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FDI in India's Food Retail

The decision to announce 100 percent Foreign Direct Investment (FDI) in domestic food retail operations in India can have a significant impact in controlling food inflation. The government has taken a major political risk by allowing retail investment. The policy can attract new investments in India's food processing industry by encouraging both traditional and e-commerce global retailers like Wal-Mart and Amazon to invest more in food processing and marketing operations.

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India has recently allowed FDI up to 100 per cent in the marketing and retailing of food items produced, processed and manufactured in India. The policy applies to both traditional and online retailing and does not come with any specific conditions of procurement. Economic implications of the policy are far-reaching.

Food Retail, Food Prices and FDI

Unorganised sector retailers, mostly 'Mom & Pop' stores, dominate India's food retail business. Though domestic organised retailers have begun capturing some parts of the

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retail business, their shares have been low, given the requirement of large investments. Food retail entails investments in cold chains and logistics enabling quick movement of produce, particularly perishables like fruits and vegetables, from the growers to the consumers. The absence of such investments and infrastructure in India has had various adverse implications, most notably on quality of perishable food and domestic food prices.

Due to lack of large-scale organised retail services connecting the upstream and downstream ends of the food supply-chain, intermediaries have emerged at various points of the chain. Mushrooming of intermediaries has contributed to supply bottlenecks, through hoarding of food items, particularly products travelling long distances from one state or region of the country to another. Apart from the usual infrastructure bottlenecks of delays in movement of vehicles at inter-state check points, which increase supplier costs that are eventually passed on to consumers through higher retail prices, hoarding creates artificial shortages creating further pressure on food prices. The situation worsens during droughts and irregular monsoons, when food production as it is suffers due to lack of adequate rainfall.

The supply bottlenecks make food inflation in India largely ‘structural’. Such inflation, by its very nature, can hardly be controlled by monetary policy instruments like interest rate that attempt to manage inflation by reducing money supply. This is the main reason why food inflation in India has been ‘sticky’ and mostly unresponsive to the Reserve Bank of India’s inflation control policies.

Economists have for long been demanding foreign investment in food retail for its virtuous effect in controlling food prices. Modern and efficient food retail chains require large investments from investors with deep ‘pockets’, which are scanty in India, given the length of time these investments require for fetching profits. Large funds are necessary for building cold chains, warehouses and other supporting logistics for transporting fresh food from growers to consumers. Substantive investments in real estate are also necessary for running retail formats like hypermarkets and supermarkets.

Political Risk Management

There is little option other than inviting global retailers for revamping India's food retail operations. At a time when domestic businesses are suffering from acute cash crunch due to low lending from banks that are struggling hard to clean up bad loans from balance sheets, foreign capital is the only hope for revitalising food retail. It is noticeable that the policy has been announced at a time when, for the first time in the two years of the Narendra Modi Government, food inflation has begun creeping upward.

The remarkable aspect of the policy has been its political management. Unorganised retailers have been important constituents of the urban and semi-urban vote banks of the ruling BharatiyaJanata Party. Earlier, as the main opposition party in the Parliament, the BJP had vehemently protested against foreign investment in retail, particularly the entry of multi-brand operators, when the earlier United Progressive Alliance (UPA)Government had intended to do so. During the campaign in the run-up to the last parliamentary elections also, the BJP maintained its opposition to foreign investment in retail.

Recent developments suggest a much different posture of the BJP. The last Union Budget presented in February 2016 allowed foreign investment in the marketing of agricultural produce. This was a clear example of indicating to foreign investors the government's intention to open up the food retail sector. The latest policy announcement affirms the intention. It is important to note though that the government has not allowed the entry of foreign operators in all branches of retail but has confined the entry to food retail. This is probably because politically foreign investment in food retail is easier to defend given the benefits it entails for both producers and consumers. Nonetheless, the BJP has taken the political risk of alienating one of its traditional constituencies – unorganised food retailers – who would no doubt be feeling badly let down.

Food Processing Industry and New Investments

From a foreign investors' perspective, the opening up of food retail to 100 percent FDI creates interesting possibilities. Multi-brand retailers like Wal-Mart, who are

already trading in India, would now be looking closely at the food retail business. Similarly, global e-commerce giants like Amazon and Alibaba, who are looking to expand operations in India, would also be keenly eyeing food retail as a long-term opportunity. All these global retailers are multi-brand and it would be interesting to see if the government, in the foreseeable future, allows food retailers to combine some non-food retail functions with the food business, either through e-commerce or otherwise. The other distinct possibility is of food processing companies manufacturing in India moving into retailing business, either on their own, which is possible for large brands like Coke, Pepsi and Macdonald's, or teaming up with local partners in the e-commerce space for offering retail services. The overall prospects are exciting for India's food processing industry, which can look forward to new doses of FDI and corporate collaborations. The efforts by the Food Safety and Standards Association of India (FSSAI) to align quality standards of domestic food products in India with international benchmarks should further encourage investors.

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