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Competition and Regulation in Indian Retail Sector

INTRODUCTION

The retail sector has witnessed unprecedented growth in recent times and is currently one of the fastest growing sectors in India. Given the large size of this sector, its expansion is both a cause as well as a consequence of rapid economic growth. However, it is largely unregulated – a fact which implies that efforts to block competition or cartelise can be effective and threaten the growth and welfare generation potential of this sector. It is for this reason that competition and regulation scenario in the retail sector needs to be reviewed.

This Note is structured as follows. Section 1 provides an introduction followed by Section II that describes the structure of the retail sector, as well as its diverse components. Section III looks at the main challenges faced by this sector, while Section IV analyses the nuances of regulation and competition in this sector. Section V concludes with questions for discussion.

STRUCTURE OF THE SECTOR

In India, the retail sector is categorised into two segments: organised and unorganised. Traditional format retailing, such as the traditional family run stores, popularly known as the *kirana* stores (the small stores) or the mom-and-pop stores, hand cart and pavement vendors come under unorganised retailing. On the other hand, licensed retailers, who are registered for sales tax, income tax etc., such as corporate run retail chains

and hypermarkets, and privately owned larger retail business come under organised retailing.¹

The retail sector is highly fragmented in India, with 97 percent of the businesses run under unorganised retailing. The sector grew at the rate of 25-28 percent in 2007. The size of both organised and unorganised retail segments in 2007 was estimated at US\$330bn. The retail industry is expected to swell up to US\$365bn at the end of 2008 and might reach US\$440bn by 2010, according to a research report of RNCOS (a research and e-publishing solution firm) entitled, 'India Retail Sector Analysis (2006-2007)'.

The retail sector is the largest source of employment after agriculture, has deep penetration into rural India and generates around 10 percent of India's gross domestic product (GDP). The key drivers of the rapid growth of the sector include: i) growing consumer base, which is estimated at 217 million people or around 20 percent of population; ii) growing disposable incomes and increasing urbanisation; iii) new technological innovations that increase demand for consumption, i.e. credit cards, debit cards, online payments etc.; and iv) the growing popularity of one stop shopping, according to a study by CII and Morgan Stanley (2007) on the retail sector.

Another study (2007) by the Associated Chambers of Commerce and Industry of India (ASSOCHAM) revealed

¹ "FDI in India's Retail Sector - More Bad than Good?" By Mohan Guruswamy, Kamal Sharma, Jeevan Prakash Mohanty and Thomas J. Korah – Centre for Policy Alternatives.

that organised retail players occupied a space of only one million sq ft in 2002 and nearly 14 million sq ft by 2007, illustrating a huge expansion in the intervening period. This is likely to grow to 16 million sq ft in 2008.

Large players like Reliance Industries, Plaza, DLF, Spencer and a new entrant in the field, the Aditya Birla Group, plan to embark on a major expansion drive in their retail businesses in 2008. The study estimated that the organised retail segment would witness an additional investment of US\$70bn by 2010. At the end of 2008, the cumulative investment would be in the region of US\$25-28bn.

The study also estimated that the share of retail trade in the country's GDP, currently at around 10 percent, would jump to 12 percent soon and to 22 percent by 2010. The study also estimated that rural retail would continue to be driven by the unorganised sector for some time.

As far as employment is concerned, the sector (organised or unorganised) employs 40 million people and there are around 200 million people dependent on it (assuming an average employee supports a family of 5). As organised retail is growing, it is also providing quality employment. Employees are being retrained according to international standards and practices, as international companies are opening their ventures in the country.

Traditional Unorganised Retailers

For ages, the easiest way to enter the retail sector has been through *Kirana* stores, which generally are self employment initiatives, requiring minimal investment in terms of capital, land and labour. Despite the phenomenal growth rate in modern organised retailing, the *Kirana* store has managed to hold its own and still remains a most convenient avenue for shopping for a significant proportion of the population. As a result of the competition from big organised retailers, the *kirana* stores are also changing with the times, increasing their services to include credit facilities, phone services, home delivery, etc. However, small stores located just around big retail establishments are suffering losses.

An Indian Council of Research in International Economic Relations (ICRIER) study on the retail sector, 2007 suggested an inclusive model for organised retail, with big stores co-opting several *kirana* stores and hawkers drawn from the pool of traditional retailers and upgrading them with adequate infusion of capital and training. The report further states that the emerging structural transformation in retail trade would benefit the society as a whole, but noted, "the gains will accrue early to consumers and a little later to farmers".

The emerging structural transformation and increase in healthy competition in the retail sector would benefit the consumers. However, due to the existence of monopsonistic intermediaries in the value chain, the benefits of competition will not accrue significantly to the farmers. Lack of conducive policies and regulatory framework, growing disparities among the states, lack of credit availability and inefficient supply chains are some of the concerns being faced by the sector.

To ensure that traditional retailers do not become losers in this revolution, efforts are needed from the government and cooperation might be required from the modern organised retail sector. Moreover, traditional retailers have to follow innovative ways to stay alive in the market.

Modern Organised Retailers

In India, modern retailing (organised segment) is characterised by extensive malls and big complexes, with a variety of formats, such as discount stores, supermarkets, hypermarkets, specialty chains, etc.

For the promotion of growth in the sector, there is a need for more investment, which can come from the organised private sector constituted by corporate houses. It is easy to enforce taxation mechanisms and implement labour laws better in modern retailing, as compared to the unorganised segment, thus allowing the government to gain through higher collections of tax revenues.

Modern retailing encourages efficient supply chains for the smooth movement of goods from farmers to consumers,

thereby helping farmers to realise more income from their produce. With modern retailing, the e-retailing or non-store retailing channels are also getting popular, like HLL initiating *Sangam Direct*, a direct-to-home service.

The government has been making attempts to increase the share of organised retailing in total retail. Though organised retail comprises of highly organised supermarkets and hypermarkets, it presently does not enjoy a significant share in the total Indian market. Nevertheless, it is felt that the future belongs to such modern organised retailing.

CHALLENGES

Inadequate infrastructure, such as cold chains, electricity, roads, ports, etc., has hindered the growth of the sector. These constraints have imposed additional costs on the modern retailing business. For example, lack of good cold chains, coupled with irregular power supply, has only increased wastage in transit. Poor infrastructure is also affecting farmers in a big way by low price realisation, as farmers cannot store, transport and market their produce efficiently without good infrastructure facilities.

As a result of monopsonistic intermediaries in the sector, the supply chains are inefficient and imply higher costs to retailing business, thereby burdening consumers with higher prices. Modern retail players have been trying to make their supply chains efficient. However, lack of conducive policies, regulatory framework and growing disparities among the states, in terms of policies, are major obstacles in bringing about efficiency in the supply chains. For example, many states have failed to follow the guidelines laid down by the model Agriculture Produce Marketing Committee (APMC) Act, which encourages private players to buy agricultural produce directly from farmers. While Bihar has scrapped the Act the UP Government has recently withdrawn the agricultural investment policy, under which private players could directly buy the produce from farmers.

Presently, the sector is plagued with differential tax rates in different states,

implying high costs and complexities in establishing an effective distribution network. Soaring real estate prices in the country is another area of concern for retail industry.

Thus, the major challenges faced by the retail sector are as follows:

1. Poor infrastructure and power supply;
2. High wastages in transit and high cost logistics;
3. Differential and high taxes;
4. Inconsistency in government policies;
5. Soaring cost of real estate; and
6. Restrictions on foreign direct investment (FDI) and, therefore, on investment in the sector.

REGULATION AND COMPETITION

Presently, there is no exclusive regulatory framework for the retail sector in India. Regulation of the retail sector is mainly in the domain of the state governments. Since the growth of the retail sector impacts on the various sectors of the economy (like agriculture, real estate, food processing, etc.), various central ministries, such as the Ministry of Agriculture, the Ministry of Commerce, and the Ministry of Finance, also have influence over the regulation of the sector. However, considering the huge growth the sector is experiencing and its increasing overall contribution to the GDP, it requires a better and exclusive regulatory framework to sustain the impressive overall growth.

Competition in the retail sector is getting stiffer in the country as many big players (national and international) are experimenting and implementing different retail formats in the market. Entry by new players is still at a nascent stage. Nevertheless, increasing competition in the sector would, in due course, lead to a reduction of margins with each retail chain trying to attract customers through innovative and efficient ways.

The key players currently operating in the Indian retail industry include the Future Group, Trent Ltd, RPG Enterprise, Vishal Retail Ltd, Shoppers Stop Ltd, Bata India Ltd, Provogue India Ltd, Videocon

Appliances Ltd, ITC Ltd, Godrej Agrovert Ltd DCM, *Hariyali Kisaan Bazaar*, HLL, Bharti Group and Reliance Retail. All of them are making large investments, which will ultimately enable them to reap economies of scale.

However, the increased competition in the sector requires efficient supply chains to sustain them and better management of stock availability and reduction of the wastage levels in fresh produce. As for the Indian retail sector, it has a long way to go in developing modern supply chains, and facilitating better management of stock availability and reduction in wastage levels. Inadequacies in infrastructure and the large numbers of intermediaries in agricultural supply chains are the major impediments in this regard.

In a competitive environment, proper infrastructure is a prerequisite for retail firms and helps in attracting customers and ensuring efficient delivery of goods. Competition from foreign companies is also increasing. International retailers see India as an exciting destination with China's retail sector becoming saturated². However, Government restrictions on FDI in all retailing with the exception of single brand stores constitute barriers to entry by international players, such as Walmart and Tesco³.

The Government has allowed only 51 percent FDI in the sector to 'one-brand'

consumer stores like Nike, Reebok etc and other stores specialising in the sale of private labels, high tech goods, medical and diagnostic services and items sourced from the Indian small sector, manufactured with technology provided by the foreign collaborations. In spite of this, international players are entering the market through strategic licensing agreements, franchisee agreements and cash and carry wholesale trading, where 100 percent FDI is allowed.

The Government is reluctant to open up the sector, because of the fear that the big foreign retailers may out-compete the small local players and render thousands of people unemployed. However, opening up the retail sector gradually to foreign investors would help in promoting competition in the sector and contribute to the overall development of the economy. The gradual opening of the sector might ensure competition that is conducive for encouraging incremental business, rather than cut-throat competition. Consumers will also benefit through lower prices facilitated by greater competition. Care should be taken to ensure that opening up the sector to big players does not promote cartels and create monopolies, given the absence of a proper regulatory framework. For example, in the cement industry, the Government opened the sector for FDI without having proper regulation to

Table 1: M&A in Retail Sector in India, 2006

Year	Acquired/ JV Company/ Target	Acquirer	Nature of Business	Stake (in percent)	Consideration (in millions of US\$)
2005	Liberty Shoes	Future group	Retail (Footwear)	51	3
2005	Indus - League Clothing	Future group	Retail clothing	68	5
2005	Odyssey India	Deccan Chronicle Holdings	Leisure retail chain (books, music, toys)	100	14
2005	Landmark	Tata Trent	Books, music, accessories	74	24
2006	Bistro Hospitality	TGI Friday's (a subsidiary of Carlson Restaurant World-wide)	Restaurant (Food retail)	25	N/A
2006	Indus League clothing (Future group company)	Etam group, France	Lingerie and women's wear retailing	50	8

Source: PricewaterhouseCoppers, Asia-Pacific M&A bulletin, Mid year 2006

² "An analysis of the Indian Retail sector" by Tarannum M Sarwar, 2006

³ *Ibid*

control cartelise behaviour. As a result, now the Government is finding difficult to control cartelising behaviour in the cement industry.

While organised retail is in a nascent stage, the segment is already experiencing merger and acquisition (M&A) activities. Recently, the retail sector has witnessed a number of M&As, which may distort the competition scenario, if they are not regulated properly. In 2006, M&As worth about US\$25.6bn occurred in the retail sector and this includes those depicted in the Table 1.

In order for the modern retail sector to grow, it is necessary that steps are taken for reviewing laws, building a better regulatory framework, restructuring the tax regime and encouraging investment significantly. However, at the same time, a

comprehensive national policy and uniform state level policies to address the needs of small retailers for accessing institutional credit and technology are required.

With the development of the sector, the issue of the security of the farmers would become evident, as large retail chains start procuring agricultural goods directly from farmers. While the big guns, like Reliance, purchasing directly from farmers is a good idea, what happens if they enter into a dispute over payments, for example. Can the farmer sustain a legal battle against a big giant? Therefore, a strong regulatory framework would go a long way in ensuring that the growth of the retail sector is inclusive and sustainable.

ISSUES FOR DISCUSSION

- ◆ How should a better and exclusive regulatory framework that promotes healthy competition be built?
- ◆ How would such a regulatory framework reconcile promotion of equality with distributive goals?
- ◆ Different policies in different states are hampering the growth of the modern retail sector. What can be done to ensure some uniformity and simplicity in policies across states?
- ◆ What can the Government do to make the growth in the retail sector more inclusive and, thus, reduce the protest against organised retail?
- ◆ What changes can the Government make to restructure the tax regime to enable a favourable environment for the growth of the sector?
- ◆ How can coordination between the Centre and the State for effective policy implementation be sustained?
- ◆ What can be done to increase the access of small/marginal retailers to credit?
- ◆ What can the Government do to help in making the agricultural supply chain efficient and in reducing the number of intermediaries?
- ◆ Do we need large doses of foreign investment in the retail sector? If the answer is affirmative, what measures should be taken by the Government to increase the foreign investment in the retail sector?
- ◆ What are the steps the Government should take to ensure that the issue of the security of the farmers is dealt adequately?

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