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India's retail FDI bid fails to sell

By Kunal Kumar Kundu

NEW DELHI - Why are foreign retailers not interested in India?

An apparently substantial policy measure, nay, a revolutionary leap (as the mandarins in the government would want us to believe), was announced on September 14, 2012, and everybody started to believe that the Indian government has finally been able to overcome the policy paralysis gripping it thus far and would end its current tenure in a blaze of glory.

When India finally allowed 51% foreign participation in multi-brand retail, the pall of gloom was suddenly lifted. It was believed that, besides improving the investment sentiment (which would also result in large inflow of foreign currency which would help finance the current account deficit), the policy would also bring about large benefits to farmers, small manufacturers, consumers and young job seekers.

Unfortunately, however, even after seven-and-a-half months have elapsed since the grand announcement, the Walmarts, the Tescos and the Carrefours of the world have maintained a studied silence. So what gives?

The government, while approving foreign participation in the retail sector, had two major objectives. One was to show that things are under its control, the second to ensure that there's not too much opposition to its politically contentious move. While eventually its didn't succeed in either (currently the politically hamstrung government is stumbling from one corruption scandal to another and is barely surviving, while the opposition is looking at every opportunity to derail foreign direct investment - or FDI - in retail), the policy in itself turned out to be way too restrictive for the liking of the would-be foreign investors.

The policy envisages that at least 50% of total FDI in the retail sector (minimum investment requirement being US$100 million) shall be invested in "back-end infrastructure" within three years of the first tranche of FDI. This would include investment made towards processing, manufacturing, distribution, design improvement, quality control, packaging, logistics, storage, warehouse, agriculture market produce infrastructure and so forth.

Crucially, however, expenditure on land cost and rentals, if any, will not be counted for the purposes of investment that can be considered as back-end infrastructure.

Clearly, this is way too restrictive. The fact is, all the retail sector does not require the same back-end and front-end allocation. While food retail, for example, would require higher investment in back-end infrastructure, other consumer retail might require higher investment in front-end infrastructure. Also, in case of most fast-moving consumer goods and durable products, the back-end infrastructure is fairly developed already and hence would require little additional allocation.

Additionally, retail sales outlets may be set up only in cities with a population of more than 1 million as per the 2011 census and only in those cities where the state governments allow FDI in retail. There are only 53 cities in India with a population of 1 million and above, of which only around 20 cities will allow FDI.

For India, with prices for retail space being exorbitantly high, especially in the large cities, disallowing investment in retail space infrastructure as part of mandatory back-end infrastructure investment makes it an even more expensive proposition for the investors.

Also, since companies would be allowed to set up outlets only in those cities where the respective state governments would allow FDI and to ensure that local mom and pop shops are not too impacted by the foreign retail giants, the policy has also disallowed retailing in any form of e-commerce.

The FDI policy in retail trade also mandates 30% procurement from micro, small and medium-sized enterprises. This is clearly inconsistent with World Trade Organization (WTO) requirements to which India is a signatory. The "National Treatment" clause under Trade Related Investment Measures of the WTO is at clear variance with the FDI policy and one can expect multiple representations to the government on this issue.

It seems that, in an effort to send out a message to the world after months of being plagued by policy paralysis that the government is still up to the challenge despite serious constraints, it hurried through the entire process and inserted debilitating restrictive clauses simply to garner support for the passage of the bill rather than opting for a wider discussion and making it a business friendly move.

Now that the move has received very thin support, there is little chance of the government diluting some of the restrictive clauses as it is faced by a hostile parliamentary opposition looking at every possible opportunity to bring them down. Nor can the government afford to allow the bill to collapse as that would cost it whatever credibility it built up through the passage of the bill.

Senior executives and representatives of global retail chains such as Walmart and Carrefour recently met government officials in New Delhi to lobby for concessions such as making investment in real estate part of the mandatory US$50-million investment that foreign retail companies have to make in back-end infrastructure, lowering the minimum investment figure itself, and diluting the mandatory 30% local sourcing requirement. They were clearly told that there can be no further discussion on these clauses and that they would have to operate within the set parameters.

It is not a surprise, therefore, that so far not a single global retailer has shown any inclination to invest in the Indian retail space. In fact, in March, when India's commerce minister claimed that one of the UK's leading retailers, J Sainsbury PLC, had shown interest in setting up stores in India, the company publicly refuted the claim.

It seems, therefore, that the eventual granting of permission for FDI in the retail trade in India was simply used as a signaling tool for foreign investors by a government unsure of its survival rather than a government that means business.

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