

INDIAN RETAIL INDUSTRY: An Update

Relaxation of FDI norms for the Indian Retail Sector, albeit continues to face political roadblocks

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Summary

The recent approval by the Union Cabinet for allowing 51% foreign direct investment (FDI) in multi-brand retail in India and increasing the FDI limit in single brand retail in India to 100% (from the existing 51%) has come at a time when global retailers are facing headwinds in their home countries and thus scouting for new emerging markets, while domestic players, on the other hand, are burdened with piling debt. While this long awaited approval, which has come as a relief to many organised retailers, includes a set of riders for the foreign investors like minimum investment, deployment of funds invested, local sourcing, cities being opened for initial roll-out, etc. Also, opposition from certain State Governments and political parties raises significant hurdles for effective implementation of the reforms. FDI in multi-brand retail has been opposed by several in the past citing fears of loss of employment and that traditional retail may be affected. However, adherents of the same indicate easy access to capital for domestic retailers, increased transfer of technology, enhanced supply chain efficiencies, increased employment opportunities and curtailment of inflation as the perceived benefits. While this long awaited move is not expected to have an immediate impact on the Indian retail sector, it is expected to reap benefits in the medium to long-term. However, the move needs to be monitored in the wake of the current opposition by several political parties, which if persists, may pose a major roadblock in the entry of the foreign retailers in India. Besides restricting the number of cities these retailers can operate in, it could also lead to problems in creating supply chain efficiency. For the domestic retailers, reforms at structural level would be required for partnering with foreign companies for the purpose of entering the states where FDI will be encouraged. At the same time, local retailers (kirana stores) are expected to remain a key element in the ecosystem in the foreseeable future, with their ability to offer door step service and convenient access.

Background

In 1997, the Indian retail sector witnessed the first footprints of FDI with 100% FDI being permitted in cash & carry wholesale trading under the government approval route, subsequently brought under the automatic route in 2006. As a step ahead, FDI in single brand retail was permitted to the extent of 51% in 2006, while FDI in multi-brand retail remained prohibited till recently. In July 2010, the Department of Industrial Policy and Promotion (DIPP) had put up a discussion paper proposing FDI in multi-brand retail. In July 2011, a Committee of Secretaries (CoS) had cleared the proposal to allow upto 51% FDI in multi-brand retail, which has been approved by the Union Cabinet in November 2011, albeit with a few riders. The Union Cabinet has also approved increasing the FDI limit in single brand retail to 100% with government approval. While no parliamentary approval is needed for the decision, State Governments have the prerogative to disallow the same in their respective states. Mounting opposition by several political parties and State Governments have raised hurdles in the effective implementation of the key reform measure.

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Associated riders aimed at safeguarding interests of farmers and small unorganized retailers, ensuring funds deployment towards improving Indian supply chain and logistics infrastructure; political roadblocks could hamper potential investments

This long impending approval includes a set of riders for the foreign investors, aimed at ensuring the foreign investment makes a genuine contribution to the development of Indian infrastructure and logistics, at the same time facilitating integration of small retailers into the upgraded value chain. These riders could complicate potential FDI investments, acting as a damper. Some of the key riders are as follows.

Parameters	Multi-brand Retail	Single Brand Retail
Ownership/ investment requirement	Minimum investment of US\$ 100 million by the foreign investor	The foreign investor should be an owner of the brand
Investment towards back-end infrastructure	At least 50% of the investment by the foreign company to be in back-end infrastructure ¹	-
Location of stores	Stores to be restricted to cities with a population of one million or more (53 cities as per 2011 Census); given constraints around real estate, retailers are allowed to set up stores within 10 km of such cities	-
Sourcing	At least 30% of manufactured items procured should be through domestic small and medium enterprises (SMEs)	In respect of proposals involving FDI beyond 51%, 30% sourcing would mandatorily have to be done from domestic SMEs and cottage industries artisans and craftsmen
Sales	-	Products to be sold should be of a 'single brand' (only those brands which are branded during manufacturing) only; sold under the same brand name internationally
Approval of State Governments required	While the proposals on FDI will be sanctioned by the Centre, approvals from each State Government would be required	

Source: Press Information Bureau, ICRA

While the minimum capital requirement of US\$ 100 million is unlikely to be an issue for the large foreign players vying to enter India in the supermarket/ hypermarket segment, it could make it difficult for foreign investors planning to enter specialty formats such as music, mobile, electronics goods, among others, as these formats require relatively lower investments. Further, the approval requirements from State Governments could limit the cities that FDI backed retailers can operate in. The current opposition raised by a number of political parties, if persists, may pose a major roadblock in the entry of the foreign retailers in India. Besides restricting the number of cities these retailers can operate in, it could also lead to problems in creating supply chain efficiency. For the domestic retailers, reforms at structural level would be required for partnering with foreign companies for the purpose of entering the states where FDI will be encouraged.

¹ Back-end infrastructure will include capital expenditure on all activities, excluding that on front-end units; i.e. it will include investment made towards processing, manufacturing, distribution, design improvement, quality control, packaging, logistics, storage, warehouse, agriculture market produce infrastructure, etc. Expenditure on land cost and rentals, if any, will not be counted for purposes of back-end infrastructure.

Impact on the Indian Retail Sector: No immediate impact, benefits to accrue over the medium to long-term

While FDI in multi-brand retail has been opposed by several in the past citing fears of loss of employment, adverse impact on traditional retail and rise in imports from cheaper sources like China, adherents of the same indicate increased transfer of technology, enhanced supply chain efficiencies and increased employment opportunities as the perceived benefits. Besides, entry of large retail chains in India is expected to benefit the consumers by helping address inflation concerns through price reductions facilitated by the extent of reduction in trading margins effected to by the retail giants like Walmart, in addition to cutting of agri-waste. However, some estimates suggest that the move has been in support of multinational retail chains like Walmart, Tesco and Carrefour, who have been vying to be a part of the India retail growth story and that the entry of these companies in multi-brand retail would lead to oligopolistic pressures on the farmers and consumers at the same time throwing small retailers out of business. Nonetheless, proponents hint at creation of jobs across front-end and back-end operations, whether direct or indirect, and both in urban and rural areas. But there are concerns over talent crunch being faced by the sector. There has not been adequate investment in talent development and thus it would be difficult for retail companies to get qualified manpower, requiring them to invest significantly in upgradation of skill sets.

Parameters	Key concerns raised by opposition parties	Key perceived benefits
Capital Infusion	-	Would enable cash-starved domestic retailers to deleverage their overly stretched balance sheets by plugging the gap between capital required for growth and the ability of local players to raise capital
Local incumbents	Adverse impact on domestic small and unorganized retailers as the move would lead to unfair competition and ultimately result in large-scale exit of domestic retailers, especially the small family managed outlets	<ul style="list-style-type: none"> ❖ Local incumbents to benefit from technical inputs, investments in supply chain, and investments in human capital ❖ There could be a potential shift in bargaining power of these retailers with FMCG companies (at present, large FMCG players are better positioned vis-à-vis retailers in discussing terms of trade) once these retailers become large and attain size and scale
Supply chain improvement	Disintegration of established supply chains by establishment of monopolies of global retail chains, leading to their control on both ends of the supply chain	Improvement of supply chain/ distribution efficiencies, coupled with capacity building and induction of modern technology, which will help arrest wastages (in the present scenario, lack of investment in logistics and inadequate storage facilities have been creating inefficiencies in the food supply chain, leading to significant wastages). Though FDI is permitted in cold chains to the extent of 100% through the automatic route, in the absence of FDI in front-end retail, investment flows into this sector have been insignificant
Inflation/ Consumer Welfare	Sidelining of consumers' welfare due to predatory pricing dictated by retail giants on account of their monopolistic position	<p>The move to open up retail sector to FDI will reduce inflationary pressures as</p> <ul style="list-style-type: none"> ❖ Farmers will be able to directly sell their produce to retailers, thereby reducing margins for middlemen ❖ Investments in cold-storage and warehousing will ease supply-side pressures that have driven inflation close to a double-digit ❖ Improved supply chain contributes to savings in food wastages which

Parameters	Key concerns raised by opposition parties	Key perceived benefits
		has been rampant on account of inadequate infrastructure Further, consumers would also benefit from wider choices and better quality products
Farmers	Farmers to get affected on account of non-remunerative prices paid to them by these corporate giants	Improvement in productivity and realizations for farmers through direct sales to these large organised players, thus eliminating the margins outflow to the middle-men who have been dominating the value chain, and whose pricing lacks transparency
Employment Generation	Entry of global retail giants will lead to uneven playing field, resulting in large scale labour displacement in the retail sector	<ul style="list-style-type: none"> ❖ The opening of the sector to FDI is expected to result in creation of over 10 million jobs (including 6 million jobs in the logistics sector alone) in three years, across agro-processing, sorting, marketing, logistic management and the front-end retail business ❖ Expectations are that it would create jobs not only in the retail industry but also in related areas like real estate and construction

Source: Press Information Bureau, ICRA

This decision to widen the retail sector's doors has come at a time when global retailers are facing headwinds in their home countries and thus scouting for new emerging markets, while domestic players, on the other hand, are burdened with piling debt. With some of the major foreign retailers like Metro, Walmart, Tesco already having presence in the Indian retail sector through the cash and carry route or through tie-ups with domestic retailers for supply chain management, some of the near-term possibilities could be a) Bharti Retail extending its back-end alliance with Walmart to front end b) Trent extending its relationship with Tesco for a front-end joint venture. In addition, with full ownership resting with the foreign retailer in the single brand retail segment, India can expect entry of new global brands in the segment.

Conclusion

Opening up of FDI in multi-brand retail in India could potentially be a mixed blessing for domestic players. While initially the small indigenous retailers' business would be impacted once modern retail enters the locality, this adverse impact is expected to be short-lived and to weaken over time. While this long awaited move is not expected to have an immediate impact on the Indian retail sector, it is expected to reap benefits in the medium to long-term as it will help improve the a) balance sheet and liquidity profile of cash-starved retailers with aggressive expansion plans b) supply chain and back-end infrastructure while reducing margins for middlemen through direct sourcing from farmers and c) arrest inflationary pressures through increased supplies facilitated by improved productivity of farmers and reduction of agri-waste. However, once 100% FDI is allowed in retail, that is when the landscape will become extremely competitive. Further, the move needs to be monitored in the wake of the current opposition by several political parties.

Table: Multi-brand Retail FDI Policy in other countries

Country	FDI Limits	Benefits	Remarks
China	100%	<ul style="list-style-type: none"> ❖ First permitted in 1992 with foreign ownership restricted to 49%, progressively lifted and now no restrictions ❖ Over 600 hypermarkets opened between 1996 and 2011 ❖ The number of small outlets (equivalent to 'kiranas) increased from 1.9 million to over 2.5 million ❖ Employment in the retail and wholesale sectors increased from 28 million people to 54 million people from 1992 to 2001 	Impressive growth in retail and wholesale trade
Thailand	100%	<ul style="list-style-type: none"> ❖ Referred to a country where FDI had an adverse effect on local retailers ❖ Has a limited capital requirement for retail and wholesale outlets 	Growth in agro-processing industry
Russia	100%	<ul style="list-style-type: none"> ❖ Supermarket revolution took place in 2000s ❖ Heavy growth registered 	
Indonesia	100%	<ul style="list-style-type: none"> ❖ Modern retail took off in 1990s ❖ No limit on number of outlets ❖ Matahari is leading chain 	
Brazil, Argentina, Singapore and Chile allow 100% FDI in retail sector while Malaysia permits FDI to a certain limit			

Source: Press Information Bureau



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