FDI and Retail Regulation in India

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ABSTRACT

Foreign Direct Investment (FDI) undoubtedly is the most influential channel through which foreign capital comes into a country. In India FDI is being allowed in different sectors of the economy in different percentage/ratios through either the government or the automatic route. Till the early '90s the Government of India's (GOI) approach toward foreign capital has been reflective of a stiff and restrictive outlook. But all that changed with the Industrial policy of 1991 which marked the beginning of a paradigm shift in Indian economic planning, with the gradual opening up of the markets to foreign capital. India's retail sector has undergone a rapid transformation over the past decade. With the marked growth in India's per capita income and a rising middle class accompanied by a massive scale of urbanization, it is the retail sector that is pitted to be the real growth engine for the Indian economy. The GOI has recently in a slew of its reform statements, announced up to 51% FDI in multi brand retail and 100% in single-brand retail. The GOI mandate on FDI in retail also prescribes that that an organized retail outlet may be set up only in cities with a population of more than 10 lakh as per 2011 census. The most interesting part of the note released by GOI

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with regards to enabling FDI in retail is that most of the policies mentioned are only enabling in nature. Hence, government in states and union territories are free to make their own policies. Obviously this has led to significant interest among policy analysts to develop the necessary regulatory frameworks to channelize the move. Now, as per the Indian Constitution, Retail features on the State list of powers.

Looking into the current scenario, domestic large organized retailing units have already entered our economic spaces which are having their own peculiarities and need to be regulated in a sui generis fashion. Two major apprehensions that loom largely at this juncture are that large retailers will leverage their strengths to first, bully suppliers, farmers and consumers through anticompetitive means, and secondly to push out smaller stores from the market merely by their marketing strategies, which may not be prima facie anticompetitive. Most countries who have opened up to large retailers have had to deal with both the issues – some successfully and some not so successfully. The paper will entail a detailed study of the regulatory mechanisms adopted by countries across the development spectrum such as Indonesia, Thailand, Malaysia, China, Japan, Spain, Russia, South Korea Brazil and Mexico to respond to the challenges of FDI in retail. By reviewing the cross country evidences the researchers seek to reveal the imminent requirement of framing a strong retail regulation in India. The paper provides a set of policy recommendations as inputs towards the proposed regulatory framework.

Keywords: Competitive Neutrality, Cross Country Analysis, FDI in Retail, Government of India Regulations, Policy Recommendation

Introduction

Till the early '90s the Government of India's (GoI) approach toward foreign capital has been reflective of a stiff and restrictive outlook. However, all that changed with the Industrial Policy of 1991 which marked the beginning of a paradigm shift in Indian economic planning. The gradual opening up of the markets to foreign capital has enabled India's retail sector to undergo a rapid transformation over the past decade. As a consequence of the marked growth in India's per capita income, a rising middle class and a massive scale of urbanization, it is the retail sector that is pitched to be the real growth engine for the Indian economy. The Indian retail industry is expected to more than double to $1.3 trn by 2020. According to the Federation of Indian Chambers of Commerce and Industry (FICCI), if overseas investment is permitted in the sector, average annual growth in organized retail will increase by an estimated 25%. According to the FICCI president RV Kanoria, with the current market size estimated at $500 bn, this growth translates to an additional $800bn in the next eight years.

Objectives

The paper will entail a detailed study of the regulatory mechanisms adopted by nations to respond to the challenges of FDI in retail. Countries such as Indonesia, Thailand, Malaysia, China, Japan, Spain, Russia, South Korea, New South Wales, Brazil and Mexico have been considered. By reviewing the cross country evidences the researchers seek to reveal the imminent requirement of framing a strong retail regulation in India. Based on the researchers' observations, they have suggested a framework to enhance the performance of the sector.

Methodology

The researchers have used secondary sources and examined the Government of India's FDI policy in retail vis-à-vis the regulatory mechanisms adopted by countries as mentioned above. The secondary data has been collected from various published sources and websites across a time span of twelve years. Interpretation of the data is more on qualitative terms than on quantitative terms.

Government of India (GoI) Policy Reform on FDI in Retail

The GoI has recently (September 2012), in a slew of its reform statements, announced up to 51% FDI in multi brand retail and 100% in single-brand retail. The interesting part of the note released by GoI with regards to FDI in retail is that most of the policies mentioned are only enabling in nature. Hence, governments in states and union territories are free to make their own policies. Obviously this has led to significant interest among policy analysts to develop the necessary regulatory frameworks to channelize the move. Given below is a snapshot of the changes brought forth[1]:

Table 1: Changes in Government Policy for FDI in Retail

Types of Retail	*Earlier Position on Allowance for FDI*	*Post Amendment*
Cash & Carry Trading	Upto 100%	Continues
Single Brand Retailing	Upto 100%	Continues with relaxed conditions
Multi brand Retailing	Not Allowed	Up to 51%FDI allowed subject to conditions

The Indian retail market is currently unorganized and highly fragmented, with estimated 13-15 mn outlets countrywide. According to research from CRISIL, the overall Indian retail sector is set to grow at a CAGR of 15 percent from 2011/2012 to 2016/2017, while organized retail will grow at a CAGR of 24 percent over the same period.[2]

Table 2: Share of Organized Retail in India[3]

Year	*2005*	*2009*	*2010*	*2013 (projected)*
Total Retail (in billion INR)	10000	18450	19500	24000
Organized Retail (in billion INR)	350	920	1350	2400
Share of organized Retail (%)	3.50%	5.00%	7.00%	10.00%

The above table portrays the steady growth of organized retail in India and this is expected to continue to increase in the years to come. It is this steady growth that can be attributed to the reforms brought forth by GoI in FDI policy in retail trade, with a view to increase the chances of achieving a double digit economic growth by attracting global retail majors.

While the policy posture clearly indicates a welcoming opportunity for global retailers to explore the vast potential of Indian markets, what remains to be seen is whether it will be easy for a global retailer to simply

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1 Press Note 4 (2012 series) http://dipp.nic.in/English/acts_rules/Press_Notes/pn4_2012.pdf& Press Note 5 (2012 series)http://dipp.nic.in/English/acts_rules/Press_Notes/pn5_2012.pdf

2 CRISIL Opinion, Indian retail: Short-term blips but long term prospects bright, CRISIL Research, May 2012.

3 www.nielson.com (Sourced from: http://www.ipublishing.co.in/ajmrvol1no1/volthree/EIJMRS3008.pdf)

invest money and apply global best practices to initiate operations in India. Trade history is witness that whenever global retailers have ventured out of their base country, their prospects of success have diminished considerably. Wal-Mart in Germany and South Korea, Best Buy in China are glaring examples. It also remains to be seen, how sincere the authorities would be in monitoring the compliance aspect. The Bharti-Walmart controversy[4] is a case in point. Another big concern is about what the government plans to do to implement uniform regulations while allowing FDI in retail only in cities that had a population of over 10 lakhs (53 is the figure so far) and also provisioning that all states could make their choice. For a country like India, two sets of retail trade laws – for those who allow FDI and those who do not – is not feasible. On Jan 22, 2013, the Supreme Court has sought the Government's response on how it intends to safeguard the interest of small traders after opening up the retail sector to foreign direct investments (FDI).[5] Thus the way FDI in retail trade has been approached has already raised many brows over questions not just relating to circumvention of the extant laws, but also the objectives.

Challenges Facing the Current Policy

(a) Complex regulatory system with multiple acts (some even state wise).

(b) Rising real estate prices and land availability.

(c) The mandate on 30% local sourcing and 50% investment in back-end infrastructure requires a meticulous familiarity with vendor culture and practices.

(d) The mandate on 51% FDI limit (multi brand retail) calls for forging win-win partnerships with the indigenous organized retail players.

(e) Apprehension of unfair trade practices likely to be adopted by large foreign retailers like predatory pricing, creation of monopoly, promotion of cartels, etc.

(f) Growing pressure put by transnational corporations to bring in changes in the General Agreement on Trade in Services (GATS)

[4] http://www.financialexpress.com/news/of-fdi-walmart-amp-controve-rsies-an-eventful-year-for-retail/1049567/2

[5] http://www.financialexpress.com/news/retail-fdi-how-will-you-protect-small-traders-is-this-a-political-gimmick-supreme-court-asks-govt/1063049/0

to ensure that their entry in overseas retail trade is irreversible and ever-expanding.

Thus what is urgently required is preparation of a common legal and regulatory framework and enforcement mechanism to ensure fair play and overall growth of small and big retailers, through healthy competition.

Cross Country Analysis of FDI Policy Regime

A study of the emerging market economies reveal that it was since early '90s, that these nations began supporting the supermarket development as a part of their modernization policies with China opening its retail sector in 1992, Brazil, Mexico and Argentina in 1994 and Indonesia in 1998. Most have in general adopted policies that limit the growth of supermarkets to a certain extent to support the parallel growth of traditional retailers. For instance, Japan first allowed FDI in specific retail formats such as speciality stores and then gradually expanded it to hypermarkets and supermarkets; while Russia and South Korea, had taken the policy of tax remission for setting up supermarkets in municipalities. Some governments have even directly invested in modern retail with the twin objective of modernizing the retail chain as well as generating revenue for government. Many nations like Thailand had imposed strict zoning limits and hygiene regulations on wet-markets (fresh food informal market) to boost the modernization process. The Chinese Government by contrast had adopted a program of converting wet-markets to supermarkets – an attempt similar to transforming unskilled unorganized retail sector to skilful modernized organized retail sector. In contrast, the governments of Brazil and Mexico took the intermediate approach towards modernization without providing any protection or support to traditional (informal) retailers; while the Korean government pursued liberalised FDI policy regime in the aftermath of the Asian financial crisis in 1997-98 to fulfil the conditionality of the International Monetary Fund (IMF) in exchange for standby credit.

Post the 90s a distinct change is discernible in the retail policies of the same nations. Countries like Indonesia, Thailand and Malaysia, which up to the 1990s had a lenient policy towards the retail sector regulations, are found to increasingly impose restrictions on the proliferation of multinational retailers, large-format shops and the domination of the market by a small number of retailers. In most cases these drives are being impelled by indigenous retailers. Malaysia, for instance, imposed a five-year renewable ban in November 2003 on the construction of large format retail stores in Klang Valley which includes densely populated urban areas like Kuala Lumpur. Thailand has also passed laws to restrict development of large format stores in inner city areas and is found to rely on competition laws to control them. The Thai competition commission has powers to search premises without a search warrant and to arrest violators. In Japan too, government regulations [such as the Amendment of City Planning law in 2006, Large-scale Retail Location Law (2000), City Centre Invigoration (Downtown Revitalization) Act 1998, etc.] have been drawn up to ensure smooth operation of traditional small stores parallel to the large retail outlets. There is also a law concerning the Adjustment of Retail Business Operations of Large-Scale Retail Stores, which regulates the operation of organised retail outlets in order to ensure that small and medium scale retailers operating within vicinity of large enterprises enjoy reasonable opportunities for business. The Indonesian experience shows that the growing number of modern retailers made suppliers' bargaining position and the traditional market increasingly weak. This prompted the government to enforce Presidential Regulation (No. 112 Year 2007) regarding management of traditional market, shopping centre, and modern shop, and Regulation of the Minister of Trade (Permendag, No. 53 Year 2008). Indonesia's Business Competition Supervisory Commission (KPPU) also restricted companies from expanding into areas where traditional suppliers operate. Individual cities like Jakarta too came up with similar restrictions.

China, in the first phase, allowed FDI in retailing with some restrictions like – only six major cities (viz., Beijing, Shanghai and Guangzhou, Tianjin, Dalian, Qingdao) and Special Economic Zones, foreign ownership restricted to 49% of joint ventures, limiting of foreign retailers that operate large retail to 50 units, etc. 2004 saw the government implementing a new retail law in which seek to strike a balance between incentives and regulations. The new law calls for abolition of geographical restriction, drastic reduction of minimum capital requirements, simplified approval process and non-mandatory joint ventures. Further, the foreign-invested enterprises (FIEs) enjoy tax incentives according to geographical location which widened the choice of location and modus operandi for FIEs. The regulations issued require foreign retailers to pass annual inspections before they can open any new stores and the local government is empowered to check for compliance with the regulations according to Ministry of Commerce, and in conformity to urban development and urban commercial development plans. Also, the domestic companies get more benefits than foreign ones in zoning and urban development requirements.

In Spain, the retail trade sector is subject to a broad set of regional regulations encompassing various aspects of shop opening hours, seasonal sales, definitions of large retail outlets, regional licensing of hard discount stores, moratoria in retail trade licence issuance, specific taxes on large retail outlets, etc. Although retailing is regulated by the regional governments, the central government has the power to establish basic general economic rules.

In France and Vietnam there is an Economic Need Test which examines the requirement for a retail outlet. There are stringent labour-related regulations in some nations while in Austria, Czech Republic, France, Hungary, Italy and Korea there are nationality requirements.

For New South Wales, the Director-General has the power to exempt shops from trading restrictions subject to conditions or in the exceptional circumstances of the case in the public interest like the nature of the shop and the kinds of goods sold by the shop and/or the likely effect of the proposed exemption on the local economy, tourism and small businesses and other businesses in the area etc. They had enacted regulatory acts like Retail Trading Act 2008 and Retail Trading Regulation 2009, followed by The Amendment Bill 2012. Regarding enforcement, the act has given powers to inspectors to investigate a possible contravention of the regulations. The proceedings for an offence against this Act or the regulations may be instituted only by the Minister or by a person with the written consent of the Minister, or by an inspector, or by a person, or a person of a class, prescribed by the regulations. It prescribes a five yearly review of the Act to be undertaken by the Minister to determine whether the policy objectives of the Act remain valid and whether the terms of the Act remain appropriate for securing the stated objectives.

Thus the experiences of emerging markets suggest that the appropriate implementation of FDI in multi-brand retail with effective checks designed to protect indigenous small and medium-size enterprises, is what is required to alleviate the sector in the case of India.

Proposed Regulatory Mechanism for Indian Multi-brand Retail

The current scenario indicates that large organized retailing has already entered into our domestic economic spaces which have their own peculiarities and need to be regulated in a contextual fashion. In India, all regulations regarding the retail sector is currently concentrated at the state level. Consequently it is being influenced by political parties of different ideologies. By varying across states the impact is also heterogeneous. Therefore the need of the hour is to consolidate the regulatory requirements and synchronize the laws in different states to do away with ambiguity of operations. Two major apprehensions that loom large at this juncture are that large retailers will leverage their strengths to (a) bully suppliers, farmers and consumers through anti-competitive means and (b) to push out smaller stores from the market merely by their marketing strategies.

Conclusion and Recommendations

The India government's policy on FDI in multi-brand retail trading has several riders built in as safeguards, and is perceived to be among the most stringent, globally. While the sector is experiencing over-regulation in some aspects, there remain some other vital areas in urgent need of regulation. Therefore, the researchers propose the incorporation of adequate checks and balances in the current FDI policy via regulatory mechanisms such as:

1. Formulation of a standard central law regarding enforcement of regulations relating to FDI in retail.
2. Setting up of a national level regulatory body overseeing the state regulatory bodies.
3. Formulation of uniform rules across states governing working hours and employment contracts.
4. Formulation of a "National Shopping Mall Regulation" Act to regulate the fiscal and social aspects of the entire retail sector.

5. Implementation of Goods and Services Tax (GST) and elimination of state border levies – creating "single window clearance" systems for collection of these taxes to facilitate efficient sourcing.
6. New controls for managing competition from new retail/store formats like e-retail, direct selling, and organized specialty retail, members-only sites for branded products/food items, etc.
7. Subsidies for the small and medium enterprises (SMEs) and traditional retail segments to help them meet the environmental and other health/hygiene standards.
8. Controls for gradual elimination of intermediaries and transparency of the supply chain in compliance with the government regulations.
9. Offer tax incentives according to the geographical location to widen the choice of location and modus operandi for foreign retail agencies.
10. Undertake a review of the current policy and regulations every three years

Given that the gains from allowing unrestrained FDI in the retail sector manifestly outweigh the disadvantages (as can be seen from the experiences in countries like Thailand and China), the government should continue with the policy of the gradually increasing the limit of equity participation over a period of time. A proper mix of regulations and incentives is what would boost India's image as a preferred investment destination in the retail sector.It is urged that a new regulatory framework be framed by GOI incorporating the proposed amendments. Implemented on a fast track, the revised policy would act as an enabler for a level playing field and competitive neutrality in the sector.

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