CUTS International

Policy Options Note

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Regulatory Reforms to Boost Organised Retail in Rajasthan

The overall development of organised retail in the country is determined by the different state initiatives in this regard, since retail is a subject on the state list. The recent decision of the Government of India to allow FDI of up to 51% in multi-brand retail and 100% in single-brand retail has been welcomed by Rajasthan.

A nod to the foreign chain retailers to set up stores in the state is not sufficient to entail development of organised retail in the state. In order to be able to reap benefits of this policy change for various levels of the economy and society, the Government of Rajasthan needs to put in place an exclusive retail regulatory regime in order to create an investment attractive policy and regulatory atmosphere and thus, conducive to inclusive development. This note lays out the context.

Introduction

The word retail is derived from the French word retailer, means to cut off a piece or to break bulk. Therefore, a retailer is a dealer or trader who sells goods in small quantities. Retailing is the final step in the distribution of products, for consumption by the end consumers. It consists of all activities involved in the marketing of goods and services directly to the consumers. India ranks 5th on Global Retail Development Index (GRDI) published by AT Kearny in 2012. Retailing in India is one of the pillars of our economy and accounts for 14 to 15 percent of its GDP.

In local terms, retailing in India can be broadly classified into organised or modern retail and un-organised or traditional retail. Organised retail chains comprise only 6% of the Indian market. Rest 94% market is comprised of mom and pop type shops or *kirana* stores and hawkers.

A developed organised retail sector brings along numerous opportunities of growth and employment generation. Retail marketing is one of the largest employment generating industry. It provides employment to skilled, semi-skilled as well as to unskilled persons. Thus it helps in the socio-economic development of the society.India's retail and logistics industry employs about 40 million people (3.3% of the population). Consumers benefit from competitive pricing, choice, quality of products. Organised retailers make investment in the back-end drive to streamline upstream processing and distribution logistics.

In India organised retailers operate in the most "super-market hostile" environment. The obstacles they are confronted with range from a lack of adequate infrastructure, high costs of real estate, complex and sometimes un-necessary regulations, inadequate cold-storage facilities to a multiple and complex taxation system. A list of typical clearances required by these retailers can be found in the Annexure to this note.

This makes a case for the need of regulatory initiatives and policy reforms on the part of the state government for smooth setting up and functioning of the shops in a fair and competitive environment.

Recommendations for Regulatory Initiatives for Boosting Organised Retail in the State

- **Establishment of a Swift Approval Process an attractive Investment Climate**

The approval process and the concerned rules towards allowing a new entity should be simplified, transparent and less time consuming. Single window clearance system should be adopted. Quick administrative procedures, land for establishing the store, adequate power availability, a developed infrastructure and upfront highlighted exemptions and concessions smoothen the process of setting shop and would make Rajasthan an attractive organised retail investor destination.

- **Establishing a Platform for Retailer-Farmer Direct Contact**

A buyer-seller platform would be beneficial to retailers in accruing a better terms of trade. It would also ensure farmers to be more efficiently connected to the urban economy; otherwise the farmer is primarily dependent on the local *mandi* which hasn't yet witnessed any significant modernisation.

This would help in addressing the major problem faced by the retailers of being able to come in direct contact with the farmers, due to the presence of the rent-seeking APMC officials and their middlemen. The APMC act needs to be repealed.

This platform would also lead to: a) compliance with contracts by both retailers and suppliers; (b) equal treatment among suppliers; (c) prompt payment; and (d) cooperation in logistics development.

Argentina – Code on Good Commercial Practices

In Argentina, the Competition Commission has formulated a national regulation to closely regulate supermarkets and their relations with suppliers—if the retail, wholesale, processing, and farming sectors did not formulate and self-implement a private code of commercial conduct. Retailers and suppliers in Argentina responded to this "potential stick" policy and in July 2001 signed the Code of Good Commercial Practices, the first of its kind in Latin America and probably the first in the developing world.

- **Licensing Policy to Large scale Retail**

A proper licensing policy needs to be designed and licenses should be distributed on the basis of the definition retail outlets and based on population under a single municipality. License can be distributed through auction to avoid any kind of malpractices as a part of crony capitalism. The entrant may be asked to make a presentation before regulatory authority to get license by demonstrating their game plan that conforms to urban commercial development. In case of expansion/joint venture, incumbent may also ask for similar presentation before the regulatory body. Penalty provisions should be there including withdrawal of licenses in case of violations of terms and conditions of licenses.

Spain – Retail Trade Law 7/1996

Spain has demonstrated a similar practice to enhance its base of modern retail trade. In Spain, powers over domestic trade are transferred to the regions, meaning that retailing is regulated by the regional governments, although the central government has the power to establish basic general economic rules.

Retail Trade Law 7/1996 of 15 January 1996 introduced a series of administrative requirements, including, in particular, the need for large retail outlets (2,500 m^2 or more) to obtain a second specific licence before opening, in this case a regional licence, in addition to the municipal licence.

- **Establishing a State Retail Regulatory Body**

There is need for a regulator to oversee the functioning of the modern retail outfits and the constraints faced by them in their dealings for procurement of supplies, taxation structure faced, infrastructure inadequacies, etc. The regulations should be made on the following lines:

- Choice of location and modus operandi of the retailer
- Provision of oversight regarding the business practices of retailers
- Hours of operation
- Specific tax laws/differential tax structure for large retail outlets to encourage organised retail as well as boost revenue of the state.
- Inter-state retail trade
- Business strategy of the retail chain to protect producers' (mainly farmers and small scale enterprises) and consumers' interest, particularly relating to anti-competitive practices

Japan – Store Location Law

The Ministry of Economy, Trade and Industry (METI) designed Store Location Law (SLL) that gives local governments the primary responsibility for the regulation of large stores, subject to important constraints. The new regime shifts the basis for store regulation from protecting small retailers to preserving the physical environment surrounding new stores.

Thus, a new large stores law is introduced that gives powers to local authorities to regulate retail outlets sized between 500 and 1,500 square meters. The authorities can insist on changing the size of the store, working hours and even the number of holidays in deference to small stores. Retail stores are also given tax holidays.

Small stores exist alongside big stores, not because of a benign large store culture but due to government regulations.

Effects on & Protective Measures for Traditional and Mini Markets[1]

Government policies should support the supermarket development as a part of their modernisation policies but at the same time this liberalisation should be adopted in a step-wise procedure for the parallel growth of traditional retailers with the supermarkets.

Some Relevant Experiences

In densely populated countries (with consequent higher real estate prices) of Europe and Japan, small-store formats thrive and flourish even in the face of competition from big-box retail. However, introduction of foreign competition forced manufacturers to cut costs in their supply chains and small stores became more efficient. This has been seen in Indonesia and Brazil, where even after opening the retail sector to FDI, 50-70 percent of the trade in groceries, fruits and vegetables takes place through the traditional small stores.

In Germany one of the large supermarket chains is actually a cooperative of small stores. By coming together under a large cooperative, the small retailers retained a large level of ownership and independence while gaining the cost, marketing and process-capability advantages of modern retail. Hence, it is possible for small store owners to respond and acquire many of the key advantages of large stores while building on their own areas of strength.

What is clear is that in India, and notwithstanding the political dogma and fears of the trading community, the prognosis of the traditional (and the innovative modern independent) retail sector's demonstrated ability to hold its own against corporate players in the organised sector has so far been good.

Experience also shows that rather than decimating the traditional retail shops,

[1] Chapter on 'Regulating Retail Distribution in India'. Competition & Regulation in India, 2011-CIRC & CUTS. *Forthcoming*

competition from the organised sector in the past few years has in fact spurred the traditional retailers into upgrading to modern formats with convenient and better organised displays, ICT-enabled storage and procurement management and electronic billing counters etc. on the one hand, and on the other to improve their services and customer-interfaces by making home deliveries and customising the offerings to specific consumer preferences.

In the case of China, since liberalisation of retail sector in 1992, the number of small outlets equivalent to *kiranas* have increased from 1.9 million to over 2.5 million and employment has in both wholesale and retail sectors nearly doubled from 28 to 54 million in less than a decade.

BRIC Country Cases

A case in point is that the local online book stores like Flipkart are out-competing the global giant Amazon, simply by virtue to tweaking the online advance-payment-by-credit cards to the more acceptable cash-on-delivery mode. Similar customisation to meet Indian consumer's idiosyncrasies are being noticed in every retail product segment, and it is the local firms that are always first to adopt while the MNCs are trying to implement their global practices.

Forecasters are also unanimous in their assessment that even if the share of modern retail grows from the present less than 5 percent to the estimated 16 percent by 2016, the absolute market size of traditional retail will be larger than that of the organised retail.

Analysis of available data on the impact of big players on small retailers in Brazil indicates that the India projection is not a one-off case. Even after opening up to foreign investment in 1994, traditional small retailers in Brazil managed to increase their market share by 27 percent. With the introduction of FDI and efficiencies of organised retail, it is to be hoped that the pro-active traditional retailers in India will also adopt some of the best practices by consolidation and collectivisation of purchases and integrating with logistics operators for addressing the price and quality concerns of consumers.[2]

Conclusion

The organised retail domain has a long way to go in the state as well as the country, if any substantial benefits are to be reaped for the country. In order to develop healthy competition for investment, each state must adopt the best practices prevalent in the others and identify policies that will have the maximum impact on the development and spread of organised retail in the country.

There is a need to make necessary reforms and to introduce new regulatory actions that can help make seem the retail market less 'hostile' to the organised sector players. The 51% foreign direct investment is only the first step in this direction.

Note: This policy note has drawn a few facts from the ICRIER Report, Impact of Organised Retailing on the Unorganised Sector

[2] Earlier research by OECD (1997) and by Reardon *et al* (1996) suggests that large firms or firms who have co-operative arrangements tend to innovate more than small independent firms. But with India's head-start in the cooperatisation experiment since 1980s, it is possible that even the smaller independent firms might quickly group together and try to benefit from collective/large scale sourcing to compete against the large corporate retailers.

Annex 1

<u>Typical clearances required for retail stores</u>[3]

A. General

1. Trade License
2. NOC for Fire License from Municipal Corporation
3. Health and Sanitary License
4. Registration under Weights and Measures Act
5. Forecourt License (for sale outside the shop area) (if required)
6. Signboard License (Within & Outside the Store)
7. Approval from the State Pollution Control Board (water disposal / solid waste disposal) (if required)

B. Operations Related

1. APMC Licenses (F&V and Staple - Procurement and Sale)
2. Eating House / Food License (Food & Beverages)
3. FSSA clearances – under the integrated food law, which covers over 16 laws
4. PFA License required for the different categories of products stored / sold in the distribution centres (DCs) under the Prevention of Food Adulteration Act (PFA)
5. Cold Storage License – under the Factories Act, but now also under the Warehousing (Development and Regulation) Act
6. Sweets Shop (Shop-in-Shop) License (if required)
7. Licenses under the Drugs and Cosmetics Act, 1940 and the Drugs and Cosmetics Rules
8. Household Pesticides and Insecticides License (if required)
9. Registration of manufacturers, packers, and importers under Rule 35 of the Standards of Weights and Measures (WM) (Packaged Commodities) Rules
10. Essential Commodities Act - Storage Control Order
11. Manufacturer's Warranty to Consumer under the PFA Act

C. Infrastructure Related

1. Power Connection
2. DG Set Approval as required from the Local Electricity Board
3. License if the Facade of the Store faces a Road (if required)
4. License for Ground Water Storage and Usage

D. Labour Related

1. Shops and Establishment Act
2. Employees PF Act- Apply for PF Code
3. Employees State Insurance Corporation (ESIC) Act regarding Medical Benefit/Sickness Benefit and Employment Injury
4. The Contract Labour Act
5. The Payment of Gratuity Act
6. The Factories Act

E. Taxation Related

1. Professional Tax (if applicable).
2. Octroi / Cess in lieu of Octroi (if applicable)
3. Entry Tax (if applicable)
4. Service Tax Registration
5. Permanent Account Number (Income Tax
6. Sales Tax Registration (State-wise) - VAT & CST

[3] Source: Retailers Association of India.