Multi-Brand Retailing in India: curse or boon?

Introduction

India's retail industry is divided into organized and unorganized sectors. Post-liberalization, organized retail has grown exponentially and is a testament of the Indian middle class's burgeoning purchasing power. As a consequence, the opening up of the wholesale and single brand retail sector to foreign direct investment (**"FDI"**) was inevitable. India is ranked as the third most attractive nation for retail investment among 30 emerging markets[1] with domestic companies like the Future Group, Tata's Westside, Reliance Fresh, Raheja Group and Bharti Retail competing for market share.

Multi-brand retail comes in different formats like supermarket, hypermarket, compact hyper and the ubiquitous mall. The success of this sector is best reflected in the fact that the shares of retail companies are well represented in all top mutual funds. However, the sector is constrained by several factors, primarily by a highly restrictive licensing regime and overall poor infrastructure. These factors have contributed to restrict organized retail to only about 3% of the total retail industry. This newsletter examines the prospects of FDI in multi-brand retail in India, and builds a case as to why the sector needs to be opened.

1. A case for FDI in multi-brand retail

The current regulations on retail allow 100% FDI in wholesale cash-and-carry trading. In single-brand retailing, 51% FDI is permitted while it is prohibited in multi-brand retailing. The question arises whether opening up of FDI in multi-brand retail will create problems or provide opportunities. There is no clear answer and ample views have been expressed by those in favour and against FDI. In our view, the benefits, described below, will, in the long run, outweigh the problems. Some of the key benefits of permitting FDI in multi-brand retail are:

1.1 *Opportunities galore*: While it is important not to lose sight of the local "Mom and Pop" shops, there is a distinct opportunity for FDI in multi-brand retail. At the present moment, Indian companies are exporting different types of products to numerous retailers across the globe. There is a large segment of the population which feels that there is a difference in the quality of the products sold to foreign retailers and the same products sold in the Indian market. In view of the availability of higher

[1] US-based global management consulting firm, A T Kearney in its 9th annual Global Retail Development Index (GRDI) 2010, seen on http://www.atkearney.com/index.php/Publications/at-kearneys-global-retail-development-index.html accessed on March 21, 2011.

disposable incomes for Indians, there is an increasing tendency to pay for quality and ease and access to a "one-stop shop" which will have a wide range of different products. If the market is opened, then the pricing could also change and the monopoly of certain domestic Indian companies will be challenged. In the eventual analysis, the consumers will benefit in the form of potential lower prices due to enhanced and, possibly, tough competition in the market.

1.2 *Benefits for the farmers:* Presumably, with the onset of multi-brand retail, the food and packaging industry will also get an impetus. Though India is the second largest producer of fruits and vegetables, it has a very limited integrated cold-chain infrastructure. Lack of adequate storage facilities causes heavy losses to farmers, in terms of wastage in quality and quantity of produce in general, and of fruits and vegetables in particular. With liberalization, there could be a complete overhaul of the currently fragmented supply chain infrastructure. Extensive backward integration by multinational retailers, coupled with their technical and operational expertise, can hopefully remedy such structural flaws. Also, farmers can benefit with the "farm-to-fork"[2] ventures with retailers which helps (i) to cut down intermediaries ; (ii) give better prices to farmers, and (iii) provide stability and economics of scale which will benefit, in the ultimate analysis, both the farmers and consumers.

1.3 *Improved technology and logistics*: Improved technology in the sphere of processing, grading, handling and packaging of goods and further technical developments in areas like electronic weighing, billing, barcode scanning etc. could be a direct consequence of foreign companies opening retail shops in India,. Further, transportation facilities can get a boost, in the form of increased number of refrigerated vans and pre-cooling chambers which can help bring down wastage of goods.

1.4 *Impact on real-estate development*: Retail is closely dependant on real estate as any retailer will require substantial spaces for setting up business. Real estate in India has gone through a revamp due to the demand of high-end retail malls and people's changing perception towards an enjoyable shopping experience. Thus real estate can get a further facelift in India and receive more investment with the opening up of FDI in multi-brand retail.

2. Critics of FDI

Opponents of the FDI feel that liberalization would jeopardize the unorganized retail sector and would adversely affect the small retailers, farmers and consumers and give rise to monopolies of large corporate houses which can adversely affect the pricing and availability of goods. They also contend that the retail sector in India is one of the

[2] the chain of food supply, from the farm where it is produced to the consumer

major employment providers and permitting FDI in this sector can displace the unorganized retailers leading to loss of livelihood.

However, these arguments can be overruled in the light of the ICRIER study[3] conducted in India in 2008, which showed that although unorganized retail suffered initially with the opening up of organized retail in their vicinity, this effect significantly weakened over time. The rate of closure of unorganized retail shops in gross terms was found to be 4.2 % per annum, which was much lower than the international rate of closure of small businesses. Similarly, the rate of closure on account of competition from organized retail was found to still lower, at 1.7 per cent per annum. This was achieved through competitive response from traditional retailers and through improved business practices and technology upgradation.

In our view, the development of organized retail has the potential of generating employment for both the skilled and unskilled sections of the population. The Government can protect small retailers by restricting FDI to be permitted only for stores having floor size greater than, say, 2,000 square feet. Moreover, monopolies of large corporate houses can also be controlled by the Government by enforcement of strict regulations and, where needed, through the Competition Commission of India which is empowered to evaluate abuse of dominant position.

3. Current regulatory framework

At present, the regulatory regime for the existing homegrown retailers is quite exhaustive with as many as 40 licenses and permissions required to be obtained by the retailer from diverse authorities, depending on the nature of activity. For example, a multi-brand retailer selling food and perishable items has to have a prevention of food adulteration license under the Prevention of Food Adulteration Act, a weights & measures license under Weights & Measures Act for regulating the weights and measures and labels on the food products sold, along with an agricultural produce marketing committee license under the Agricultural Produce Marketing Committee Act for selling fruits and vegetables. If a retailer decides to launch a store in more than one state then the number of licenses will multiply accordingly. Therefore, an entity establishing retail stores across India will have to face enormous licensing obligations in each state of operation. This too acts as a deterrent.

When the government opens up this sector to FDI, in addition to the regular operating licenses, chances are that the foreign multi-brand retailers will have to seek investment approvals as well from the central regulator which, at present, is the Foreign Investment Promotion Board. With the passage of time, the expectation would be that

[3]ICRIER study, "Impact of Organized Retailing on the Unorganized Sector" May 2008 from http://siadipp.nic.in/policy/icrier_report_27052008.pdf accessed on January 26, 2011

the multitude licenses across different states would be reduced and (possibly) homogenized. Only time will tell.

Conclusion

In the final analysis, for India, FDI in multi-brand retail should be seriously considered by the government and, as with many other sensitive sectors (like defence), a gradual opening up could be made possible. Despite country wide speculation on the plight of small retailers, India needs to take a lesson from China where organized and unorganized retail seem to co-exist and grow together. Further, India's local enterprises will potentially receive an upgradation with the import of advanced technological and logistics management expertise from the foreign entities.

In our view, the government has an opportunity to utilize the liberalization for achieving certain of its own targets:

- improve its infrastructure;
- access sophisticated technologies;
- generate employment for those keen to work in this sector

FDI would lead to a more comprehensive integration of India into the worldwide market and, as such, it is imperative for the government to promote this sector for the overall economic development and social welfare of the country. If done in the right manner, it can prove to be a boon and not a curse.

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