

# India's Retail Ties That Bind

*New Delhi needs to get a grip on food-price inflation by modernizing inefficient supply chains*



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New Delhi

If there's one cloud on the silver lining of India's economic recovery, it's food-price inflation. Wholesale food prices rose by 17.4% in mid-January compared to a year earlier, and food inflation hit a 12-year high of 20% in December. While the government lays much of the blame on last summer's poor monsoon, that argument misses important steps New Delhi could be taking to counter this problem. Liberalizing regulations on the distribution of farm produce and retailing should be at the top of the list.

Low food output is not the inflation driver this time. Output is expected to be about 230 million tons this year, not much different from a year ago. The government also holds buffer stocks of essential commodities like wheat and rice. At the other end of the food chain, demand has increased no more than 4% over the previous year—an increase attributable to rising prosperity and a growing population.

Instead, something is going badly wrong along the supply chain. India loses as much as 15% of its annual cereal and grains output, and as much as 35% of its horticultural output, to a systemically inefficient distribution and retail system. Vegetables and grains rot or get eaten by rats and other vermin wending their way through a labyrinthine route from farmer through multiple middlemen to store shelves and street hawkers.

Giving greater scope to relatively large, modernized retailers is key to fixing that problem. In other countries, supermarket chains and big boxes have built up extensive experience in creating and managing super-efficient supply chains to offer consumers lower prices and dampen inflationary trends. Their size allows them to develop relationships with more efficient producers, and apply

efficiencies of scale in moving the goods to retail shelves with minimal wastages and in quickest time.

Yet successive Indian administrations over the past 15 years have taken a head-in-the-sand attitude when it comes to reforming and modernizing India's retail system. Foreign investment is strictly limited. Overseas companies can own at most a 51% stake in "single-brand" retailers—typically boutiques like a Nike or a Benetton store. Foreign investment in any other kind of direct-to-consumer multi-brand retail enterprise is banned. This bars even joint ventures between Indian companies and foreign supermarket chains or consumer-goods big boxes like Wal-Mart or Carrefour.

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Wal-Marts like this one in Amritsar, India, can fight food-price inflation.



India's investment rules are so draconian they even hinder the development of local equivalents of the foreign retailers. Conglomerates like Tata, Birla, Ambani and Mittal have all attempted to enter food-and-grocery retailing with mixed success. They've been hampered by their inability to accept any direct foreign investment in their retailing ventures, even from overseas financial investors like pension plans or mutual funds who simply want an equity stake and wouldn't be exercising any day-to-day business role.

Notwithstanding these challenges, those Indian companies are pushing ahead. Some are forming creative partnerships with foreign retailers. Wal-Mart and Bharti Enterprises in 2007 launched a

joint venture in cash-and-carry wholesaling: Since they can't sell directly to consumers, they're instead trying to bring "everyday low prices" to India by selling to small retailers who hopefully pass the savings to consumers. Germany's Metro has tried to go that route on its own. Tesco is poised to launch its own foray into the market later in 2010 with a partnership with the Tata Group.

Yet once such a company, Indian or foreign, manages to set up shop, the regulatory challenges are just beginning. Whereas back home Tesco or Carrefour might build relationships directly with farmers or middlemen of the retailers' choice, in India farmers are allowed to sell their produce only to government-appointed Agricultural Produce Marketing Committees. Regulators have discouraged the development of agricultural futures markets, so retailers are forced to manage their purchases through spot buying.

Shipping produce across state lines is a nightmare—not only is physical infrastructure bad, but states impose their own tariffs and regulations. Stocking up on nonperishables to manage inventory can run afoul of antiquated "anti-hoarding" laws. And every state and district has the power to impose its own retail regulations, including trading hours, employment of female workers, weekly days off and a range of other licensing rules. The absurdity can be seen in the National Capital Region of Delhi itself. Delhi now allows seven-day operation of retail stores with prior regulatory permission, yet in the neighboring suburb of Gurgaon, even shopping malls have to observe a weekly day off.

Reform has proven politically impossible up to now because it would ruffle many entrenched feathers such as distribution middlemen, and challenge India's longstanding pro-regulation political dogma. But if India is to manage its food security and battle inflation, it has to adopt a more pragmatic, modern vision for its retail industry, supported by bold reforms at the farm end as well as the distribution and retail end. Delay will prove costly for hundreds of millions of poor Indians who bear the brunt of food-price rises.

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