefits of traditional outlets (Joseph and Soundararajan 2009). Consumers are the major beneficiaries of the retail boom as organized retailers are initiating measures such as tracking of consumer behavior and consumer loyalty programs to retain their

3. Effect on Farmers- It is being claimed by the advocates of FDI in retail that the elimination of intermediaries and direct procurement by the MNCs would secure better prices for the farmers. The fact is that the giant retailers would have far greater buyer power vis-à-vis the farmers compared to the existing intermediaries. The entry of giant MNCs into agricultural procurement would make the problems worse for the farmers. As against the mandis that operate today, where several traders have to compete with each other in order to buy the farmers' produce, there will be a single buyer in the case of the MNCs. This will make the farmers dependent on the MNCs and vulnerable to exploitation. On the contrary, the advocates of FDI believe that FDI in retail in the agriculture will help in improving supply chain, infrastructure and ensure economic security for farmers through the elimination of middlemen in the country.

4. Effect on Traditional Stores- Traditional retailing has been established in India for many centuries, and is characterized by small, family-owned operations. Because of this, such businesses are usually very low-margin, are owner-

operated, and have mostly negligible real estate and labor costs. Such small shops develop strong networks with local neighborhoods. The informal system of credit adds to their attractiveness. Moreover, low labor costs also allow shops to employ delivery boys, such that consumers may order their grocery list directly on the phone. These advantages are significant, though hard to quantify. In contrast, players in the organized sector have to cover big fixed costs, and yet have to keep prices low enough to be able to

compete with the traditional sector. Getting customers to switch their purchasing away from small neighborhood shops and towards large-scale retailers may be a major challenge. The experience of large Indian retailers such as Big Bazaar shows that it is indeed possible. The oppositions, on the other hand, believe that local Karana shops will not be affected. The Karana stores operate in a different environment catering to a certain set of customers and they will continue to find new ways to retain them.

In 2010, the Indian retail market was valued at \$435 billion of which the share of modern retail was 7 per cent. The sector is expected to grow to \$535 billion by 2013 with the share of modern retail at 10 per cent. In 2007, India was ranked the twelfth largest consumer market and it is expected to be the fifth-largest consumer market by 2025 after the US, Japan, China and the UK (McKinsey & Company 2007). In 2010, India attracted the largest number of new retailers among emerging and mature markets (CBRE 2011). According to study conducted by ICRIER, total retail business in India will grow at 13% annually, from US \$322 billion in 2006-07 to US \$590 billion in 2011-12 and further US \$1 trillion by 2016-17 (figure-3)

Figure -3



Source: Technopak Analysis, CSO and other sources.

Scope of FDI in India

India is the 3rd largest economy of the world in terms of purchasing power parity and thus looks attractive to the world for FDI. Even Government of India, has been trying hard

to do away with the FDI caps for majority of the sectors, but there are still critical areas like retailing and insurance where there is lot of opposition from local Indians / Indian companies.

Some of the major economic sectors where India can attract investment are as follows:-

- Telecommunications
- Apparels
- Information Technology
- Pharma
- Auto parts
- Jewelry
- Chemicals

In last few years, certainly foreign investments have shown upward trends but the strict FDI policies have put hurdles in the growth in this sector. India is however set to become one of the major recipients of FDI in the Asia-Pacific region because of the economic reforms for increasing foreign investment and the deregulation of this important sector. India has technical expertise and skilled managers and a growing middle class market of more than 300 million and this represents an attractive market.

Conclusion:

On the basis of above research and discussion FDI has both positive and negative impact on India Economy. Government should promote FDI and in order to lower down its negative impact it

should have redesigned framework for the local players. Government should encourage FDI on gradual basis depending on products from one area to other Product category wise clauses should be developed to allow FDI. India needs inflows to drive investment in infrastructure, a lack of which is often cited as restricting the country's economic growth. Investment is also needed to expand capacity and technology in sectors such as autos and steel, as well as to offset a big current account deficit. In a nutshell, FDI should be encouraged with strict feasible and mutually beneficial regulations. "Better Investment Climate" Need of the Hour.

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