DISCUSSION PAPER

SUBJECT: ISSUE OF DISCUSSION PAPER ON FOREIGN DIRECT INVESTMENT (FDI) IN MULTI-BRAND RETAIL TRADING

1.0 INVITATION OF VIEWS:

1.1 The Department of Industrial Policy and Promotion has decided to release Discussion Papers on some subjects on FDI. In the series of these Discussion Papers, this is the second paper on 'Foreign Direct Investment (FDI) in multi-brand retail trading'. Views and suggestions are specifically invited on Section 7 of the paper entitled 'Issues for Resolution' apart from any other issues of concern relating to FDI in multi-brand retailing. These views/ suggestions backed up by facts, figures and empirical evidence may be furnished by 31 July, 2010.

1.2 The views expressed in this discussion paper should not be construed as the views of the Government. The Department hopes to generate informed discussion on the subject, so as to enable the Government to take an appropriate policy decision at the appropriate time.

DISCUSSION PAPER ON FOREIGN DIRECT INVESTMENT (FDI) IN MULTI-BRAND RETAIL TRADING

1.0 PRESENT SCENARIO

1.1 FDI in Multi-Brand retailing is prohibited in India. FDI in Single-Brand Retailing was, however, permitted in 2006, to the extent of 51%. Since then, a total of 94 proposals have been received till May, 2010. Of this, 57 proposals were approved. An FDI inflow of US $ 194.69 million (Rs. 901.64 crore) was received between April, 2006 and March, 2010, comprising 0.21% of the total FDI inflows during the period, under the category of single brand retailing. The proposals received and approved related to retail trading of sportswear, luxury goods, apparel, fashion clothing, jewellery, hand bags, life-style products etc., covering high-end items. Single brand retail outlets with FDI generally pertain to high-end products and cater to the needs of a brand conscious segment of the population, mainly attracting a brand loyal clientele, which often has a pre-set positive disposition towards the specific brand. This segment of customers is distinctly different from one that is catered by the small retailers/ *kirana* shops.

1.2 FDI in cash and carry wholesale trading was first permitted, to the extent of 100%, under the Government approval route, in 1997. It was brought under the automatic route in 2006. Between April, 2000 to March, 2010, FDI inflows of US $ 1.779 billion (Rs. 7799 crore) were received in the sector. This comprised 1.54 % of the total FDI inflows received during the period.

1.3 Trade is an important segment in India's Gross Domestic Product (GDP). As per the National Accounts, released by the Central Statistical Organisation (CSO), GDP from trade (inclusive of wholesale and retail in organised and unorganised sector), at current prices, increased from Rs 4,33,963 crore in 2004-05 to Rs 7,91,470 crore, at an average annual rate of 16.2 per cent. The share of trade in GDP, however, remained fairly stable at little over 15 per cent in last four years[1]. The share of the private organised sector in total GDP from trade was 23.2 per cent in 2008-09 and it grew at 15.0% during the year. The share of the retail trade in GDP remained stable at 8.1 per cent during this period.

[1] Quick Estimates of National Income, 2008-09, Central statistical Organisation

1.4 Though the data on volume of turnover by retail is not separately maintained, commodity composition of private consumption expenditure provides reasonable estimates of the size of the retail sector.

1.4.1 As per the National accounts, private final consumption expenditure, increased from Rs 19,26,858 crore in 2004-05 to Rs 32,26,826 crore in 2008-09, at an average rate of 13.8 per cent per annum[2]. However, expenditure on some items like transport and communication; expenditure on food in hotels and restaurants; expenditure on rent, fuel and power; and expenditure on education and recreation are distinct from trade. Private consumption expenditure adjusted for items which could be considered a close approximation to trade, increased from Rs 11,92,405 crore in 2004-05 to Rs 19,93,380 crore in 2008-09, at an average rate of 13.7 per cent[3].Rate of growth of GDP at current market prices during this period at 14.5 per cent, was higher than this growth.

Table A: Private Final Consumption Expenditure- Commodity Composition (Rs. in crore)

item	2004-05	2005-06	2006-07	2007-08	2008-09
Food and Beverages	763,345	852,798	947,856	1,070,794	1,182,211
Clothing & Footwear	127,608	150,633	188,276	202,797	213,344
Rent, Fuel and Power	250,986	277,310	311,915	356,197	415,436
Furniture and Appliances	64,944	76,458	93,401	111,536	121,984
Medical Care	95,560	105,244	115,900	127,648	140,584
Transport and Communication	378,217	418,363	477,521	521,858	608,048
Recreation, Education and Culture	65,327	73,348	82,778	97,962	110,954
Miscellaneous Goods and Services	180,871	204,195	259,562	336,564	434,265
Total Private Consumption Expenditure	1,926,858	2,158,349	2,477,209	2,825,356	3,226,826
Estimated Trade Sales[4]	1,192,045	1,339,646	1,538,827	1,771,252	1,993,380

1.4.2 When seen at constant 2004-05 prices, however, private final consumption expenditure increased from Rs 19,26,858 crore in 2004-05 to Rs 26,51,786 crore

[2] Quick Estimates of National Income, 2008-09, Central Statistical Organisation
[3] Estimates of Retail Trade by ICRIER at Rs 11,308 billion in 2004-05 are close to these estimates.
[4] Excluding expenditure on Rent, fuel and power; Transport and communication; Recreation, education and cultural activities; and expenditure on Food in hotels and restaurants

in 2008-09, at an average rate of 8.3 per cent per annum. Private consumption expenditure adjusted for items like transport and communication etc , increased from Rs 11,92,045 crore in 2004-05 to Rs 16,67,286 crore in 2008-09, at an average rate of 8.8 per cent. Rate of growth of GDP at constant market prices during this period at 8.4 per cent was lower than the growth of private consumption expenditure that could be attributed to trade.

Table B: Private Final Consumption Expenditure- Commodity Composition (1999-2000 prices, Rs. in crore)

item	2004-05	2005-06	2006-07	2007-08	2008-09
Food and Beverages	763,345	820,702	851,630	912,807	937,064
Clothing & Footwear	127,608	158,249	194,922	210,720	209,361
Rent, Fuel and Power	250,986	259,624	270,039	283,040	292,771
Furniture and Appliances	64,944	74,133	85,917	98,474	102,148
Medical Care	95,560	101,101	105,657	108,278	117,067
Transport and Communication	378,217	397,148	427,332	464,794	521,957
Recreation, Education and Culture	65,327	71,128	76,085	86,159	90,780
Miscellaneous Goods and Services	180,871	209,554	254,083	319,085	380,638
Total Private Consumption Expenditure	1,926,858	2,091,639	2,265,665	2,483,357	2,651,786
Estimated Trade Sales	1,192,045	1,316,391	1,432,667	1,582,125	1,667,286

1.5 The National Accounts do not provide disaggregated data of retail turnover originating from the organised or unorganised sector. As per the study on "Impact of Organised Retailing on the Unorganised Sector" by ICRIER, organised retail accounted for 4.1 per cent of the total retail turnover in 2006-07[5].

1.6 A number of concerns have been expressed with regard to opening of the retail sector for FDI.

1.6.1 The first is that the retail sector in India is the second largest employer after agriculture. As per the latest NSSO 64th Round, in 2007-08 retail trade

[5] ICRIER study- Impact of Organised Retailing on the Unorganised Sector-May, 2008

employed 7.2%[6] of total workers and provided job opportunities to 33.1 million persons[7]. The share of employment in the broad sector of trade, hotels and restaurants in 2007-08 was significantly higher compared to its share in 1993-94 for both males and females, in rural, as well as urban areas[8]. More than 2/3rd of the total employment, in the broad category of trade, hotels and restaurants, is in the retail sector.

Table C: Share of persons working in Trade, Hotels and Restaurants (per cent)

	Rural		Urban	
	Male	**Female**	**Male**	**Female**
2007-08	7.6	2.3	27.8	12.8
Of which in Retail Trade	5.6	1.7	18.8	8.6
1999-2000	6.8	2.0	29.4	16.9
1993-94	5.5	2.1	21.9	10.0

1.6.2 A *second* concern is that it would lead to unfair competition and ultimately result in large-scale exit of domestic retailers, especially the small family managed outlets, leading to large scale displacement of persons employed in the retail sector. Further, as the manufacturing sector has not been growing fast enough, the persons displaced from the retail sector would not be absorbed there.

1.6.3 A *third* argument is that the Indian retail sector, particularly organised retail, is still under-developed and in a nascent stage and that, therefore, it is important that the domestic retail sector is allowed to grow and consolidate first, before opening this sector to foreign investors.

2.0 LIMITATIONS OF THE PRESENT SETUP

2.1 There has been a lack of investment in the logistics of the retail chain, leading to an inefficient market mechanism. Though India is the second largest producer of fruits and vegetables (about 180 million MT), it has a very limited integrated cold-chain infrastructure, with only 5386 stand-alone cold storages, having a total capacity of 23.6 million MT. , 80% of this is used only for potatoes. The chain is highly fragmented and hence, perishable horticultural commodities find it difficult to link to distant markets, including overseas markets, round the year. Storage infrastructure is necessary for carrying over the agricultural

[6] NSSO, Report No 531, Employment and Unemployment Situation in India, 2007-08

[7] Estimates using NSSO- Principal and Subsidiary employment ratio and population in 2007-08

[8] Share of employment in retail trade, as per the 2004-05 NSSO Survey, was estimated at 7.3%, marginally higher than its share as per 2007-08 Survey.

produce from production periods to the rest of the year and to prevent distress sales. Lack of adequate storage facilities cause heavy losses to farmers in terms of wastage in quality and quantity of produce in general, and of fruits and vegetables in particular. Post-harvest losses of farm produce, especially of fruits, vegetables and other perishables, have been estimated to be over Rs. 1 trillion per annum, 57 per cent of which is due to avoidable wastage and the rest due to avoidable costs of storage and commissions[9]. As per some industry estimates, 25-30% of fruits and vegetables and 5-7% of food grains in India are wasted[10]. Though FDI is permitted in cold-chain to the extent of 100%, through the automatic route, in the absence of FDI in retailing; FDI flow to the sector has not been significant.

2.2 Intermediaries dominate the value chain. They often flout *mandi* norms and their pricing lacks transparency. Wholesale regulated markets, governed by State APMC Acts, have developed a monopolistic and non-transparent character. According to some reports, Indian farmers realize only 1/3rd of the total price paid by the final consumer, as against 2/3rd by farmers in nations with a higher share of organized retail[11]. A study commissioned by the World Bank attributes the export non-competitiveness of India's horticulture produce to its weak supply chain. The study shows that the average price that the farmer receives for a typical horticulture product is only 12–15 per cent of the price the consumer pays at a retail outlet[12].

2.3 There is a big question mark on the efficacy of the public procurement and PDS set-up and the bill on food subsidies is rising. In spite of such heavy subsidies, overall food based inflation has been a matter of great concern. The absence of a *'farm-to-fork'* retail supply system has led to the ultimate customers paying a premium for shortages and a charge for wastages.

2.4 The MSME sector has also suffered due to lack of branding and lack of avenues to reach out to the vast world markets. While India has continued to provide emphasis on the development of MSME sector, the share of unorganised sector in overall manufacturing has declined from 34.5% in 1999-2000 to 30.3% in 2007-08[13]. This has largely been due to the inability of this sector to access latest technology and improve its marketing interface.

Table: GDP from Organised and Unorganised Manufacturing (Rs. crore)

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[9] CRISIL Research, 2007

[10] Annual Report 2006-07, Ministry of Agriculture, Department of Agriculture and Cooperation.

[11] ICRIER Report on Impact of Organized Retailing on the Unorganized Sector, May 2008

[12] Mattoo, A., D. Mishra, and A. Narain. 2007. *From competition at home to competing abroad: A case study of India's horticulture*

[13] National Accounts Statistics, 2009

	1999-2000	2004-05	2005-06	2006-07	2007-08
Organised	173003	312622	360409	428533	488578
Unorganised	91110	140981	159334	189115	216552
Share of Unorganised Manufacturing in total GDP from Manufacturing sector	34.5	31.1	30.7	30.6	30.7

3.0 NEED FOR INVESTMENTS IN AGRICULTURE INFRASTRUCTURE AND LINKED RETAIL SECTORS

3.1 It is estimated that India will need substantial investment to develop infrastructure for supporting retail development. A significant portion of this will need to be earmarked for up gradation of the supply chain for fruits & vegetables. A major portion of his investment is expected to come from the private sector, for which an appropriate regulatory and policy environment is necessary. An 11th Plan working group has estimated a total investment of Rs. 64,312 crore in agricultural infrastructure. A storage capacity gap of 35 million tonnes has been assessed, requiring an estimated investment of Rs. 7,687 crore during the 11th Plan.

4.0 GIST OF RECOMMENDATIONS OF VARIOUS STUDIES:

4.1 A number of views have been expressed regarding the subject of FDI in the retail trade sector. Various issues have also been raised on the possible approach to opening the retail trade sector for FDI. Some of the views expressed/issues raised are summarized ahead.

4.2 'FDI IN RETAIL- A POLICY PERSPECTIVE', PREPARED BY FICCI AND ICICI PROPERTY SERVICES IN FEBRUARY, 2005

i. Competition within the host country sector is a critical driver of improvements in sector performance as a result of FDI.

ii. However, FDI's potential for impact can be greater because of the combination of scale, capital, and global capabilities which allow MNCs to close existing large productivity gaps more aggressively.

iii. FDI can be a powerful catalyst to spur competition in industries characterized by low competition and poor productivity. Examples include the cases of consumer electronics in Brazil and India, food retail in Mexico, and auto in China, India, and Brazil.

iv. Competition is also key to diffusing FDI-introduced innovation across an industry. In Brazilian food retail, high competitive intensity caused by informal players forced all modern retailers to rapidly increase productivity; in Mexican and Brazilian auto cases, increasing competition from imports induced foreign players themselves to increase their productivity.

v. Increasingly, foreign direct investment is integrating developing countries into the global economy, creating large economic benefits to both the global economy and to the developing countries themselves. Industry restructuring enables global growth as companies reduce production costs and create new markets. For the large developing countries, integrating into the global economy through foreign direct investments improves standards of living by improving productivity and creating output growth. The biggest beneficiaries from this transition are consumers - both global consumers that reap the benefits from global industry restructuring, and consumers in the host countries that see their purchasing power and standards of living improve.

vi. FDI can be a powerful catalyst to spur competition in the retail industry, due to the current scenario of low competition and poor productivity. It can bring about:

- *Supply Chain Improvement*
- *Investment in Technology*
- *Manpower and Skill development*
- *Tourism Development*
- *Greater Sourcing From India*
- *Upgradation in Agriculture*
- *Efficient Small and Medium Scale Industries*
- *Growth in market size*
- *Greater Productivity*
- *Benefits to government: through greater GDP, tax income and employment generation*

vii The report *inter alia* made the following recommendations:

- *Permit FDI in retail*
- *Remove Bottlenecks in the supply chain*
- *Relax SSI Reservation*
- *Remove distribution constraints*
- *Organize market for real estate*

- *Increase land supply*

4.3 CENTRE FOR POLICY ALTERNATIVES: 'FDI IN INDIA'S RETAIL SECTOR: MORE BAD THAN GOOD?'

i. The retail sector is severely constrained by limited availability of bank finance. The Government and the RBI need to evolve suitable policies to enable retailers in the organized and unorganized sector to expand and improve efficiencies.
ii. A National Commission should be set up to study the problems of the retail sector which should also evolve a clear set of conditionalities on foreign retailers on procurement of farm produce, domestically manufactured merchandise and imported goods. These conditionalities must state minimum space, size and other details like construction and storage standards.
iii. Entry of foreign players must be gradual with social safeguards so that the effects of labour dislocation can be analysed and policy fine tuned. Foreign players should initially be allowed only in metros.
iv. Manufacturing sector in India must be developed to address the dislocation of existing retailers.

4.4 RECOMMENDATIONS IN THE MID TERM APPRAISAL OF TENTH PLAN

- Mid Term Appraisal of the tenth Five Year Plan made a strong case for FDI in modern retailing as entry of modern foreign retailers through joint ventures in India would help develop backward linkages to sources of supply and thus develop a domestic supply chain capable of meeting international standards.

- Review of the existing policy as part of general strategy of promoting labour intensive manufacturing by the same retailers has been suggested.

- Fears of large adverse effects on existing retailers are grossly exaggerated especially since modern domestic retailing has begun in any case.

- Allowing FDI in joint ventures is likely to provide access for domestic suppliers to international retailing which purely domestic modern retailers may not be able to offer.

4.5 ICRIER STUDIES ON: (i) FOREIGN DIRECT INVESTMENT IN RETAIL SECTOR-INDIA (2005) and (ii) *'IMPACT OF ORGANIZED RETAILING ON THE UNORGANIZED SECTOR'-2008*

4.5.1 The 2005 study recommended:

i FDI be allowed in retail trade as it would speed up the growth of organized retail formats.

ii Gradual opening of the retail sector over a period of 3-5 years to give domestic industry enough time to adjust to the changes.

iii In the initial stage, FDI up to 49% could be allowed to enable domestic players to enter into joint ventures have access to investment, technological know-how and best management practices while retaining management control.

4.5.2 The 2008 study has observed that organized retail, which now constitutes a small four per cent of the total retail sector, is likely to grow at a much faster pace of 45-50 per cent per annum and quadruple its share in total retail trade to 16 per cent by 2011-12.[14] However, this represents a positive sum game in which both unorganized and organized retail not only coexist but also grow substantially in size.

4.5.3 Unorganized retailers in the vicinity of organized retailers experienced a decline in their volume of business and profit in the initial years after the entry of large organized retailers. The adverse impact on sales and profit, however, weakens over time. There was no evidence of a decline in overall employment in the unorganized sector as a result of the entry of organized retailers. The rate of closure of unorganized retail shops in gross terms was found to be 4.2 per cent per annum, which is much lower than the international rate of closure of small businesses. The rate of closure on account of competition from organized retail was found to still lower, at 1.7 per cent per annum. There was competitive response from traditional retailers through improved business practices and technology upgradation.

4.5.4 Consumers definitely gained from organized retail on multiple counts. Overall consumer spending has increased with the entry of the organized retail. While all income groups saved through organized retail purchases, the lower income consumers saved more. Thus, organized retail is relatively more beneficial to the less well-off consumers. Proximity is a major comparative advantage of unorganized outlets.

[14] *The expected growth, however, has not taken place*

4.5.5 There was no evidence of an adverse impact by organized retail on intermediaries. There is, however, some adverse impact on turnover and profit of intermediaries dealing in products such as, fruit, vegetables, and apparel. Over two-thirds of the intermediaries planned to expand their businesses, in response to increased business opportunities opened by the expansion of retail.

4.5.6 Farmers were found to benefit significantly from the option of direct sales to organized retailers. The average price realization for cauliflower farmers selling directly to organized retail was about 25 per cent higher than their proceeds from sale to regulated government *mandis*. The profit realization for farmers selling directly to organized retailers was about 60 per cent higher than that received from selling in the *mandis*. The difference was even larger when the amount charged by the commission agent (usually 10 per cent of sale price) in the *mandi* is taken into account.

4.5.7 Large manufacturers have started feeling the competitive impact of organized retail through price and payment pressures. Manufacturers have responded through building and reinforcing their brand strength, increasing their own retail presence, 'adopting' small retailers, and setting up dedicated teams to deal with modern retailers. The entry of organized retail is transforming the logistics industry. This will create significant positive externalities across the economy. Small manufacturers, however, did not report any significant impact of organized retail.

4.5.8 The study made the following major recommendations:

- *i.* *Modernization of wetmarkets through public-private partnerships.*
- *ii.* *Facilitating cash-and-carry outlets, like Metro, for sale to unorganized retail and procurement from farmers, as in China.*
- *iii.* *Encouraging co-operatives and associations of unorganized retailers for direct procurement from suppliers and farmers.*
- *iv.* *Ensuring better credit availability to unorganized retailers from banks and micro-credit institutions through innovative banking solutions.*
- *v.* *Facilitating the formation of farmers' co-operatives to directly sell to organized retailers.*
- *vi.* *Encouraging formulation of "private codes of conduct" by organized retail for dealing with small suppliers. These may then be incorporated into enforceable legislation.*
- *vii.* *Simplification of the licensing and permit regime for organized retail and move towards a nationwide uniform licensing regime in the states to facilitate modern retail.*

- viii. *Strengthening the Competition Commission's role for enforcing rules against collusion and predatory pricing.*
- ix. *Modernization of APMC markets as modelled on the National Dairy Development Board (NDDB) Safal market in Bangalore.*

4.6 ECONOMIC SURVEY 2008-09:

The Economic survey recommended FDI in multi-format retail, starting with food retailing, mentioning that: *"initially this could be subject to setting up a modern logistics system, perhaps jointly with other organized retailers. A condition could also be put that it must have (for 5 years say), wholesale outlets where small, unorganized retailers can also purchase items (to facilitate transition)".*

4.7 COMMITTEE ON FOREIGN AND DOMESTIC INVESTMENT IN RETAIL SECTOR-90TH REPORT OF DEPARTMENT RELATED PARLIAMENTARY STANDING COMMITTEE ON COMMERCE

4.7.1 The Hon'ble Department Related Parliamentary Standing Committee on Commerce, in its 90th Report, on 'Foreign and Domestic Investment in Retail Sector', laid in the Lok Sabha and the Rajya Sabha on 8 June, 2009, had made an in-depth study on the subject and identified a number of issues related to FDI in the retail sector. These included:

- *Labour displacing effects of FDI driven modern retailing*
- *Job losses due to predatory pricing strategies of large retailers*
- *Disintegration of established supply chains by establishment of monopolies of global retail chains, leading to their control of both ends of the supply chain*
- *Inability of retail to boost GDP by itself, it being only an intermediate value added process*
- *Disruption of current balance of the economy by rendering millions of small retailers jobless*

4.7.2 The Hon'ble Standing Committee, in its report on 'Foreign and Domestic Investment in Retail Sector', had, accordingly, made a number of observations/ recommendations related to the subject, which, *inter alia,* included:

- *Non-adherence of provisions of single-brand trading, practicing of product bundling by corporate retailers and backdoor entry of foreign companies into retailing through wholesale cash and carry trading*

- *Unemployment due to slide-down of indigenous retailers as a result of FDI in retail, sidelining of consumers' welfare due to predatory pricing by retail giants, leading to their monopolistic position and dictating of retail prices and unduly affecting of farmers due to non-renumerative prices, paid by procurement centres constituted by big corporates*
- *Blanket ban on large domestic corporate houses and foreign retailers from entering retail trade in grocery, foods and vegetables and restrictions on opening of large malls by them for selling other consumer products; reservation policy and extension of financial assistance schemes for expansion and modernisation of small and medium retailers; stopping of issuance of licenses for 'cash and carry'*
- *Unemployment created by corporate retail, as unorganised retail provides employment to 40 million people, which accounts for 8% of the total employment*
- *Establishment of in-built policy to re-employ/re-locate people dislocated due to opening of big malls in the vicinity of their shops*
- *Preparation of a legal and regulatory framework and enforcement mechanism to ensure that large retailers are not able to dislocate small retailers by unfair means*
- *Extension of institutional credit, at lower rates, by public sector banks, to help improve efficiencies of small retailers; undertaking of proactive programme for assisting small retailers to upgrade themselves*
- *Establishment of a National Commission to study the problems of the retail sector; Enactment of an Act to protect medium and small retailers*
- *Providing a level playing field for small retailers; Analysis of traffic and economic impacts before a store is given permission to open*
- *Setting-up of a Retail Regulatory Authority to look into problems and to act as a whistle-blower*
- *Adequate safeguards to prevent diversion of agricultural land for building malls etc.*
- *Enactment of a National Shopping Mall Regulation Act to regulate the fiscal and social aspects of the entire retail sector*
- *Formulation of a Model Central Law*

5.0 **POLICY FOR FDI IN RETAIL TRADING IN OTHER COMPARABLE COUNTRIES:**

5.1 **POLICY FOR FDI IN RETAIL TRADING IN OTHER COUNTRIES**

5.1.1 FDI is permitted in the retail sector in Brazil, Argentina, Singapore, Indonesia, China and Thailand without limits on equity participation, while Malaysia has equity caps on FDI in the retail sector.

5.2 **EXPERIENCE OF FDI IN RETAIL TRADE IN CHINA**[15]

- FDI in retailing was permitted in China for the first time in 1992. Foreign retailers were initially permitted to trade only in six Provinces and Special Economic Zones. Foreign ownership was initially restricted to 49%.
- Foreign ownership restrictions have progressively been lifted and, and following China's accession to WTO, effective December, 2004, there are no equity restrictions.
- '*Wholesale and retail projects*' forms part of the Catalogue for Encouraged Foreign Investment Industries (Annexure 1).
- Retail trade in China has been growing since 1992.
- Employment in the retail and wholesale trade increased from about 4% of the total labour force in 1992 to about 7% in 2001. The number of traditional retailers also increased by around 30% between 1996 and 2001.
- In 2006, the total retail sale in China amounted to USD 785 billion, of which the share of organized retail amounted to 20%. [16]
- Some of the changes which have occurred in China, following the liberalization of its retail sector, include[17]:
    - Over 600 hypermarkets were opened between 1996 and 2001
    - 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
- China is witnessing robust economic growth and increasing urban and rural incomes are fueling consumption level in this vast and complex retail environment. According to Euromonitor, retail sales in China, which amounted to nearly USD 554 billion in 2003, were expected to grow rapidly to reach USD 900 billion by 2009. [18]

[15] FICCI-ICICI Property Service Report, February, 2005
[16] Impact of organized retailing on the unorganized sector – ICRIER study May, 2008
[17] The benefits of modern trade to transitional economies – CII - PwC study, 2008
[18] The benefits of modern trade to transitional economies – CII - PwC study, 2008

- China's retail sector registered growth in 2007. The nominal growth of China's retail sales of consumer goods accelerated to 16.8% in 2007, up from 13.7% in 2006. Total retail sales amounted to 8,921 billion yuan, of which the wholesale and retail trade sector grew nominally by 16.7%, to reach 7,504 billion yuan.
- China's promising consumer market has led to huge foreign interest. FDI in the country's retail and wholesale trade climbed in 2007. There were 6,338 new foreign retail and wholesale enterprises in 2007, up by 35.9% year-on-year. The actual utilized foreign direct investment value amounted to 2.68 billion US dollars, up by 49.6%. China's retail and wholesale trade sector has witnessed impressive growth in foreign direct investment, among others.

5.3 <u>EXPERIENCE OF THAILAND IN OPENING RETAIL SECTOR TO FDI</u>

5.3.1 Thailand is frequently referred to as a country in which FDI had an adverse effect on the local retailers. It permits 100% foreign equity, with no limit on the number of outlets. For the retail business, it has a capital requirement of TBH100 million and TBH20 million for each additional outlet, while it has a capital requirement of TBH100 million for each wholesale outlet.

5.3.2 The factual position, as reflected in the Report of ICRIER, is as follows:

- Wet market and small family owned grocery stores dominated the Thai Retail industry.
- Modern retail outlets by local Thai people came to prominence during the economic boom in the early 1990s.
- Prior to 1997, no foreign investment was allowed and hence the retail sector faced limited competition and thus had few incentives to upgrade their operation.
- With the start of the Asian crisis in 1997, the entry ban on foreign players was removed. Within a short span of time, the foreign players expanded their operations significantly and marginalised the local retailers who were already suffering from a recessionary trend of economy.
- Many local players had to close down their business.
- Entry of foreign players in a recessionary economy adversely impacted all segments – wholesalers, manufacturers and domestic retailers in the short run.

- However, entry of the foreign players had certain positive effects also, such as:
  - It led to the development of organised retailing and Thailand has now become an important shopping destination.
  - It encouraged growth of agro-food processing industry and enhanced the exports of Thai-made goods through networks of the foreign retailers

5.4 **EXPERIENCE OF RUSSIA**[19]

The Russian supermarket revolution has occurred only in the 2000s. It is still a fragmented sector in a country with a population of 140 million. Very high growth rates have been recorded. In 2002, sales by the top-15 chains totaled US$2.7 billion; by 2006, sales by those chains had soared to US$19.2 billion. The share of the top-3 chains was 40 per cent in 2002 and 54 per cent in 2006, with the lead domestic chains acquiring many small regional and local chains. The foreign share of sales was 33 per cent in 2002 and 35 per cent in 2006—only inching up and spreading over 8 foreign chains among the top 15. The two largest companies are Russian, but the origin of the capital, even of the Russian companies, is usually a mix of domestic and foreign.

5.5 **EXPERIENCE OF CHILE**[20]

The Chilean supermarket sector is a case of a take-off driven by domestic capital, followed by nascent multinationalization, followed by abrupt "demultinationalization." The supermarket sector in Chile was launched in the 1990s, with the backing of domestic capital. Late in the 1990s, the number two and number three global chains entered: Carrefour and Ahold. By 2002, those two companies had 13 per cent of the US$4.6 billion in total sales of the top-eight chains. However, by 2006 their share had plummeted to zero per cent of the US$12.6 billion in total sales of the top eight (growing at a pace similar to China's); the Chilean subsidiaries of two foreign chains had been bought by the top-two Chilean chains in 2003. Today those top-two chains have 65 per cent of the market. The three market leaders, all domestic, are expanding rapidly into other Latin American countries in mergers and acquisitions, becoming regional multinationals. The domestic capital was based in a combination of domestic bank credit and real estate, commercial, and financial services. These were the tertiary sector ripple effects of the fundamental boom in copper and wood products, and the fruit and fish boom.

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[19] ICRIER Report on Impact of Organized Retailing on the Unorganized Sector, May 2008
[20] *ibid*

5.6 EXPERIENCE OF INDONESIA[21]

Indonesia permits 100% foreign equity in retail business, with no limit on the number of outlets. It also does not impose any capital requirements. The take-off of modern retail in Indonesia in the 1990s primarily involved domestic chains. The current leading chain, Matahari, is indicative. Matahari started as a small shop in 1958, grew into a chain of department stores, and was then purchased by a giant banking and real estate conglomerate, Lippo Group, in 1997, just before the crisis. The crisis created a sharp dip in modern retail sales, which began recovering in the 2000s. Matahari doubled its sales between 2002 and 2006, becoming a billion-dollar chain by 2006. The share of foreign chains (one European and one Hong Kong) in the top-seven chains is now 40 per cent. However, because the sector is still fragmented, foreign chains do not have more than a 20 per cent share, similar to the situation in China.

6.0 RATIONALE FOR FDI IN RETAIL TRADING:

6.1 The Agriculture sector needs well-functioning markets to drive growth, employment and economic prosperity in rural areas of the country. Further, in order to provide dynamism and efficiency in the marketing system, large investments are required for the development of post-harvest and cold-chain infrastructure nearer to the farmers' field. FDI in front end retailing is imperative to fund this investment. Allowing FDI in front end retail operations will enable organized retailers to generate sufficient cash to fund this investment. Investment in organized retail by domestic players will be ineffectively deployed if FDI is delayed. International retailers should be mandated to bring with them technology and management know-how which will ensure that investment in organized retail works to India's advantage. In order to provide dynamism and efficiency in the marketing system, large investments are required for organized retailing, linked with the back end of the value chain. FDI in front-end retailing is imperative to derive full advantage of the value chain for the producer and the consumer. International retailers will bring with them technology and management know-how that will finally impact our whole retail sector through the adoption of best practices.

6.2 There is a need to ensure that issues of cost and quality, relating to consumers, are adequately addressed. This could be achieved through stabilizing prices and reducing inflation, which, in turn, could be achieved through direct buying from farmers, improving supply chain inefficiencies to lower transit

[21] *ibid*

losses, improved storage capabilities to control supply/demand imbalances, better quality and safety standards through farmer development and increased processing of produce.

6.3 Similarly, there is a need to address issues relating to farmers, through removal of structural inefficiencies. This could be achieved through liberalized markets, with direct marketing and contract farming programmes, from which farmers could profit, as also more predictable farm-gate prices, steadier incomes and better access to evolving consumer preferences through private investors, especially the organized retail sector. There is also a need to improve post-harvest management, which could be achieved through investments in supply chains and cold storage to minimize losses and improving processing, as also value addition for better farm incomes. Further, there is a need for yield improvement, which could be achieved through use of contract farming to disseminate technological know-how, working with farmers to promote awareness about soil quality, pesticides and fertilizer usage, grading, sorting capabilities and increasing availability of low interest credit for farmers.

6.4 FDI in retail, may, therefore, be an efficient means of addressing the concerns of farmers and consumers, as referred to above. The private sector, especially organized retail, is best suited to make investments of this magnitude. Permitting foreign investment in food-based retailing is likely to ensure adequate flow of capital into the country & its productive use, in a manner likely to promote the welfare of all sections of society, particularly farmers and consumers. Opening FDI in retail could also assist in bringing in technical know-how to set up efficient supply chains which can act as models of development. It would also help bring about improvements in farmer income & agricultural growth and assist in lowering consumer prices /inflation.

6.5 National Accounts Data, sourced from the Central Statistical Organisation, reveals that the rates of growth of the private organized sector and private unorganized retail trade have virtually converged over the four years ending 2008-09.The rate of growth of the private organized sector decelerated from 27% in 2005-06 to 15% in 2008-09, while the rate of growth of the private unorganized retail sector remained more or less stable, from 15.6 % in 2005-06 to 14.9% in 2008-09. As per the data available from CMIE, profit before and after tax of the companies engaged in retail trade as proportion to their total income became negative in 2007-08 and remained so in 2008-09. Profit before and after tax as percentage to sales also turned negative in 2007-08 and 2008-09. This may, perhaps, be due to both-competition from unorganized retail, as also entry of other players. A year-wise comparison of the Profitability ratios of organised retail shows that the Profit After Tax, net of PE & OI (Prior Period, Extraordinary income/expenses and Other incomes), as a percentage of sales, which stood at 1.09% in the financial year ending March, 2003, declined to 0.50 in the financial year ending March, 2007 and turned negative in the financial years ending March, 2008 and March, 2009, standing at -5.60 and -6.35 respectively.

6.6 It is therefore clear that organized retail cannot have a cake walk and will face a growing challenge from the unorganized retail sector. It is possible that the unorganized retail sector may be re-inventing itself, through new and improved practices, to meet the challenges posed by organized retail. It is also evident that without addressing the gaps in the value chain, organized retail will neither be profitable nor make any great difference to the economy.

6.7 Keeping in view the large requirement of funds for back-end infrastructure, there is a case for opening up of the retail sector to foreign investment. At the same time, in the Indian context, there is a view that this may be more appropriately done in a calibrated manner. We must ensure that the FDI does make a real contribution to address the inadequacies of back-end infrastructure. Alongside, we need to address the challenge of integrating the small retailer in the value chain.

7.0 ISSUES FOR RESOLUTION

7.1 Should FDI in multi brand retail be permitted? If so, should a cap on investment be imposed? If so, what should this cap be?

7.2 To develop the retail trade in food grains, other essential commodities and multi-brand retail in general; should FDI be leveraged for creating back-end infrastructure? To ensure that foreign investment makes a genuine contribution to the development of infrastructure and logistics, should it be stipulated that a percentage of the FDI coming in (say 50%) should be spent towards building up of back end infrastructure, logistics or agro processing?.

7.3 It is necessary to encourage only genuine players in this sector and avoid a situation where retail outlets are run through working capital support from financial institutions. Should a minimum threshold limit for investment in backend infrastructure logistics be fixed? If so, what should this financial threshold be?

7.4 To develop our rural sector, should conditionalities be put on the FDI funded chains relating to employment? For example, should we stipulate that at least 50% of the jobs in the retail outlets should be reserved for the rural youth?

7.5 Similarly, to develop our SME sector through local sourcing, should we stipulate that a minimum percentage of manufactured products be sourced from the SME sector in India?

7.6 How best can small retailers be integrated into the upgraded value chain? Can they be provided access to the logistics/ supply chain set up by the FDI funded retailers? Should it be stipulated that a minimum percentage of the latter's sales should be made to retailers through special wholesale windows?

7.7 As a part of a calibrated reform process, should foreign investment for such stores be initially allowed only in cities with population of more than 10 lakhs (2001 census)? As there may be difficulties faced with regard to availability of real-estate in such cities for setting up such ventures, should an area of 10 kms around the municipal/urban agglomeration limits of such cities be included within the definition of the city?

7.8 Will any of the conditionalities mentioned above be inconsistent with our commitments under the agreement on TRIM at WTO? If not, to ensure national treatment, can such conditionalities be extended to all retail chains in India above a certain size? Will such extended conditionalities be consistent with Article 301 of the Constitution?

7.9 What additional steps should be taken to protect small retailers? Should an exclusive legal and regulatory framework be established to protect their interests? Is a Shopping Mall Regulation Act required? Does this require intervention at national level or should this be left to the States?

7.10 The present public distribution system provides a valuable safety net to vulnerable sections of society. To ensure that the integrity of the PDS system is not weakened and buffer stock is maintained at the desired level, should Government reserve the right of first procurement for a part of the season or put in place a mechanism to collect a certain amount of levy from private traders in case the level of buffer stock falls below a certain level?

7.11 How should compliance be ensured with the above stipulations? Should a centralised agency, to be nominated by the State Governments concerned, be empowered to grant permissions to every outlet to be opened? The onus of proving compliance with these conditions could rest with the concerned retail chain. The chains could submit an annual statement to such State Government agency providing proof of compliance. Should this agency be empowered to monitor compliance of the present cash and carry outlets too?

7.12 The penalty for non compliance could include cancellation of approvals as well as denial of future permissions for such activities. What additional penalties could be levied? Should civil penalties be imposed? Or criminal? Or both?

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