Why FDI in Retail ? A Study with Reference to Select Stakeholders

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1. Introduction

Retailer is usually the interface between the producer and the individual consumer who is buying for his/others personal consumption. Retailing excludes direct interface leading to sale between the manufacturer and institutional buyers such as the government and other bulk buyers. It is the last link in the chain that connects the individual consumer with the manufacturing and distribution chain. A retailer is involved in the act of selling goods to the individual consumer at a margin of profit. (Ninetieth Report of Parliamentary Standing Committee on Commerce related to FDI in Retail, Government of India, 2009).

Whether or not to allow a higher proportion of FDI in multi-brand retail has been debated in India for nearly a decade and half. Yet, the Government felt that it needs more time and/data to convince the stakeholders before deciding to go ahead with this reform measure. Presently, only 26% equity stake for a foreign player is allowed in this format. In the meanwhile FDI has been allowed in single brand retail as also in what is termed as the 'cash and carry' segment or the wholesale business. Though there was opposition to these changes too, not only these reforms have been undertaken but there is no evidence of the same having adversely hit a large section of the operating middlemen.

2. Objectives

The study aims at looking at empirical evidence that is available to establish whether or not the move to allow FDI in retail will affect/benefit the farmers and Kirana shops as stakeholders.

3. Methodology

The paper uses the exploratory research method for its study. It relies on a vast statistical data and empirical evidence in respect of organised retail in India and outside. The secondary data has been collected from authentic sources such as Working Papers and reports of ICRIER, A.T.Kearney's study report and rated journals.

4. Literature Review

There is no dearth of research work pertaining to performance of retail sector in the global arena. There is not much of a difficulty either in accessing the relevant and latest data. But in the Indian context, it is a different story. Despite the fact that the question of whether or not to allow FDI in retail has attracted so much media attention and debate over a long time span, yet sector specific authentic data is not readily available. Though there are a fair numbers of research papers and articles on the subject, lack of reliable data does impact the outcomes and quality.

There is no Government agency which collects data exclusively to this important and emerging sector. As a result, for any research study, data needs to be collated in bits and pieces from different Government agencies such as CSO, RBI, Planning Commission and Budget and Economic Survey papers/documents. There are a few research organisations and consultants who have carried out vital research in this area. But private houses such as Planet Retail, A.T. Kearney and others have commercial interests; as such their works are not in the public domain. At times some details are released after a time lag or with an intention to market their offerings.

ICRIER-Indian Council for Industrial and Economic Research has published research and working papers. The Institution has also been appointed by the Government to address issues such as FDI and impact on stakeholders such as the unorganised players, farmers and the public at large.

ICRIER Working Paper 22 of September 2008 entitled 'The impact of organised retailing on the unorganised sector' is a comprehensive study on the subject. It has looked at the growth of both the organised and the unorganised retail sectors. Through a comprehensive survey covering pan India, the study has pointed out that the impact of organised retail on the unorganised sector is marginal. The study concludes with the finding that though the impact of a newly started organised retail store is higher in the immediate neighbourhood, it peters out over a time period.

An Econometric Analysis On Organized And Unorganized Retail Share- By Subhadip Mukherjee finds that the organised retail has a positive influence on consumers, farmers and GDP growth rate. The study uses a multi regression model. It reveals that the urbanisation, women's' participation and GDP have positive influence on growth of share of organised retail.

4.1 The Macro Picture

India ranks as the fourth most emerging destination for retail in the world (A.T. Kearney's annual Global Retail Development Index, 2011) The retail market in India is divided into organized and unorganized retail. The share of organized retail market as a percentage of the total market is estimated to be 6.5 % (Images Retail Report, 2011) and is growing at a CAGR of 27.69 % contributing 2.1 % to the GDP (Images Retail Report, 2011). Organized retailing refers to trading activities undertaken by licensed retailers, that is, those who are registered for sales tax, income tax, etc. These include the corporate-backed hypermarkets and retail chains, and also the privately owned large retail businesses. (Ninetieth Report of Parliamentary Standing Committee on Commerce related to FDI in Retail, Government of India , 2009). Unorganised retailing refers to the traditional formats of low-cost retailing, for example, the local *kirana* shops, owner operated general stores, *paan/beedi* shops, convenience stores, hand cart, pavement vendors, etc. (Ninetieth Report of Parliamentary Standing Committee on Commerce related to FDI in Retail, Government of India ,2009)

The nation is growing at around 16% in nominal terms; the estimated aggregate GDP for 2011-12 is estimated at Rs.89.12 lakh crore (Table 1) and the share of retail is around Rs.470 billion. Though the GDP growth rate has slowed down to 6.9%, it is expected that the GDP would grow from the present $1.8trillion to $7.3 trillion in a decade, by which time; retail would have topped Rs.1.9 trillion. It is to be noted that the economy grew by 8.4% in the preceding two years. Even if organised retail grows as projected, which is very unlikely, kiranas will still be left with space to grow at 13% p.a. (CSO and Economic survey 2011-12)

Economic Survey 2011-12

The per capita incomes too are rising as the economy is registering adequate growth rate on a consistent basis. It is estimated that the per capita income is in excess of Rs.60, 000 up from Rs.53,000 a year earlier. Growing incomes are an indicator of huge potential for growth of organised retail in the country.

Agriculture has a sporadic growth over a period of time. Yet the average growth of agriculture is impressive. That is the reason why the incomes in rural areas have stated picking up. The

Table. 1 Macro-economic Indicators

0.1 KEY INDICATORS							
Data categories and components	Units	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12
1 GDP and Related Indicators							
GDP (current market prices)	₹ crore	4294706	4987090	5630063	6457352PE	7674148QE	8912178AE
Growth Rate	%	16.3	16.1	12.9	14.7	18.8	16.1
GDP (factor cost 2004-05 prices)	₹ crore	3564364	3896636	4158676	4507637PE	4885954QE	5222027AE
Growth Rate	%	9.6	9.3	6.7	8.4	8.4	6.9
Savings Rate	% of GDP	34.6	36.8	32.0	33.8	32.3	na
Capital Formation (rate)	% of GDP	35.7	38.1	34.3	36.6	35.1	na
Per Capita Net National Income (factor cost at current prices)	₹	31206	35825	40775	46117	53331	60972

Table 2

Rate of Growth of GDP at Factor Cost at 2004-2005 Prices (per cent)

	2005-06	2006-07	2007-08	2008-09	2009-10PE	2010-11QE	2011-12AE
Agriculture, forestry & fishing	5.1	4.2	5.8	0.1	1.0	7.0	2.5
Mining & quarrying	1.3	7.5	3.7	2.1	6.3	5.0	-2.2
Manufacturing	10.1	14.3	10.3	4.3	9.7	7.6	3.9
Electricity, gas & water supply	7.1	9.3	8.3	4.6	6.3	3.0	8.3
Construction	12.8	10.3	10.8	5.3	7.0	8.0	4.8
Trade, hotels, transport & communication	12.1	11.7	10.7	7.6	10.3	11.1	11.2
Financing, insurance, real estate & business services	12.6	14.0	12.0	12.0	9.4	10.4	9.1
Community, social & personal services	7.1	2.8	6.9	12.5	12.0	4.5	5.9
GDP at factor cost	**9.5**	**9.6**	**9.3**	**6.7**	**8.4**	**8.4**	**6.9**

Source : CSO.
Notes: PE : Provisional Estimate, QE: Quick Estimate, AE: Advance Estimate.

Government of India's social programs such as NREGA (National Rural Employment Guarantee Act) has also lent certain stability to rural households. Together, they have resulted in boosting demand for consumer goods and durables in the rural markets.

5. FDI Policy on Retail

The Department of Industrial Policy and Promotion (DIPP), Ministry of Commerce and Industry, Government of India revised the FDI norms in retail to "100 % single brand retail" and "51 % multi brand retail" through a notification.

Details of Notification (paragraph 6.2.16.4, Circular 2, Consolidated FDI policy)

(1) Foreign Investment in Single Brand product retail trading is aimed at attracting investments in production and marketing, improving the availability of such goods for the consumer, encouraging increased sourcing of goods from India, and enhancing competitiveness of Indian enterprises through access to global designs, technologies and management practices.

(2) FDI in Single Brand product retail trading would be subject to the following conditions:

(a) Products to be sold should be of a 'Single Brand' only.

(b) Products should be sold under the same brand internationally i.e. products should be sold under the same brand in one or more countries other than India.

(c) 'Single Brand' product-retail trading would cover only products which are branded during manufacturing.

(d) The foreign investor should be the owner of the brand.

(e) In respect of proposals involving FDI beyond 51%, mandatory sourcing of at least 30% of the value of products sold would have to be done from Indian 'small industries/ village and cottage industries, artisans and craftsmen'. 'Small industries' would be defined as industries which have a total investment in plant & machinery not exceeding US $ 1.00 million. This valuation refers to the value at the time of installation, without providing for depreciation. Further, if at any point in time, this valuation is exceeded, the industry shall not qualify as a 'small industry' for this purpose. The compliance of this condition will be ensured through self-certification by the company, to be subsequently checked, by statutory auditors, from the duly certified accounts, which the company will be required to maintain.

(3) Application seeking permission of the Government for FDI in retail trade of 'Single Brand' products would be made to the Secretariat for Industrial Assistance (SIA) in the Department of Industrial Policy & Promotion. The application would specifically indicate the product/ product categories which are proposed to be sold under a 'Single Brand'. Any addition to the product/ product categories to be sold under 'Single Brand' would require a fresh approval of the Government.

(4) Applications would be processed in the Department of Industrial Policy & Promotion, to determine whether the products proposed to be sold satisfy the notified guidelines, before being considered by the Foreign Investment Promotion Board for Government approval.

6. Implications

6.1 Farmers

Agricultural markets in most states of India are established and regulated under the State

Agriculture Produce Market Committee (APMC) Act, 2003. The Act in most states requires all agricultural products to be sold only in government - regulated markets. These markets impose substantial taxes on buyers, in addition to commissions and fees taken by middlemen, but provide little service in areas such as price discovery, grading or inspection. A key impact of this regulation is the inability of private sector processors and retailers to integrate their enterprises directly with farmers or other sellers, eliminating middlemen in the process. Farmers also are unable to legally enter into contracts with buyers. This leaves no incentives for farmers to upgrade, and inhibits private and foreign investments in the food process sector. However, the state governments can make amendments in the Act to suit farmers' needs.

The existing market mechanisms in most of the rural areas need a closer look. APMC, much against its mandates and objectives, has been sheltering and promoting middlemen at the cost of the growers and consumers. Taking advantage of regulations, they have acquired monopolistic and non-transparent character. Ideally APMC needs to be scrapped so that there is free movement of agricultural goods and large numbers of middlemen in the supply chain are eliminated. A World Bank study reveals that growers get no more than 20% to 25% of the final price paid by the consumer in India; the global average is as high as 50%. Big retailers need to buy directly from farmers and a whole lot of intermediaries-aggregator, market trader, wholesaler, sub-wholesaler-are removed.

The APMC act also provides provision for contract farming. **Contract Farming** means farming by a person called "Contract Farming Producer" under a written agreement with another person called "Contract Farming Sponsor" to the effect that his farm produce shall be purchased as specified in the agreement (APMC act, 2003). The retailers can have a contract farming arrangement with the farmers. However, the argument is that retailers with larger procurement power may make the farmers vulnerable to exploitation (CPI(M)'s National Policy proposal for Organized Retail, 2011). The UK supermarket chain Tesco paid its suppliers 4% below the average price paid by retailers (Stichele et al 2006). The retailers would also prefer to contract with big farmers and the small farmers may lose out (Approach paper on Agro Business by Indian Banks Association)

6. 2 Unorganized retailers

Unorganized retailers have significant competitive strengths that include consumer goodwill, credit sales, amenability to bargaining, ability to sell loose items, convenient timings and home delivery. Proximity is a major advantage of unorganized outlets . They also understand the consumer behaviour of their area (Ninetieth Report of Parliamentary Standing Committee on Commerce related to FDI in Retail, Government of India, 2009) and have much lower operating costs compared to organized retail. The operators often own the land of their shops and use household labour to operate the store (PWC, 2011). Pricewaterhouse Coopers believes that *kiranas* can exist alongside modern trade players and can explore partnership models in a rapidly changing retail environment. There was no evidence of a decline in overall employment in the unorganized sector as a result of the entry of organized retailers (ICRIER report, 2008). However, there are contrary views. Opening up FDI may lead to unfair competition and ultimately result in large-scale exit of incumbent domestic retailers, especially the small family-owned business (Chari, Raghavan, 2011). Kalhan (2007) highlights how small shops in Mumbai were adversely affected in terms of falling sales by the growing influence of shopping malls in the city. Recent evidence also suggests that having a chain store in a market makes roughly 50% of the discount stores unprofitable and that Wal- Mart's expansion over the 1990s explains about 40–50% of the net reduction in the number of small discount stores (Jia, 2008).

7. Conclusion

Based on this study, it can be said that growth of organised retail would benefit majority of the farmers in India. They will be able to realise better prices for their produce. The practice of bulk buying may also bring in advantages of improved techniques of farming and higher levels of productivity.

The impact of organised retail on the unorganised sector would, at the most be marginal. Objections to FDI in retail stem from the fear that Kirana shops or the pop-and-mom stores will die; this will hit a section of the traders who are presently self employed. It is imperative to call this bluff. Already there are big chains, malls and super malls- Reliance, Pantaloon-they occupy large retail space in the country. It can be no body's claim that only foreign competition hurts and 'desi' players spare the corner shops! Organised retail has hardly grown as anticipated. Consultants do paint a rosy picture about the potential of organised retail; according to them, they should have commanded a market share of 16%. In reality, their joint share was no more than 6 % in total retail sector. (ICRIER, 2008)

Moreover, it is not as if organised retail has a cake walk. Far from it, there is now a growing realisation that India is a tough market. A few of the bigwigs have had to close down-the Subhikshas, Vishal Mega Marts. As per newspaper reports, over three thousand outlets have shut shops as they were found to be unviable. Even those who are surviving are grappling with a whole range of problems. Rentals are sky-high on the one hand; on the other, retail space construction has not been able to keep pace with the requirements. Strangely, there is huge concentration of different formats in small geographical areas in some metros and cities. In the complexity of Indian markets, it has not been clear so far as to which format would succeed! Rentals are eating away 50% of the revenues, whereas the affordability on an average is around 6 to 8%.

Big retail space, globally norm being around 25,000 sq.ft., is expensive and simply not available in central business districts of metros. They are also now realising that an average Indian does not buy large scale; most big retailers are therefore hit by low revenue and sub-optimal turnovers. The smaller stores do not get the scale advantage, nor, can they cater to the variety needs of the demanding Indian customer. Scaling up in retail is not quick; it happens over a period of time. Top lines of several stores do not seem to be materialising, a cause for major concern. The bottom line, therefore, is that kiranas have nothing to fear.

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