

FDI IN ORGANIZED RETAIL IN INDIA: LOOK TO THE MULTIBRAND OPPORTUNITIES

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ABSTRACT

Compared to power sector reforms, an infrastructure push or restructuring labour laws, the change in rules to allow 51% FDI in multi brand retail may seem a relatively minor economic policy measure. However, the debate surrounding the retail decision – the government notified the new FDI rules on September 20 – is telling. It has regurgitated many of the shibboleths of Indian economic orthodoxy. The retail sector in India is witnessing a huge revamping exercise as traditional markets make way for new formats such as departmental stores, hypermarket, supermarkets and specialty stores. Western-style malls have begun appearing in metros and second-rung cities are too introducing the Indian consumer to a shopping experience like never before. India's vast middle class and its almost untapped retail industry are key attractions for global retail giants wanting to enter new markets. But in the absence of the adequate funds and a model for the sector we are not able to capitalize on the organized retail sector. Multi brand is the option in the Indian retail sector through foreign direct investment if the government allows FDI in Indian retail market that to with multibrand then it's really a boom for Indian retail market.

KEYWORDS

FDI, multibrand.

INTRODUCTION

India is without doubt a 'growth' economy and many consider it an attractive country to invest in, particularly in its rapidly growing and changing retail market. However, Foreign Direct Investment (FDI) is restricted in the retail sector, and despite many years of debate, the regulations are still only changing very slowly and there are still lots of uncertainties. AT Kearney (2009), the well-established international management consultancy, in their Annual Global Retail Index, ranked India as No.1 out of 30 of the top emerging markets, and has done for some years. Foreign Investors are watching India, ready for a piece of the action in the retail market, but there are still plenty of uncertainties, restrictions and potential socioeconomic risks.

Amidst opposition from its own allies, government went ahead implementing its decision to allow FDI in multi-brand retail. Under the notification relating to FDI in multi-brand retail, multinational companies can invest up to 51 per cent to open stores in 10 states and UTs which have so far agreed to implement the decision. The decision to allow Multibrand retailers to open stores rests with the state governments.

Minimum amount to be brought in by the foreign investor would be \$100 million and outlets may be set up only in cities with a population of more than 10 lakh. India Inc hailed the government's decision to implement FDI in multi brand retail and voiced that it will give a strong message to investors that the government means business and stands firm on its initiatives. This decision is a right step and will go a long way in capital infusion and is expected to strengthen the farmer's community.

WHAT IS FDI? AN OVERALL VIEW OF FDI ALLOCATION IN INDIA

Foreign direct investment is the acquisition of assets in a country by foreign entities for the purpose of control. FDI is ownership of at least 10% of a business. There are two types of FDI: (a) Inward foreign direct investment and (b) Outward foreign direct investment. Foreign direct investment excludes investment through purchase of shares. Foreign direct investment can be used as one measure of growing economic globalization.

SINGLE BRAND

Single brand implies that foreign companies would be allowed to sell goods sold internationally under a 'single brand', viz., Reebok, Nokia and Adidas. FDI in 'Single brand' retail implies that a retail store with foreign investment can only sell one brand. For example, if Adidas were to obtain permission to retail its flagship brand in India, those retail outlets could only sell products under the Adidas brand and not the Reebok brand, for which separate permission is required. If granted permission, Adidas could sell products under the Reebok brand in separate outlets.

MULTIBRAND

FDI in Multi Brand retail implies that a retail store with a foreign investment can sell multiple brands under one roof. Opening up FDI in multi-brand retail will mean that global retailers including Wal-Mart, Carrefour and Tesco can open stores offering a range of household items and grocery directly to consumers in the same way as the ubiquitous 'kirana' store.

According to the Ministry of Commerce & Industry, "FDI is freely allowed in all sectors including the services sector, except a few sectors where the existing and notified sectoral policy does not permit FDI beyond a ceiling. FDI for virtually all items/activities can be brought in through the Automatic Route under powers delegated to the Reserve Bank of India (RBI), and for the remaining items/activities through Government approval. Government approvals are accorded on the recommendation of the Foreign Investment Promotion Board (FIPB)." Ministry of Commerce and Industry has fixed limits for other sectors as follows:

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THE CHARM OF THE INDIAN MARKET

Indian companies need money. But what explains the attraction from the other side? Why is FDI in retail being built up as the beacon of the next phase of liberalization? The answer is in the numbers. According to the government's Economic Survey, "The retail sector is expected to record healthy sales in 2010-11 and grow by 10.2% in 2011-12. The sector's PAT (profit after tax) margin is expected to expand over the next three years on account of a faster rise in income vis-a-vis expense." Adds the PwC-CII study: "India is ranked as one of the world's most exciting retail destinations." The study says that India's retail sector is worth an estimated US\$350 billion and is growing between 30% and 40% per annum. (This relates to 2008, but there is a huge divergence in the absolute numbers and growth estimates put forward by various organizations.)

"Despite about 75% of India's population earning less than US\$2 a day, the Indian retailing context could appeal to foreign firms due to rising income levels of consumers in several segments; the low penetration levels of several product categories; the huge presence of the unorganized sector with regard to offerings that provide scope for penetration of branded goods; the emerging youth population that is going through a radical change of lifestyles; and, of course, the unorganized nature of retail sector itself," says S. Ramesh Kumar, professor of marketing at the Indian Institute of Management Bangalore. "However, unlike in the West, the *kirana* stores will continue to be a part of the Indian scenario for several years given the shopping styles of consumers (only a fraction would be interested in driving to huge stores to stock up items for the entire week). The culture of shoppers to shop daily coupled with lack of storage space make the *kirana* store a part of the Indian middle class."

Kumar doesn't see smaller Indian retailers giving up in the face of a FDI invasion. "The small organized neighborhood store [like Subhiksha] with limited SKUs (stock-keeping units) offering discounts to consumers is also a good strategy provided they are able to get the supply chain and choice of merchandise right."

He gives a snapshot of the future of retail in India as he sees it. "Multiple formats will become the trend [like the Tesco's chain in the U.K.]. Private labels offering good value will have huge scope given the escalating prices of conventional branded offerings. Retailers like Reliance or Big Bazaar [Future Group] will have an advantage due to their scale. Such outlets will attract a huge consumer base in urban markets due to their variety as well as value-based sales promotion plus private labels. Consumers will divide their purchases between *kirana* stores and modern retail outlets."

CURRENT SCENARIO OF INDIAN RETAILING INDUSTRY

A study conducted by ICRIER on Indian retail industry estimates that the total retail business in India will grow at 13 per cent annually from US\$ 322 billion in 2006-07 to US\$ 590 billion in 2011-12. The unorganized retail sector is expected to grow at approximately 10 per cent per annum with sales rising from US\$ 309 billion in 2006-07 to US\$ 496 billion. Organized retail, which constituted a low four per cent of total retail in 2006-07, is estimated to grow at 45-50 per cent per annum and attain a 16 per cent share of total retail by 2011-12. In short, both unorganized and organized retail are bound not only to coexist but also achieve rapid and sustained growth in the coming years. This is clearly not a case of a zero sum game as both organized and unorganized retail will see a massive scaling up of their activities.

Share of Organized Retail in Selected Countries, 2009

Country	Total Retail Sales (US\$ bn)	Share of Organized Retail (%)
USA,	2983	85
Japan	1182	66
China	785	20
United Kingdom	475	80
France	436	80
Germany	421	80
India	322	4
Brazil	284	36
Russia	276	33
Korea, South	201	15
Indonesia	150	30
Poland	120	20
Thailand	68	40
Pakistan	67	1
Argentina	53	40
Philippines	51	35
Malaysia	34	55
Czech Republic	34	30
Vietnam	26	22
Hungary	24	30

Source: Planet Retail and Technopak Advisers Pvt. Ltd

<http://www.planetretail.net/Reports/ReportDetails?catalogueID=61069>

FDI in India's Multi Brand Retail Sector

From the above table it is clear that Indian organized retail sector is far behind when compared to other developed and developing nation and hence there is always a huge scope for growth

EXPANSION OF ORGANIZED RETAIL

When India opened its economy to the global marketplace in the early 1990s, many multinational corporations rushed in to pursue its middle-class consumers, only to confront low incomes, social and political conservatism, and resistance to change. "In the past, retail conglomerates avoided the Indian market because they did not find the large investment a worthwhile opportunity, as India accounts for a very small percentage of the U.S. market in pure dollar terms," said Technopak's Singhal. India also lacked the infrastructure, supply chain, foreign direct investment regulations and value-added tax required for retailers to succeed.

"If the government permits foreign direct investment in retailing, consumer goods companies would have greater opportunities to sell products in the modern formats they understand," Karwal said. "Currently, about 60% of all purchases are made in the food and grocery segment, which has a unique supply chain that multinationals don't understand. The optimal retail format in India mimics a local bazaar experience, vastly different from the neat aisles and structured store layout present in other countries."

Skeptics point out that even if government policy works in favor of large retail, understanding of the consumer's psyche is paramount to cracking the Indian market. Karwal went on to say that "most bleeding happens at the front end, as real estate prices are exorbitant. To combat these expenses, companies such as

Zara and Best Buy have set up their own buying houses in India. If foreign retailers are able to get their back end in order while regulation evolves and rental prices cool down, the government policy is likely to work in their favor."

At the same time, the government has a responsibility to make sure that foreign inflows do not disrupt employment or functioning of smaller, homegrown players. Karwal minimized that concern: "Even though large conglomerates have a 7% to 10% buying advantage, small retailers benefit from the close proximity to customers. The necessity to buy fresh food due to a lack of electricity and inefficient public transportation systems serves to check the displacement of traditional retail. The network of local retailers will remain an important segment for years, even if modern retail continues to grow at the current pace."

RETAIL IMPACT, S A GAME CHANGER

Farmers, consumers and small entrepreneurs stand to benefit from supply efficiencies. The announcement on notifying 100 per cent FDI in single brand retail, and opening up multi-brand retail to FDI is a welcome move, and sparks hopes of restoring investor confidence and attracting more funds from overseas. It is worth reiterating the benefits expected from this move. The arguments against FDI in multi-brand retail range from fear of local kiranas being wiped out, to farmers being exploited or use of monopolistic practices. But several studies have emphasised that FDI in multi-brand retailing would boost the organised retail sector, with a positive impact on stakeholders, including producers, workers, employees and consumers. The fund inflow and technology from overseas would help bring in greater efficiencies down the supply chain.

IMPACT ON MOM-AND-POP RETAILERS

FDI is often opposed on the grounds that it will put mom-and-pop stores out of business. This is very unlikely for several reasons.

The big-box retailers, when they venture into developing markets, do not use the same business model as they do in the U.S. Walmart -- the most iconic of these companies and the one most often cited as a threat to Indian mom-and-pop stores -- is by no means the lowest-price retailer in China. Walmart U.S. is based on "everyday low prices." The firm has an activity system that is meant to help Walmart compete as a cost leader. The company began by locating in rural areas and then moved to suburban and semi-urban areas in the U.S. In China, the rural areas and semi-urban areas are not where the money is. Consumers in China -- unlike their American counterparts living in suburbia - do not drive miles and do bulk purchasing, nor do they have massive storage facilities at home. In India, China, Brazil, Indonesia, Thailand and Mexico, the vast majority of educated middle and upper classes live in the cities (and not in semi-urban and rural areas) where real estate is very expensive and population density is high.

The foreign retail chains will need to make very expensive real estate investments. They will have a very high variable cost of operation. Their fixed, volume-independent costs are also likely to be much higher than the mom-and-pop convenience stores. These chains will operate with price points that are much higher than those featured by the mom-and-pop shops.

These firms' real competition will be the domestic multi-brand retailers. A recent study by the CII and Boston Consulting Group estimated the size of organized retail of US\$28 billion in 2010 to be 6% to 7% of the total retail market in India. The study predicted that the size of retail -- total retail sector size, not just organized retail -- would grow to US\$1.25 trillion by 2020 if the efficiencies that typically come from greater competition and modernization of retail supply systems were to be unleashed. Under this scenario, the study predicts that the size of organized retail could grow to US\$260 billion or about 20.8% of the total market. So even under this scenario, the idea that a fractional segment that accounts for 20.8% of the total economic activity of a sector can drive the remaining 79% of that sector out of business does not stand the scrutiny of reason.

The CII/BCG study also estimates that if the organized retail sector is not modernized -- the "as is" economic scenario, as the study calls it -- the size of the sector will be about US\$170 billion. This underperforms the earlier scenario by about 35% or so. That difference could be a job creation deficit of about 1.4 million jobs with an even higher potential loss of economic product since organized retail pays better than local, scale-deprived mom-and-pop establishments. This is without taking into consideration other jobs that would not be created in economic activities that span infrastructure and logistics.

LOWER PRICES

A more efficient farmer-to-consumer chain would reduce prices for the final consumer. In addition, quality of goods would improve with shorter time taken to reach the final consumer. It is also expected that food safety standards would improve with better testing and aggregation facilities.

The consumer would also benefit from the wide choice that a large multi-brand retailer can afford. The fear of predatory pricing by large retailers, Walmart, Tesco or Carrefour, is misplaced, considering the competition from multiple players. The government has also recently constituted the Competition Commission precisely to check unhealthy practices.

FARMER TO BENEFIT

The foreign retail chains will have a more significant impact on traders that dominate procurement of commodities and perishables, including grains and cereals. It is not surprising that these traders are the most virulent opponents of FDI in retail (the main opposition party that derives its support from the trading castes and traders has openly stated that "traders' interests will be harmed by FDI in retail"). Indian farmers and many other rural producers are at the mercy of large and well-organized monopsony buyers. Very often these traders dominate geographies and account for nearly all procurement in their geographies. In many states, the food ministry determines who it will buy from and this is usually a small number of traders who in turn dominate direct procurement from farmers in their geographies. These are economic fiefdoms that they dominate and exploit. When the Carrefours, Walmarts and Tescos set up direct procurement mechanisms where sophisticated procurement systems are put in place and information about demand (prices, product varieties and quantities demanded) becomes more easily available, it becomes more difficult for the middlemen to dominate local geographies and restrict competition. The emergence of these supply chains that drive transparency of information will bring significantly more competition in sourcing.

The CII-Boston Consulting Group study found that an Indian tomato farmer earns about 30% or even less of the final price paid by the consumer (in developed countries, that percentage can be as much as 70%). For this reason alone, farmers and producers should welcome this development (and for this reason alone, traders oppose it). Indeed, the Indian Farmer and Industrial Alliance (IFIA), a joint venture of the Consortium of Indian Farmers Associations (CIFA), recognized the potential benefits of eliminating middlemen and has expressed its support for opening the retail sector to foreign investment.

As with any other sector, the entry of foreign players introduces competition that will benefit some and will work to the detriment of others. The beneficiaries in this case are the Indian consumers, the lower middle class, which will benefit from the well-paying jobs that will be created, and the producers of goods -- including farmers -- that have been at the mercy of middlemen and monopsony buyers and trader monopolies. As usual, the interests that are threatened have sought to portray this move as detrimental to India. In another time, it was said in the U.S. that "what was good for [General Motors] was good for America." It took some time for that belief to lose its status as an axiomatic truth. It is time that India re-examined its axiomatic beliefs. After all, the East India Company left more than 100 years ago.

ADVANTAGES FOR SMES

Third, even the non-farming sector, particularly the small manufacturer, would reap the advantages that modern retail provides.

These small players currently do not enjoy scale and distribution network to cover the market. With the entry of organised retail, SMEs would be able to go in for bulk production with guaranteed absorption of their product.

In addition, with quality becoming the main consideration, the SMEs would have to invest in modernisation and up gradation leading to a better product for the consumer, the end beneficiary.

A recent study on the impact of organised retailing on the unorganised sector by the Indian Council for Research on International Relations (ICRIER) did not show any evidence of a downtrend in employment following the entry of organised retailers.

Instead, the study said, small retailers evolve as they add new product lines and brands, go for better displays, renovation of stores, introduction of self-service, and more credit sales and acceptance of credit cards.

It is also not uncommon to hear about local kirana stores being wiped out as a result of organised retail. But against the total retail business worth billions of dollars, the present cash-and-carry retail chains account for a market share of only about seven per cent.

In the case of Metro Cash and Carry outlets, the kirana operator benefits from sourcing his products from the German MNC at a much cheaper price. Similarly, today, corporate retailers, the kirana merchant and the local vegetable vendor co-exist side by side, with the ultimate beneficiary being the consumer.

EMPLOYMENT CREATION

Finally, in terms of employment, it is expected that organised retail would generate over four million new direct jobs which would earn an incremental income of 15-30 per cent over other alternatives.

As many as six million new jobs would be created in the infrastructure segment with logistics, packaging, housekeeping and security. Most of these are expected to come in from the back-end in rural areas.

The total retail market, according to the CII-BCG study is projected at \$1,250 billion by 2020 based on macro economic factors including GDP growth, private consumption growth and mix of goods and services. Currently, organised retail trade in the country is estimated at \$28 billion, just about 6-7 per cent of the total retail market. This is expected to shoot up to \$ 260 billion by 2020.

Even then, organised retail would be just about one-fifth of the total market, the rest being covered by local stores. Organised retail would extend to food and beverages, clothing and accessories, electronics and appliances, furniture, health and personal care in addition to food services and sporting goods.

Thus, the new policy announcement can be expected to be a game-changer for India's retail sector. The Government has undertaken multiple stakeholder consultations in working out the details of inviting FDI in retail, both single-brand and multi-brand.

The resulting stipulations are prudent and designed to encourage investments in the supply chain as well as add jobs. In particular, rural areas would benefit from stronger connectivities to the urban markets.

INFLATION CONTROL

Inflation will be curbed. There are many who believe that FDI will act as guardian for the economic development of the farmers and job seekers. It will not happen that big fish will eat small fishes. This is because that in India 95% retail is in the un-organized sector that means only 5% is in organized sector. Local chains like Big Bazar and Spencers haven't dealt a deathblow to small retailers. So, the FDI in retail won't affect them either. The local kirana community is strategic and agile to get wiped off. Their offerings such as home delivery, credit facility and personalized customer relationship management can never be matched by foreign retail players. FDI in retail is certainly a step forward to eliminate the evils of adulteration, shortage in naaptol (weights and measures), unreasonable profit due to large differences between the wholesale price and the printed maximum retail price (MRP) and corruption in saving taxes leading to generate black money. The growth in the retail sector has so far been slower than what was projected, about 5 or 6 years back. The present FDI has once again arisen the hope of fast retail growth rate in India.

OTHER IMPACTS

The arrival of foreign retail chains has twofold impact. First, those companies set up supply chains and logistical capabilities, spurring significant improvements in the infrastructure needed to source, ship, store and deliver products (covering all aspects of value chain and supply chain activities, including storage, warehousing, and information-intensive operations). Second, their entry and expansion induce domestic competitors to invest in infrastructure and logistics, as well as greatly speed up the emergence of product standards (especially in perishables and personal consumables), and begin the process of bypassing monopsony buyers and traders that dominate procurement in many product categories today.

For these reasons, foreign investment in retail has an impact that goes beyond its direct investment impact. It is a force multiplier that induces even more investment from competitors.

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