

New FDI Policy to Drive Retail Growth in India

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The \$428 Bn retail sector in India has received a shot in the arm by the Indian Government's recent policy decision to allow Foreign Direct Investment (FDI) of upto 51% in multibrand retail and upto 100% in single brand retail. Given that 95% of the sector constitutes unorganized retail consisting largely of 'mom and pop' stores, the Government has treaded cautiously by building adequate safeguards for the domestic stakeholders in the unorganized sector.

Foreign investments in retail will have to go through Government approval first. The policy mandates a minimum investment of \$100 Mn with at least half the amount be invested in back-end infrastructure, including cold chains, refrigeration, transportation, storage, packaging etc. Further, foreign retailers will have to source a minimum 30% from the Indian small and micro industry. Another key policy initiative to safeguard small/unorganized sector retailers is that FDI is being allowed only in 53 cities having a population of over 1Mn out of nearly 8000 cities/towns in India. Finally in India's federal structure, retail trade is a 'state level' regulation and it will be upto the states to allow foreign participation in the respective 53 cities within their states.

Overall, the new policy shall provide a significant boost to the \$28 Bn Indian organized retail market which is expected to reach \$260 Bn by 2020. With sluggish growth in the developed markets across the globe and Indian retailers being bogged down by high debt and high cost of expansion, the new policy presents a win-win situation for both foreign and Indian retailers. The stock markets also reflected the positive outlook for the sector, by pushing up some retail stocks by up to 30% within 2 days of the announcement.

The policy will positively impact a wide cross section of the Indian population. Consumers are expected to save 5-10% on their regular household spend and get a wider choice of products. Farmers will get 10-30% higher remuneration for their produce as back end infrastructure investment will emanate the middlemen. The infusion of capital and setting up of new stores will also provide a boost to real estate as well as create 3-4 million new jobs in retail and a further 4-6 million jobs in logistics, contract labour, security, etc.

There is apprehension and resistance to the policy from some political factions and small retailers/trade associations. However the current policy decision is clearly a point of inflexion for Indian retail. Political agendas of the non-ruling parties, may only delay the policy's roll-out but it is unlikely that they will be able to reverse the direction of FDI entry. This is largely because of the cautious nature of the policy which is clearly aimed at taking small steps at a time with its caveats and restrictions. Thus in principle, allowing for both the unorganized and organized retail sectors to grow and co-exist.

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Further, Corporate India and leading Indian organized retail players have come out in strong support of the policy. Clearly the Government has the backing of India Inc. on this one. For serious global retail players waiting in the wings with India aspirations, this is clearly the opportune time to consider an India entry.

While there is no debate on the timing or the opportunity, potential foreign retail entrants need to develop a deeper understanding of the market and its challenges and to draw up a robust entry strategy.

Multiple challenges exist that need to be overcome. For one, the complex regulatory system in India. There are various acts and laws that govern retail in India – the Shop and Establishments Act (state-wise act), a dated Weights and Measurements Act, the complex tax levy system which lacks a consolidated goods and services tax. Indian organized sector retailers have gone up the learning curve on this front and have processes and systems in place to handle these effectively. Rising real estate prices, especially in the 53 cities, coupled with adequate land availability in the right catchment is another strategic factor. New entrants will also need a phasing strategy to prioritize cities for entry. The mandate on 30% local sourcing and 50% investment in back-end infrastructure requires a thorough understanding of vendor selection and vendor development business practices and culture.

All these challenges combined with the policy of 51% FDI limit (at least for multi brand retail) strongly points to identifying and tying up with the right partners. Clearly the Indian organized retail players will be prime targets for JVs/acquisitions and the existing entrants like Wal Mart have a headstart and advantage here. However, given India Inc’s interest and support, it is not late for potential new global entrants to forge new win-win partnerships with reputed Indian corporates. Ultimately it is strategy combined with patience, localization, innovation and smart execution that will segregate the Winners from the also-rans.

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