Consumer products

India

ATTRACTIVE

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(Conditional) FDI in multi-brand retail approved. The Cabinet has approved the implementation of 51% FDI in multi-brand retail (MBR), subject to specified conditions and with several caveats. We note that the Cabinet had earlier approved the same in Nov 2011, but had suspended implementation post opposition from various parties. We believe it is a good move as foreign players would bring best practices, especially on supply chain back-end. However, we expect FDI inflow to be slow as local partnerships would need to be worked out; also, the right organized retail business model in India is still in the discovery phase. Policy implementation should provide some of the existing domestic retailers an opportunity to unlock value.

Cabinet approves 51% FDI in multi-brand retail; with several caveats, though

The Cabinet has approved the implementation of 51% FDI in multi-brand retail (MBR), subject to specified conditions and with several caveats. We note that the Cabinet had earlier approved the same in Nov 2011, but had suspended implementation of the policy post opposition from various parties. The following proposals around MBR have now been approved –

- **Retail sales outlets may be set up in those states which have agreed or agree in future to allow FDI in MBRT under this policy**. The establishment of the retail sales outlets will be in compliance of applicable state laws/regulations, such as the Shops and Establishments Act etc. We note that the Union Government has had discussions with various State Governments since Nov 2011 on this issue. Exhibit 1 looks at the stance of various State Governments.
- **Retail sales outlets may be set up only in cities with a population of more than 1 mn as per 2011 Census** and may also cover an area of 10 kms around the municipal/urban agglomeration limits of such cities. In states/Union Territories not having cities with population of more than 1 mn as per 2011 Census, retail sales outlets may be set up in the cities of their choice, preferably the largest city and may also cover an area of 10 kms around the municipal/urban agglomeration limits of such cities.
- **Minimum amount to be brought in as FDI is around US$100 mn. More importantly, at least 50% of total FDI brought in shall be invested in 'back-end infrastructure'** within three years of the induction of FDI, where 'back-end infrastructure' will include capital expenditure on all activities, excluding that on front-end units. Expenditure on land cost and rentals, if any, will not be counted for purposes of back-end infrastructure.
- Other conditions/safeguards, approved by the Cabinet on Nov 24, 2011, would remain unchanged. We note the key ones –
  - **Retailers must source at least 30% of manufactured/processed products from small industries**, which have total investment in plant and machinery not exceeding US$100 mn.
  - Fresh agricultural products, including poultry, fishery and meat products, may be unbranded. The Government will have the first right to source agriculture produce.
  - Self-certification will be done by the company to ensure compliance of all the conditions.

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Under single-brand retail, the following changes have been proposed:

- 30% of the value of goods purchased will be done from India, preferably from micro, small and medium enterprises (MSMEs), village and cottage industries, artisans and craftsmen, in all sectors, "where it is feasible"
- Thus as per the new rule while 30% of the goods have to be sourced domestically, it is not mandatory to engage MSMEs, village and cottage industries, artisans and craftsmen
- Sourcing 30% of the products domestically would imply that the single-brand retailers would have to build production capacities in the country, catering specifically to their sourcing requirements
- With respect to ownership of the brand, under the new rule, only one non-resident entity, whether owner of the brand or otherwise, shall be permitted to undertake single-brand product retail trading in the country, for the specific brand, through a legally tenable agreement with the brand owner
  - This change was introduced as globally single-brand retailers often adopted multiple business models, wherein the brand owning entity and investor entities were kept separate

A good step but we expect slow pick-up; several issues linger, none more so than the questionable economics of organized retail in India

We believe that opening up the retail sector in India to the international players is a good step. Benefits are several; however, (1) these would take time to show up, and (2) so are the challenges. The key benefits of allowing the entry of foreign players in the retail sector in India include (1) international players would likely bring best practices on supply-chain integration and technology back-end, (2) better supply chain integration could mean reduced post-harvest losses and more efficient price discovery for the farmers, and (3) the requirement of 30% sourcing from small local industries would expose them to global best practices and possibly, help them move up the efficiency curve and potentially integrate themselves with global retail chains.

That said, we believe entry of foreign players is unlikely to happen in a hurry; it will likely happen over a sustained period of time on account of (1) difficult conditions being faced by international players in their own jurisdiction (especially in US and Europe) and more importantly, (2) several challenges with the organized retail business model/economics in India. Most Indian organized retail players are generating sub-par returns (we have in fact seen a few casualties). Some of the key challenges, in our view, are –

- Building scale is critical but doing the same while grappling with supply-chain challenges is tricky at best and can be a sustained drag on returns.
- High real estate prices render the per sq. ft economics comparable, if not worse, than some of the successful mom-and-pop local retail stores. Scale benefits have proven elusive mostly.
- Sourcing and logistics infrastructure is not well developed.

In addition to these operational and business model challenges, working out local partnerships would also take time, in our view.

Exhibit 1: Stance of various State Governments on FDI in MBR

Stata/ Union Territory	View on FDI in Multi-brand retail
Delhi	Expressed support in writing
Assam	
Maharashtra	
Andhra Pradesh	
Rajasthan	
Uttarakhand	
Haryana	
Manipur	
Daman and Diu	
Dadra and Nagar Haveli	
J&K	Publicly endorsed through press statement
Bihar	Expressed reservations
Karnataka	
Kerala	
Madhya Pradesh	
Tripura	
Orissa	

Source: Press reports