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FDI in Multi-brand Retail in India: Signs of New Resolve

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In September 2012, the Government of India announced several economic policy reform measures that included a move to allow 51 per cent foreign direct investment (FDI) in multi-brand retail. In the same announcement, it relaxed norms for foreign direct investment in the aviation sector, allowing international airlines to invest in domestic peers and cleared a slew of other reform-oriented measures – an increase of FDI in some broadcasting services.

The issue of FDI in retail has attracted considerable political debate. The matter was first proposed by the Government in 2010, but had to be withdrawn because of political opposition. This time, the Government appears to be firm in pushing the policy through.

It is possible to adduce several reasons for the determination of the Government. First, the ruling United Progressive Alliance (UPA) Government, and in particular the Congress party, has been battered by allegations of corruption and scams all through 2012, and needs a breather to establish its authority to govern. The criticism in the foreign media and by academics that the Government has been in a state of policy paralysis, which has prevented it from taking even basic measures to improve governance, has hurt its image.

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The crisis in coal supply for power generation and the poor progress of infrastructure projects have given the impression that executive decisions have come to a halt. On the trade front, the growing current account deficit, as well as the weakening of the rupee, has been seen as warning signals for the economy. The growing fiscal deficit, the inability to control expenditure on subsidies, and a slowing economy have caused international investors and rating agencies to downgrade expectations about the Indian economy. The latest GDP growth figures of 5.3 per cent are lower than the expectations of the Government and the Reserve Bank of India alike, and the persistent inflation is hurting the entire population, especially those with fixed incomes.

There was, therefore, a need to induce some confidence about the economy. In the past, the current account deficit was bridged by FDI, inflows into capital markets, and through inward remittances. Of these, the first two had seen a sharp drop in 2010 and 2011. The equity markets were trading 30 per cent below pre-2008 crisis levels, with little appetite for fresh capital issues. FDI was dropping steadily after 2008 and dropped to 40 per cent of the 2011-12 level in the subsequent year. The high fiscal deficit was also crowding out private borrowings. In short, there was need for a correction to infuse external capital into the economy by improving the sentiment in the financial markets and by giving a signal that could restore FDI flows. The reform announcements of September 2012 were an attempt at that.

There were other arguments as well. The retail sector in India has been growing at a combined annual growth rate of 6.4 per cent over the period 1998-2010, and is estimated to be worth around Rs. 50,000 crores (US$ 10 billion) in 2010. However, the contribution of organised retail remains low. As against the United States, which has the organised to unorganised ratio of 85:15, in India, it is only 10:90. Organised retail has been growing rapidly and is expected to have a share of 22 per cent before 2017. There are also several consumption-related growth drivers for retail. India's per capita income, in real terms, has doubled between 2000 and 2011, and income levels are expected to triple in nominal terms in the next 20 years. Average real household income has grown at an annual rate of 3.8 per cent from 1985 to 2005. The middle class population as defined at an income level of Rs. 200,000 and above at the 2000- price level is expected to increase to 40 per cent of the population by 2025. Per household consumption expenditure has also doubled in the last decade along with rising income levels.

The fast pace of urbanisation is also changing consumption patterns. As per the United Nations' state of the populations report, 40 per cent of India's population is expected to reside in urban agglomerates by 2030. Finally, the demographic pattern of the population, with 60 per cent of the population at 35 years or less, is driving consumption towards more modern, technologically advanced products that are the strength of modern retail outlets.

In terms of the share of the various sectors in the retail industry in India, clothing and food have a share of 38.1 per cent and 11.5 per cent respectively, according to the IBEF retail report 2011.

As per the Indian Government's announced policy, FDI in multi-brand retail is to be allowed only in towns which have a population of more than one million, which restricts the entry to around 35 cities. The minimum amount to be brought in by the foreign player is US$ 100 million; 50 per cent of the total FDI brought in should be invested in back-end infrastructure such as processing, logistics, warehousing and improvements in manufacturing. Fresh agricultural products may be unbranded. FDI in multi-brand retail trading in the form of e-commerce would not be permissible.

Asset creation is expected to be done primarily by the foreign player. The advantage, from the Government's point of view, is an increased opportunity for employment. It is estimated that organised retail has created over 1.5 million jobs in the period 2005-2009. The quality of employment is also superior to the opportunities in the unorganised sector. The organised sector would make a higher contribution to tax revenues through increased VAT and eventually, GST revenues. From the point of view of customers, they are likely to get better products, lower defective items, increased choice and quality of products, and the availability of global products in local markets. For the farmers, there would be a reduction in the level of intermediaries, improvement in supply chain management, requisite infrastructure in cold chain, warehousing and transportation logistics, technological improvements in crop production, and rational and fair pricing of products.

The limitation of applicability to cities with a population of one million or more implies that this would be applicable only to 35 cities in 15 states. These are Andhra Pradesh, Bihar, Delhi, Gujarat, Haryana, Jharkhand, Karnataka, Kerala, Madhya Pradesh, Maharashtra, Punjab, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal. It is also stipulated in the policy that State Governments and Union Territories would be free to take their own decisions in regard to the implementation of the policy.

In perspective, this policy appears to have several significant positives. It is an executive decision, well within the purview of the executive, with no need for parliamentary approval. First, on the economic side, this would lead to modernisation of retail and investment in technology, logistics and the value chain. Second, there would be opportunities of greater, higher quality of employment. Third, multiplier effects can be had in the domestic economy in the fields of warehousing, transportation and ancillary activities. Fourth, this opens up opportunities for improving the quality of employment in these sectors. Fifth, there is an assurance of greater revenue mobilisation. Sixth, this would lead to more inward capital flows and investments.

Against this backdrop, there has been strong opposition to the move and political parties are lined up to oppose the move. One of the members of the UPA, the Trinamool Congress, has walked out of the alliance on this issue, leaving the Government technically in parliamentary minority, though they have the outside support of two major parties from Uttar Pradesh.

The opposition puts forth several arguments. First, that unorganised retail in India is run by a large number of small entrepreneurs who serve the immediate neighbourhood, and who would be driven out of business by the advent of large supermarkets. There is evidence that this has happened in some states in the US and in smaller towns in the United Kingdom and Australia. The small stores would not have the technological capability or the financial muscle to compete on equal terms with the large retail chains, and hence would be at a disadvantage.

The strength of small retail lies in familiarity with the customer, that enables credit transactions to take place and provides for customer conveniences like small quantities and home delivery, which would not be possible from a large retail chain. Further, the very nature of large retail investment would require large real estate space, requiring transportation and higher transaction volumes. Therefore the concept is elitist, available only to a select few in the higher income ranges, and not of use to the common man, who constitutes of over 50 per cent of the rural and small-town consumers. So runs the argument.

Secondly, it is contended that farmers would be at a disadvantage. The large retailers would be in a position to enforce supply contracts that would push farm prices down, thus affecting farmer's incomes. Third, the tendency to stock mass-manufactured goods would lead to more imported goods being on offer, to the disadvantage of local manufacturers. Finally, the smaller retail stores are able to offer employment to even unskilled workers, of whom there are plenty in India. The employment requirement in large multi-brand retail stores would be for the better skilled, thus driving the poorer out of employment. These are some of the other arguments being advanced.
Existing traders are lobbying hard with their own state governments against the introduction of FDI in retail. At the same time, large local retailers, who have multi-brand shops, do not also want the international names to come in, as they fear they would not be able to meet the competition.

At the level of media, and even at the political level, these arguments are more in the realm of opinions and estimation, and not based on any hard analytical evidence. Firstly, the FDI retail shops would be set up in only 35 towns in the country, thus leaving most of the smaller retail shops untouched. Further, even in the larger urban centres, the requirement of real estate for these large stores is likely to be such that only a small number would be set up in each town. The advent of modern malls and composite shopping centres has not, in the last decade, disturbed local shopping habits or shopping centres. Rather, it has catered to a different class of young, urban consumers who are looking for products that are usually not available at traditional retail stores. It is also difficult to argue that retailing in India does not need to modernise, along with the economy, and that modern warehousing, inventory management and efficient logistics will not be of advantage to the consumer. Finally, it is also curious that there is little objection to multi-brand retail if it is owned by Indian retailers; the objection is only to FDI in retail. Perhaps this is because local large retailers do not want to face international brand competition. It is also

curious that there is little objection to FDI in single-brand goods. The fear of mom and pop stores being displaced and branded retail taking over the entire retail segment is perhaps overstated.

It is of course possible that the arguments are entirely in the realm of politics. No doubt the strong lobbies of the existing small retailers as well as the established Indian multi-brand retailers are adding to the fervour of the arguments, but the epicentre of the issue appears to be the political scene. Currently, the UPA has lost a major ally in the Lok Sabha, key lower house of national Parliament, and depends on the support of Samajwadi Party and Bahujan Samaj Party, two opposing parties in Uttar Pradesh (against both of whom the Congress fought in the recent state elections). In the upper house, the Rajya Sabha, the Government does not have the numbers for the vote. The ruling alliance, as already mentioned, has been weakened in 2012 by complaints of non-performance and a number of allegations of corruption: it is perhaps natural for the opposition parties to press home their advantage when the UPA is weak. There is little to be achieved as the FDI decision is an executive decision, unlikely to bring down the Government. So, this political tussle would only reveal the combination of political forces and allies in a kind of muscle-flexing for the next General elections, now slated for in 2014 in the normal course.

The downside would be that international confidence in governance in India would be further weakened, and in fact, may lead to reluctance to invest in India. It is therefore vital that the Government should sail through these discussions and win a decisive vote in Parliament.

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