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FDI in Retail and its Implication in India

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Abstract

Liberalization has created a conducive environment for investment in India. One of the objective of liberalization was to attract foreign direct investment (FDI) in India. FDI in manufacturing is altogether different from FDI in retail. Foreign Direct Investment in retail in India has become a matter of intensive debate for last 10 years. CII and FICCI are strongly in favour of opening of FDI in retail. These bodies support their argument by saying that it will increase employment and minimize the losses. Farmer bodies like Bharat KrishakSamaj and Consortium of Indian Farmers Association (CIFA) etc. are supporting for FDI in retail by saying that it will eliminate the middle men's margin. Farmers will get better price for their produce and consumer get the product at reasonable price. Some state governments like Andhra Pardesh are taking the help of big retailers like Wal-Mart and Carrefour etc. to establish retail chain in their states. Myth that organised retailers earn only profit doesn't carry much weight. Both small and big retailers can coexist. We should not lose the sight for the sake of criticism and political compulsion.
Key words: FDI, AMPC, CIFA, Kiryana stores and mandi.

Introduction

Foreign Direct Investment (FDI) in retail has become a contentious issue in India under the existing political scenario. On Nov. 24, 2011 the UPA cabinet had allowed foreign entities to own up to 51% stake in multi brand retail and raised FDI in single brand to 100% to boost foreign inflows into the sector and improves its infrastructure. The government has argued that move will create lakhs of jobs, boost the agriculture sector and reduce wastage besides providing better deal to the consumer. Two weeks later govt. deferred its ambitious retail liberalization plans until a political consensus emerged. This sudden shift in govt. stance wrecked plans of Indian top retailers like Future Group, Bharti Retail, Spencer's Retail and Next, all of which were banking on foreign capital for their expansion and expertise to run a complex business like retail.

CII said it strongly supports the introduction of FDI in multi-brand retail trading, it recommends a calibrated approach for introducing FDI in the retail sector in terms of the percentage and minimum capitalisation requirements.

Some traders' associations are arguing that about 40 million employed in this sector would lose their earnings because of opening of big foreign retail stores. "In fact, foreign stores will generate employment and that will be higher quality employment. Small stores would also increase their employment to compete with the big retailers," he said.

CII said FDI in multi brand retail will give a boost to the organised retail sector, which positively impacts several stakeholders including - producers, workers, employees and consumers and Government and hence, the overall economy. Opening up of FDI can increase organised retail market size to $260 billion by 2020. This would result in an aggregate increase in income of $35-45 billion per year for all producers combined; 3–4 million new direct jobs and around 4–6 million new indirect jobs in the logistics sector, contract labour in the distribution and re-packaging centres, housekeeping and security staff in the stores.

According to FICCI, FDI will bring about the development of a robust supply chain which in turn will integrate farmers and small and medium size enterprises into the modern trade process, resulting in knowledge and skills transfer, ensuring farmers and SMEs receiving higher prices for their produce/supplies, providing a more transparent mechanism for pricing, helping in planning their supplies.

Farmers Bodies Throw their Weight behind FDI in Retail

Large farm lobbies are backing the government's decision to allow foreign supermarkets to set up shop in the country, saying it will shorten the supply chain and get growers a larger share of the final selling price.

Most farmers, however, want the government to go a step further and make it mandatory for retailers to buy 75% of their produce directly from farmers, bypassing the restrictive 'mandi' auction system.

"Traders and middlemen are sucking our blood. But no political party is talking about our interest because we are not organised like labour unions, nor have deep pockets like traders," said P Chengal Reddy, secretary-general of Consortium of Indian Farmers Association (CIFA).
India has 600 million farmers, 1,200 million consumers and 5 million traders. Both farmers and consumers are benefited by FDI in retail," Reddy added.
Big farmers are all for retail reforms. Bharat KrishakSamaj, a farm lobby with more than 75,000 members, said it supports FDI in retail on the condition that direct procurement from farmers is made mandatory. "Till it is a law, nobody is going to follow it. Everyone is bothered about shopkeepers," chairman Ajay Jakhar said.
Farmer leaders say the stranglehold of middlemen and traders is at the root of rural poverty and India's food inflation.

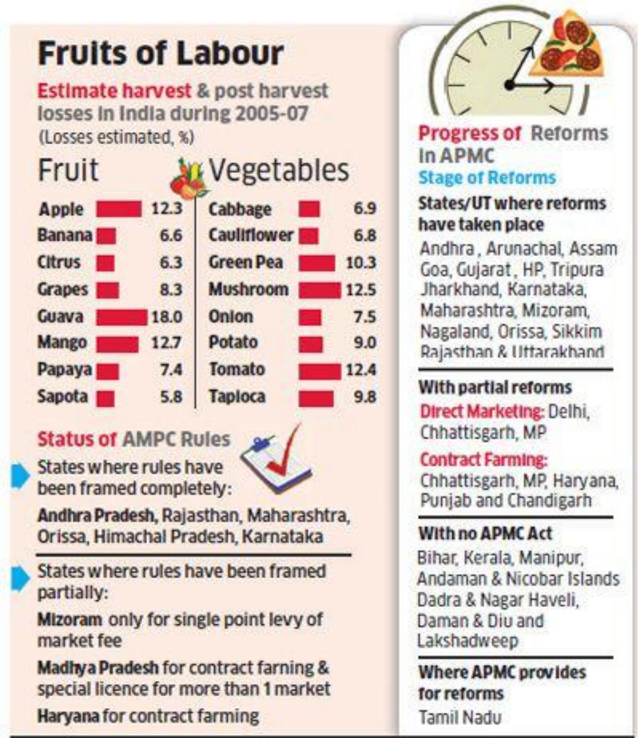
CIFA's Reddy said farmers' biggest problem is marketing. "Farmers declared a crop holiday in Andhra Pradesh because they couldn't sell. Cotton farmers in Maharashtra committed suicide because they couldn't sell," he said.

"FDI in retail will open alternative avenues of sale for us," Reddy added.

He said the mandi system does not favour farmers because they lose 5% of the value in transportation, 10% in broker commission and 10% in quality parameters. "Direct purchase by large retailers will solve this problem."

The thumb rule of price rise from a farmer to a consumer in perishables such as fruits and vegetables is 1:2:3:4, said S Baskar Reddy, joint director (agriculture & rural development) at Ficci, an industry body. What a farmer sells for 1 is sold at the mandi at 2, which becomes 3 at the mandi at the consumption centre and 4 when it reaches the consumer through a retailer.

Farmers near urban areas are already finding ways to circumvent the mandi system and reach the consumer directly. For instance, 23-year-old farmer S Chandrasekhar drives 10 km every Sunday to sell fresh vegetables to joggers and walkers on Chennai's Besant Nagar beach. Some 1,160 km away, ShriramGadhave, president of All India Vegetable Growers Association, organises buyer-seller meets at Thane and surrounding areas to facilitate better price recovery. "FDI in retail will give us an instrument to get better prices and help consumers as well," Chandrasekhar said.



Farmers say that the committees that run mandis under the Agriculture Produce Market Committee Act limit the number of licences issued to traders, thereby encouraging collusion. "Commission agents play a major role in the APMC system and thus neither the grower nor the consumer gets access to the right price," Gadhave said.

State Govt. Shops Around for Help for Retail Chain

The Andhra Pradesh government is drawing up plans to open swanky supermarkets, venturing into the multi-brand retail territory that multinational retailers such as Wal-Mart and Tesco are desperate to enter but forbidden from doing so.
It is also seeking partnerships with the wholesale units of Germany's Metro AG and Wal-Mart, a minister said, to create a hybrid retail model that combines the best attributes of the public and private sectors.

The first store will open by the end of March in an upmarket area in Andhra Pradesh's capital Hyderabad.

Eventually, the government will spend some Rs 2,000 crore to set up a retail chain that covers all the main towns and cities in India's fourth-largest state.
"Our retail stores will look like any other supermarket, with hygiene assured. We will offer quality packaged food products at reasonable rates," state Food and Consumer Affairs Minister D Sridhar Babu told ET, adding the main aim of the stores is to provide succour from inflation to the middle and lower-middle classes.

The stores will begin by stocking everyday staples such as rice, pulses and commodities before adding a broad range of consumer goods. The outlets will be operated by the government at wafer-thin profit margins so that prices are kept low.

Coexistence of Small Business Along with Big Retail

There are various entrepreneurs which are existing successfully along with big retailers and defying the notion that the entry of big multinational retailers will hurt small and micro enterprises in the country. One example is Nainital-based couple Deepak and Alka Puri who owe the success of their processed food firm Delicia Foods to the likes of Walmart and Carrefour.

Starved of funds at one point, Delicia's fortunes turned around after it negotiated a deal with Bhart Wal-Mart in 2008 to make private label jams and ketchup for both Easy Day supermarkets and Best Price wholesale stores. In the last three years, its annual revenues have grown fourfold to Rs 2 crore and it now supplies to other wholesale chains such as Metro and Carrefour as well.
"Funding is no longer an issue as banks also look at our client list," says Deepak Puri. Delicia Foods is just one of the thousands of SMEs—or, firms with assets of less than Rs 5 crore— that are dependent on modern retail for their livelihood and are flourishing as retailers gain scale. In fact, some such entrepreneurs started their businesses over the last five years, precisely to supply to a booming modern trade.

A BhartiWalmart spokesman says the cash-and-carry wholesaler sources about 90% of its products locally. "This helps minimise costs and pass on the benefits to customers," he says. The joint venture between Walmart and Bharti Enterprises supports SMEs in a variety of ways, including sharing information and resources to help raise efficiency standards, improve production techniques, provide technological support and better management skills, the spokesman said.

BhartiWalmart has built a direct network of 400 SMEs in less than three years of entering the country. And more than 40% of its total products are supplied by small and micro enterprises.
Future Group, the country's largest retailer, has more than 4,000 SMEs supplying more than 35% of its total requirements. "They have become our partners for a decade now and understand the business well to service us accordingly," says Future Group Chairman Kishore Biyani. He says it is important to source from smaller business because the retail business is highly localised.

SME Chamber of India, which represents more than 45,000 small entrepreneurs, is not in favour of allowing foreign retailers into the country.

"Going by the proposed FDI norms, top cities and towns are covered where foreign retailers can set up their stores. However, a substantial chunk of SMEs are based out of small towns and villages who have been catering to local businesses and at most few malls in nearby towns," says ChandrakantSalunkhe, president of the SME chamber.

The chamber members' bigger fear, however, is that the foreign retailers will import most their products, as is the practice among most foreign carmakers. "If you look at the auto industry, it’s just players such as Bajaj and Tata Motors that source products from our members which have small businesses. Most international firms import most of their products and source just 5-7% of auto parts from our companies. So we fear that foreign retailers might do the same thing once FDI is allowed," says Salunkhe.
Most small entrepreneurs servicing big retailers, however, welcome foreign investment in the sector. Some even say foreign retailers pay vendors on time and have a seamless working culture. "We will give 20 points extra to international retailers compared with Indian players when it comes to professionalism such as on-time payment," says Sunil Jain, managing partner of Delhi-based Trisis Corp, which supplies home and personal care products to BhartiWalmart, Reliance Retail and Future Group among others.

Retail Chain Expand in number as well as losses

Retail chains owned by corporate houses logged double-digit sales growth during the previous fiscal but widened losses as they resumed opening of new stores after a year's break, claiming that this business takes time to churn out profits.

According to their financial statements for fiscal 2010-11 filed with the corporate affairs ministry, unlisted companies such as Tata-owned Star Bazaar, Reliance Industries' Reliance Fresh and Hypermart, Aditya Birla Group-run More and Trinethra and Bharti Retail's

EasyDay increased their combined losses by 8% to Rs 987 crore during 2010-11 from Rs 917 crore in the previous year.

"Retail has a long gestation period before break-even and our financials are in conformity with those of any retail business. We now have stores across India and will continue to expand our presence," said a spokesman at Bharti Retail, which opened around 50 outlets, or a store a week, during the period.

Combined sales grew 30% to Rs 5,759 crore during financial year 2011 as compared to Rs 4,433 crore in the previous year, the growth is still lower than 2009 where they managed a 41% sales increase.

Just three years ago, most retailers were saddled with a huge inventory, faced cash crunch due to higher working capital requirements and were unable to raise funds.

However, they cut costs and deferred expansion, resulting in a 15% in reduction in losses during FY2010. But in the next fiscal, they resumed expansion which again impacted their losses. Although all the retailers continue to be in the red, they remain optimistic.

For instance, Aditya Birla Retail has reduced its EBITDA losses by 43% and said it is on a positive trajectory. "We have been more discerning on the kind of stores we have opened and some of the stores have become EBIDTA positive in just six to eight months of operations despite higher capex," said Thomas Varghese, CEO at Aditya Birla Retail, the only retailer to cut losses despite opening around 70 supermarkets and three hypermarkets during FY2011.
"As we go forward, more and more stores are becoming profitable because of the way we have managed cost efficiencies." Yet, the break-even period for these retailers is longer compared to retail chains such as Future Group's Big Bazaar which opened most of their stores before the retail rush five years ago.

"Our stores were positive in the first few days of opening as there wasn't such high competition and real estate costs were reasonable," said Kishore Biyani, chief executive officer at Future Group.
But Biyani admits that retail is a long-gestation business and now because of intense competition it is difficult to predict exactly when the stores start becoming profitable.

No wonder, experts feel that foreign direct investment would enable cash-starved domestic retailers to deleverage their overly stretched balance sheets by bridging the gap between capital required for expansion and retailers' ability to raise capital.

"To improve profitability in the F&G (food and grocery) segment, retailers need to control their supply chain costs and build scale," said Ajay D'Souza, head at CRISIL Research.

Government Argument in Favour of Retail FDI
* Huge investments in the retail sector will see gainful employment opportunities in agro-processing, sorting, marketing, logistics management and front-end retail.

* At least 10 million jobs will be created in the next three years in the retail sector.

* FDI in retail will help farmers' secure remunerative prices by eliminating exploitative middlemen.

* Foreign retail majors will ensure supply chain efficiencies.

* Policy mandates a minimum investment of $100 million with at least half the amount to be invested in back-end infrastructure, including cold chains, refrigeration, transportation, packing, sorting and processing. This is expected to considerably reduce post-harvest losses.

*This will have a salutary impact on food inflation from efficiencies in supply chain. This is also because food, which perishes due to inadequate infrastructure, will not be wasted.

* Sourcing of a minimum of 30% from Indian micro and small industry is mandatory. This will provide the scales to encourage domestic value addition and manufacturing, thereby creating a multiplier effect for employment, technology upgradation and income generation.

* A strong legal framework in the form of the Competition Commission is available to deal with any anti-competitive practices, including predatory pricing.

* There has been impressive growth in retail and wholesale trade after China approved 100% FDI in retail. Thailand has experienced tremendous growth in the agro-processing industry.
* In Indonesia, even after several years of emergence of supermarkets, 90% of fresh food and 70% of all food is still controlled by traditional retailers.
* In any case, organized retail through Indian corporates is permissible. Experience of the last decade shows small retailers have flourished in harmony with large outlets.

Opposition's argument
* Move will lead to large-scale job losses. International experience shows supermarkets invariably displace small retailers. Small retail has virtually been wiped out in developed countries like the US and in Europe. South East Asian countries had to impose stringent zoning and licensing regulations to restrict growth of supermarkets after small retailers were getting displaced. India has the highest shopping density in the world with 11 shops per 1,000 people. It has 1.2 crore shops employing over 4 crore people; 95% of these are small shops run by self-employed people

* Global retail giants will resort to predatory pricing to create monopoly/oligopoly. This can result in essentials, including food supplies, being controlled by foreign organizations.

* Fragmented markets give larger options to consumers. Consolidated markets make the consumer captive. Allowing foreign players with deep pockets leads to consolidation. International retail does not create additional markets, it merely displaces existing markets.

* Jobs in the manufacturing sector will be lost because structured international retail makes purchases internationally and not from domestic sources. This has been the experience of most countries which have allowed FDI in retail.

* Argument that only foreign players can create the supply chain for farm produce is bogus. International retail players have no role in building roads or generating power. They are only required to create storage facilities and cold chains. This could be done by governments in India.

* Comparison between India and China is misplaced. China is predominantly a manufacturing economy. It's the largest supplier to Wal-Mart and other international majors. It obviously cannot say no to these chains opening stores in China when it is a global supplier to them. India in contrast will lose both manufacturing and services jobs.

Losing the Sight for Achieving the Real Objective
The last 10 years have seen an extraordinary quantum of interest and debate on the benefits and dangers of modernization of India's retail sector, though never has this debate been shriller and more contentious than now.
Unfortunately, no discussion has taken place even once in these years on the importance of the retail sector to India (not only just the 15+ million independent retailers and street hawkers), the need to make the producer to the consumer distribution system more efficient and less wasteful, and how to make these millions of independent retailers not only relevant for tomorrow but actually increase their numbers and enhance the economic and social vibrancy of their vocation.
Sadly, much more attention has been misguidedly focused on just one single dimension of modernisation of the distribution and retail infrastructure namely "foreign direct investment". And most of the rhetoric of recent years and in particular, of the last few weeks, has largely been on emotional and sometimes incorrect factual positions.

Private consumption has long been the larger constituent of India's economy and even today, it accounts for almost 60% of India's GDP. Of this private consumption, more than 60% is what would constitute what we typically route through retail channels.

The fact is India's retail story is not a zero sum game i.e. growth of new, modern, and sometimes larger in scale retail businesses has to come at the expense of decimation of the traditional, independent retail business owners. Even at a real growth of 6% per year and inflation of about 5% for the next 15 years, India's nominal GDP will be about $8,000 billion in 2026. The size of India's retail market would have also moved up from about $500 billion in 2011 to about $2,500 billion in 2026.

Traditional retail currently accounts for as much as about $475 billion of this market. Even if modern retail attracts as much as $150 billion in fresh direct and indirect investment (from within India and overseas) over the next 15 years (i.e., $10 billion per year), the size of modern retail business in India is not likely to cross $300-350 billion by 2026, implying that traditional retail will account for as much as $2,150-2,200 billion in revenues (or more than four times of their current size).

Accounting for inflation and some increase in productivity of traditional retailers, it can be very confidently assumed that in the most optimistic of all scenarios as far as investment in modern retail is concerned, the numbers of independent retail outlets in India will more than double by 2026 rather than show any decline whatsoever. If these facts are understood, then what should India be doing to

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facilitate this retail consumption taking place in a planned, organised manner rather than seeing millions of illegal retail establishments sprouting all over?

Retail Assumptions

	2011	2016	2021	2026
Share of retail (As a % of pvt consumption)	55	55	55	55
Investment in retail (Indian, $billion)		10	10	12
Investment in retail (FDI, $billion)		5	15	20
Retail revenue to investment multiple		4	4	4
Employment at modern retail				
People in frontend/$200,000 of revenue	5	5	5	5
People in backend/$200,000 of revenue	4	4	4	4

SOURCE: Technopak

First, our politicians, our bureaucrats, and our urban planners must realise the need and relevance of providing for retail spaces in an integrated, holistic planned way. At the very least, about 10-12 square feet of retail space is needed for every urban inhabitant. Urban agglomerations such as NCR, Greater Mumbai, and Kolkata therefore require at least 200 million square feet each of legalised retail space.

Anand Kumar, professor of sociology at Jawaharlal Nehru University, says that as malls took the retail sector by storm, "their message was clear: life can be of meaning if one lives with the luxury and exclusivity of mall culture. Some consumers even wait for end of season sale so that this exclusivity comes within their budget." No wonder sales during this period go up by around 50% and profits by around 20% in most of the more popular malls.
But before anyone knew, the lala struck swiftly and with great vigour. And now, almost 15 years after Indians first saw the malls, local markets that initially feared losing their clientele to the big, bright guys aren't worried anymore. They have improvised, experimented, innovated, revamped infrastructure, given bigger heavy discounts and even installed a fridge with cool water for the thirsty customer. The customers never left them.

Dinesh Jain, secretary, Retail Textile and Garment Syndicate, Pune, says local markets continue to be a business paradise. "Laxmi Road market in Pune is always buzzing with customers, especially on weekends. Shop are more likely to get business here than in malls where footfalls are relatively less," he claims.

Pramod Kumar, president of the Sarojini Nagar Market Shopkeepers Association in Delhi, isn't worried about a DLF mall coming up some 10m away. "We receive more than 30,000 footfalls during weekends and unlike malls where the conversion rate is around 40%, those walking into our shops usually end up buying something."

SanjivMehra, president of the Khan Market Traders Association (Delhi), narrates an incident to illustrate why the ghosts of shopping malls and big retail chains don't haunt them anymore. "A showroom of a branded watch company opened next to an old wristwatch store in Khan Market about two years ago. Within a year, the showroom was shut down as it couldn't even recover its monthly rental," he says. The rental rate in Khan Market is one of the highest in India: Rs 8 lakh per month for a 500 sqft space.
Chandigarh is no different. "Malls here are struggling to survive while many on the Ludhiana-Jalandar highway shut in no time. A few shopping complexes in Noida, too, were converted to food joints later," says GurIqbal Singh, president, Market Welfare Association, Sector 37, Chandigarh.
Some shopkeepers are actually asking if there is place for new players like Carrefour. "An initial spurt is expected as consumers will explore the new ventures. But the real test will depend on who provides better service, entertainment and more lucrative offers," says AvinashPratap, marketing chief, Pune Central Mall.
While local markets are ready to compete with new players, K S Bakshi, president of the Lajpat Nagar Market Association, says every locality has its own clientele. "Hopefully, this proximity with customers will help us take this blow as well."

Views about Opening up of FDI in Retail
Until and unless it can be established that FDI in retail will do more harm than good for the economy, it should be allowed.

A major argument given by opponents of FDI in retail is that there will be major job losses. Big retail chains are actually going to hire a lot of people. So, in the short run, there will be a spurt in jobs. Eventually, there's likely to be a redistribution of jobs with some drying up (like that of middlemen) and some new ones sprouting up.

Fears of small shopkeepers getting displaced are vastly exaggerated. When domestic majors were allowed to invest in retail, both supermarket chains and neighbourhood kiryana stores coexisted. It's not going to be any different when FDI in retail is allowed. Who, after all, will give home delivery? The local kiryana. Why would anyone shun them?

If anything, the entry of retail big boys is likely to hot up competition, giving consumers a better deal, both in prices and choices. Mega retail chains need to keep price points low and attractive - that's the USP of their business. This is done by smart procurement and inventory management: Good practices from which Indian retail can also learn.

The argument that farmers will suffer once global retail has developed a virtual monopoly is also weak. To begin with, it's very unlikely that global retail will ever become monopolies. Stores like Wal-Mart or Tesco are by definition few, on the outskirts of cities (to keep real estate costs low), and can't intrude into the territory of local kiryanas. So, how will they gobble up the local guy? Secondly, it can't be anyone's case that farmers are getting a good deal right now. The fact is that farmers barely subsist while middlemen take the cream. Let's not get dreamy about this unequal relationship.

Conclusion

Although FDI in retail in India is a contentious issue but it should be allowed uuntil and unless it can be established that FDI in retail will do more harm than good for the economy. After weighing both pros and cons in terms of increase in employment, improvement in infrastructure and technical knowhow, fear of small shopkeepers getting displaced and monopoly of big retailers etc. government should take appropriate decision.

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