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Foreign Direct Investment in India

A Case Study of Supermarkets, Hypermarkets, Superstores And Retailchains

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Abstract

Henry Ford, the genius inventor and the owner of the world's largest car company, once said, "Don't find fault, find a remedy". This saying echoes ever so relevantly in today's Indian Retail Sector scenario like never before. India has been one of the most sought-after destinations for foreign investors across the globe. The Retail Sector in particular has been one of the sectors where there has been a constant buzz and excitement surrounding Government policy shaping the sector. The Indian Retail Sector has primarily comprised of Unorganized Players in the form of locally owned, Grocery Shops (kirana stores), Road side Wooden Structures (paan khokha/shops), Multipurpose Stores (general stores), Hand Cart (redi-wala) and Pavement Vendors (footpath penth), etc. On the other hand, Organized Retailing involves trading activities undertaken by licensed retailers, that is, those who are registered for Sales Tax and Income Tax. The corporate-backed Super Markets, Hyper Markets and Retail Chains and the privately owned large retail businesses are also present in India. However, the tremendous growth prospect of the sector coupled with successfully established models of organized retail in other Asian markets such as China has paved the way for the establishment of organized retail in India as well. In addition to this, a number of home-grown corporate giants such as Future Group and Aditya Birla Group have furthered the cause of organized retail by setting up exclusive outlets across India. Nevertheless, there is still a long way to go before Foreign Direct Investment in Indian Retail can be realized in its totality. Though the voices have been growing louder for Multi-Brand Foreign Direct Investment to be permitted for retail, there is still a long way to go. The Indian Government aims to take up this case gradually as suggested by the latest Economic Survey Report which states permitting Foreign Direct Investment in retail in a phased manner beginning with Metro Cities and encouraging the existing retail shops to modernize their shops, which may help in resolving the concerns of Farmers and Consumers. Foreign Direct Investment in retail sector may also help bring in technical know-how to set up efficient supply chains which could act as models of development.

1. RETAILING - PILLARS OF INDIAN ECONOMY

Retailing in India is one of the pillars of its economy and retail sector accounts for about 15 per cent of India's Gross Domestic Product. According to an estimate, the Indian retail market is about Rs.25,00,000 Crores. India is one of the fastest growing retail markets in the world, with 125 Crore people in it. As per the latest figures of the year 2010, the Hyper Stores, Super Markets, Super Stores and Retail Chains in India are only about 4 per cent of the total size of the retail industry, and that too are available in large urban places only.

About 4 Crore Indians (about 3 per cent of total Indian population) are involved in India's retail and logistics industry. Central Government of India kept on denying the Foreign Direct Investment in multi-brand retail, and hence forbidding the foreign retail groups from any ownership in Supermarkets/ Superstores. 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 Nike and Apple.

However in December 2011, under pressure from the opposition, Indian Government placed the retail reforms on hold till it reaches a consensus. In January 2012, India approved reforms for single-brand stores welcoming anyone in the world to innovate in Indian retail market with 100 per cent ownership (which was earlier restricted to 51 per cent), but imposed the requirement that the Single Brand retailer source 30 per cent of its goods from India. Indian Government continues the hold on retail reforms for Multi Brand stores.

The Indian retail is a robust pillar of the economy and employs 6 per cent of the nation's workforce. According to India Brand Equity Foundation, the Indian retail is expected to grow by 10 per cent in 2011-12. Of this, Organized Retail only forms 6.5 per cent of the pie. Hence, there is enormous scope for expansion through infrastructure and investment support. Furthermore, while Unorganized Retail has been pegged at a rate of 6 per cent annually, Organized Retail has been booming at a surprising growth rate of 35 per cent. In fact, it is expected to reach 16-18 per cent of the total market within the next five years.

A recent Annual Global Retail Development Index confirmed India as the most attractive market for retail investment for a third consecutive year. Despite this, the entry for global retail giants in the form of Foreign Direct Investment has remained more or less restricted and the Indian Government has maintained a tight rope over the Foreign Direct Investment Policy in retail, primarily owing to perceived threat posed by organized retailers on the small scale kirana shop owners.

At present, India's Foreign Direct Investment Policy in retail provides for the following guidelines, as issued by the Department of Industrial Policy and Promotion :

a) Foreign Direct Investment up to 100 per cent is allowed for Cash and Carry Wholesale Trading and export trading under the automatic route.
b) Foreign Direct Investment up to 51 per cent with prior Government approval for retail trade of Single Brand products, permitted from the year 2006 onwards.
c) Foreign Direct Investment is not permitted for Multi Brand Retail in India.

Existing Indian retail firms such as Spencer's, Foodworld Supermarkets Ltd, Nilgiri's and ShopRite support retail reform and consider international competition as a blessing in disguise. They expect a flood of joint ventures with global majors for expansion capital and opportunity to gain expertise in supply chain management. Competition and investment in retail will provide more benefits to consumers through lower prices, wider availability and significant improvement in supply chain logistics.

2. UNORGANIZED VS ORGANIZED RETAILING IN INDIA

Most Indian shopping takes place in open markets or lakhs of small, independent Grocery shops and Retail shops. Shoppers typically stand outside the Retail shop, ask for what they want, and cannot pick or examine a product from the shelf. Access to the shelf or product storage area is limited. Once the shopper requests the household product they are looking for, the shopkeeper goes to the container or shelf or to the back of the store, brings it out and offers it for sale to the shopper. Often the shopkeeper may substitute the product, claiming that it is similar or equivalent to the product the consumer is asking for. The product generally has no price tag/label in these small retail shops, although some products do have a retail price pre-printed on the packaging. The shopkeeper prices the household products arbitrarily, and two consumers may pay different prices for the same product on the same day. Price is sometimes negotiated between the shopper and shopkeeper. The shoppers do not have time to examine the product tag/label, and do not have a choice to make an informed decision between competitive products.

India's retail and logistics industry, organized and unorganized in combination, employs about 4 Crore Indians (3.3 per cent of Indian population). The typical Indian retail shops are very small. Over 1.4 Crore outlets operate in the country and only 4 per cent of them being larger than 500 square feet in size. India has about 11 shop outlets for every 1000 people. Vast majority of the unorganized retail shops in India (1) employ family members, (2) do not have the scale to procure or transport products at high volume wholesale level, (3) have limited to no quality control, (4) fake product screening technology, (5) no after-sales support or service, (6) source their products from a chain of middlemen (7) most transactions at unorganized retail shops are done with cash and (8) have no training on safe and hygienic storage, packaging or logistics.

Until the 1990s, Indian Regulations prevented innovation and entrepreneurship in Indian retailing. Some retails faced complying with over thirty regulations such as "signboard licences" and "anti-hoarding measures" before they could open doors. There are taxes for moving goods to from one states to other states (Central Sales Tax), and even within states (State Sales Tax) in some cases. Farmers and producers had to go through middlemen monopolies. The logistics and infrastructure was very poor, with losses exceeding 30 per cent. In 1990, India introduced widespread free market reforms, including some related to retail sector. Between 2000 to 2010, consumers in select Indian cities have gradually begun to experience the Quality, Choice, Convenience and Benefits of Organized Retail Industry.

3. FOREIGN DIRECT INVESTMENT IN RETAIL IN INDIA – THE BACKGROUND

In 1997 India allowed Foreign Direct Investment in cash and carry wholesale. At that time it required Government's approval. The approval requirement was relaxed, and automatic permission was granted in the year 2006. Between 2000 to 2010, Indian retail attracted about Rs.9,000 Crore in Foreign Direct Investment, representing a very small 1.5 per cent of total investment flow into India. Single brand retailing attracted 94 proposals between 2006 and 2010, of which 57 were approved and implemented. For a country of 120 Crore people, this is a very small number. Some claim one of the primary restraints inhibiting better participation was that India required single brand retailers to limit their ownership in Indian outlets to 51 per cent. China in contrast allows 100 per cent ownership by foreign companies in both single brand and multi-brand retail presence.

Indian laws already allow Foreign Direct Investment in cold-chain infrastructure to the extent of 100 per cent. There has been no interest in Foreign Direct Investment in cold storage infrastructure build out. Experts claim that cold storage infrastructure will become economically viable only when there is strong and contractually binding demand from organized retail. The risk of cold storing perishable food, without an assured way to move and sell it, puts the economic viability of expensive cold storage in doubt. In the absence of organized retail competition and with a ban on foreign direct investment in multi-brand retailers, foreign direct investments are unlikely to begin in cold storage and farm logistics infrastructure. Until 2010, intermediaries and middlemen in India have dominated the value chain. Due to a number of intermediaries involved in the traditional Indian retail chain, norms are flouted and pricing lacks transparency. Small Indian farmers realize only 1/3rd of the total price paid by the final Indian consumer, as against 2/3rd by farmers in nations with a higher share of organized retail. About 60 per cent margins for middlemen and traditional retail shops have limited growth and prevented innovation in Indian retail industry.

India has had years of debate and discussions on the risks and prudence of allowing innovation and competition within its retail industry. Numerous economists repeatedly recommended to the Government of India that legal restrictions on organized retail must be removed, and the retail industry in India must be opened to competition. For example, a report noted that an increasing number of people in India are turning to the services sector for employment due to the relative low compensation offered by the traditional agriculture and manufacturing sectors. The organized retail market is growing at 35 per cent annually while growth of unorganized retail sector is pegged at 6 per cent. The Retail Business in India is currently at the point of modulation. As of 2008, rapid change with investments to the tune of Rs.12,500 Crores were being planned by several Indian and multinational companies in the next 5 years. It is a huge industry in terms of size and according to India Brand Equity Foundation , it is valued at about Rs.2,00,000 Crores. Organized retail is expected to gather about 16-18 per cent of the total retail market in the next 5 years.

4. POOR INFRASTRUCTURE, FOODWASTE AND MALNUTRITION

Till recently, India had prevented innovation and organized competition in its consumer retail industry. The lack of infrastructure and competition in retail industry is a main cause of India's obstinately high inflation. Because of unorganized retail, in a nation where malnutrition remains a serious problem, food waste is common. Well over 30 per cent of food ends and perishable goods produced in India spoils because of poor infrastructure. The small retail outlets prevent hygienic storage and the bad shaped transport facilities prevent the movement of the goods from the farmers to the consumers.

Indian retail has experienced limited growth, and its spoilage of food harvest is amongst the highest in the world, because of very limited integrated cold-chain and other infrastructure. India has only 5,386 stand-alone cold storages, having a total capacity of 23.6 million metric tons. However, 80 per cent of this storage is used only for potatoes. The remaining infrastructure capacity is less than 1 per cent of the annual farm output of India, and grossly inadequate during peak harvest seasons. This leads to about 30 per cent losses in certain perishable agricultural output in India, on average, every year.

Indian retail market as generating sales of about Rs.23,50,000 Crores a year, of which a only a little Rs.1,35,000 Crores comes from organized retail such as Super Markets, Hyper Markets and Chain Stores with centralized operations and shops in malls. The opening of retail industry to free market competition will enable rapid growth in retail sector of Indian economy. The Economist forecasts that Indian retail will nearly double in economic value, expanding by about Rs.20,00,000 Crores by 2020.

The projected increase alone is equivalent to the current retail market size of France. In 2011, food accounted for 70 per cent of Indian retail, but was under-represented by organized retail. As per an estimate India's organized retail had a 31 per cent share in clothing and apparel, while the home supplies retail was growing between 20 per cent to 30 per cent per year. Hence the Indian retail market offers endless possibilities for the foreign investors.

5. COMPLEXITIES OF THE INDIAN RETAIL MARKET

Indian market has high complexities in terms of a wide geographic spread and distinct consumer preferences varying by each region necessitating a need for localization even within the geographic zones. India has highest number of outlets per person (7 per thousand) Indian retail space per capita at 2 square feet per person is lowest in the world Indian retail density of 6 per cent is highest in the world. 18 lakh households in India have an annual income of over Rs.45,00,000. While India presents a large market opportunity given the number and increasing purchasing power of consumers, there are significant challenges as well given that over 90 per cent of trade is conducted through independent local stores. Challenges include: Geographically dispersed population, small ticket sizes, complex distribution network, little use of Information Technology systems, limitations of mass media and existence of counterfeit goods.

Many business groups in India are welcoming the transformation of a long-protected sector that has left Indian shoppers lacking the scale and variety of their counterparts in more developed markets. The retail reform would open enormous