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ORGANIZED RETAILING IN INDIA: ISSUES AND OUTLOOK

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ABSTRACT

Domestic and multinational corporations have begun to enter retailing in India, raising concerns that they will destroy the millions of small stores and street vendor businesses that presently dominate retailing in the country. Policymakers know that corporate retailers can improve the efficiency and productivity of retailing and distribution in India, but they are also concerned about possible harm to small businesses and loss of jobs among those who might not have the skills and training needed to find alternative employment.

We examine whether corporate retailing has already harmed small retail businesses in India (and to what extent if so) and how much damage might occur in the future. We discuss how corporate retailing might benefit small retailers and consumers and consider how small and large retailers might coexist in a country where, in the next twenty years, 40% of the population and 70% of gross domestic product may be concentrated in urban areas. We consider problems that may arise if organized retailing grows and suggest ways in which such problems could be addressed by policymakers.

1. INTRODUCTION

Where India shops in the future is at the center of a vigorous and ongoing debate. On one side of the debate are the millions of street and pushcart vendors and small retail stores that have dominated Indian retailing for centuries. On the other side are large Indian and multinational corporations seeking new opportunities in retailing. Small retailers claim that large firms, especially multinationals, will destroy entrepreneurship and rob them of their livelihoods. Large businesses say that they can provide better and cheaper products and bring badly needed investment, efficiency, organization, and know-how to retailing. Policymakers in India are wary of making changes that might harm small businesses and erode employment, but they also seek to promote greater efficiency and productivity in a growing sector of the economy that presently accounts for 37% of the country's gross domestic product (GDP).

Retailing is presently one of the few sectors of the economy in which the Indian government limits entry by foreign firms. Some retailers have entered the Indian market under a provision allowing them 51% equity ownership in their Indian operations provided that they sell products under a single brand name. Examples of such firms are Louis Vuitton, Cartier, Armani, Reebok, Marks and Spencer, Debenhams, Next, Bodyshop, Oshkosh, and Carter's. International firms that want to sell multiple brands cannot open retail stores but can own 100% equity in wholesale stores. Their customers must be institutional buyers who pay in cash and carry the merchandise from the store shelves. Between 2000 and 2010, multinational companies like Walmart and Metro invested about $1.8 billion in such cash-and-carry stores that sell to retailers, cooperatives, hotels, restaurants, caterers, and various food and non-food traders (Department of Industrial Policy and Promotion 2010). They offer lower prices and wider assortments than traditional wholesalers and are open for longer hours. Still, most multinational firms see cash-and-carry wholesaling as a point of entry into India. Their aim is to obtain government approval for 100% foreign direct investment (FDI) in multi-brand retailing.

Whether FDI in multi-brand retailing is allowed in India will depend on several considerations. Joseph et al. (2008) observed that it is necessary to meet growing consumer demand and bring needed investment to the supply-chain infrastructure. They reported that an expansion of corporate retailers has a limited, short-term effect on small stores. In addition, they suggest that new and better jobs in small-scale manufacturing, food processing, and distribution are likely to more than make up for any loss in jobs due to the growth of organized retailing. Still, a report by the Parliamentary Standing Committee on Commerce (2009) expressed reservations about the effects of organized retailing on jobs in informal retailing and about the potential for predatory pricing and monopolistic practices by corporate retailers.

This paper examines key issues related to the development of organized retailing in India. Section 2 reviews the recent performance of India's retailing sector. Despite bold projections, it turns out that organized retailing has been only moderately successful. Large retailers have struggled for profitability while small retailers, including those selling food, have prospered and grown. Section 3 discusses possible reasons for the modest success of large retailers. Section 4 outlines short- and long-term prospects for retailing in India. It examines why retail sales are likely to grow at a slower rate than GDP; why sales of food are likely to grow at a slower rate than sales of transportation, communication, and durable goods; and what such trends imply for the need and opportunities for organized retailing. Section 5 considers the benefits that corporate retailing could potentially bring to the distribution system in India. Section 6 examines how organized retailing is likely to grow over the next twenty years. It suggests that a disproportionately high rate of urban growth in both population and economic activity will create a surge in urban demand that will allow both small and large retailers to prosper. Rural growth will be slower and can be stimulated in part by giving incentives for investment in the supply chain or requiring such investment by multinational firms seeking entry into multi-brand retailing. Section 7 examines various problems that can arise with the growth of organized retailing and suggests ways in which these may be addressed by policymakers.

2. ASPECTS OF RETAILING IN INDIA

Types of retail businesses

Businesses in India are commonly categorized as either formal or informal and as organized or unorganized. To understand the Indian retail climate, we must define these distinctions.

According to the Ministry of Labor and Employment,[1] the informal sector consists of unincorporated businesses that are owned and run by individuals or households. These businesses are not legally distinct from their owners, who raise capital at their own risk and have unlimited personal liability for debts and obligations. Informal businesses typically employ family members and casual labor without formal contracts. Formal businesses are corporations,

[1] See "Informal sector in India: approaches for social security," an undated report by the Ministry of Labor and Employment, Government of India.

limited companies, and businesses run by or on behalf of cooperative societies and trusts.

The organized sector comprises incorporated businesses. Information about this sector is available from company budgets and reports. Importantly, partnerships, private and limited companies, and businesses run by cooperative societies and trusts are not considered to be organized businesses in India. Instead, they are classified as part of the unorganized sector, which also includes all businesses in the informal sector.

As Figure 1 shows, organized retailing includes some large incorporated stores, and all chain stores, supermarkets, hypermarkets, department stores and store-in-stores. Unorganized retailing includes all informal retailers, including kirana stores, paan shops, vegetable and fruit stalls, street hawkers, and pushcart and street vendors. It also includes general merchants, chemists, appliance stores, and various specialty stores that are part of the formal sector but that operate as partnerships, private and limited companies, cooperatives, or trusts.

Retail employment

Retailing is the second largest employer in India after agriculture. According to the National Survey Sample Organization (64th Round), retailers employed 33.1 million people — an estimated 7.2% of all workers in the country — in 2007-08 (Department of Industrial Policy and Promotion 2010). Informal retailing provides employment to the individuals and families who run the country's 12 million or so kirana stores and to the casual workers such as shop and delivery boys who they employ. Informal retailing also provides employment to about 3.4 million street vendors and several million pushcart vendors who sell products door to door and on the street. In contrast, organized retailing, a category that includes supermarkets and hypermarkets, employ about 500,000 people, almost all in urban areas. Reardon, Timmer and Minten (2010) note that supermarkets and business hubs have rapidly grown in rural towns in India.

Retail employment grew at a slower rate than overall employment in India between 2005 and 2006. More recently, the two have grown at about the same rate because retail employment rates have risen and overall employment rates have fallen. Between 1999-2000 and 2004-05, employment in retailing grew by more than 30% in rural areas and by less than 3% in urban areas. Thus, the major growth in employment during this period was in rural areas.

The Parliamentary Standing Committee on Commerce (2009) has noted that there is still no systematic, large-scale study examining how corporate retailing affects small stores. Limited evidence is provided by Joseph et al. (2008), who use the results of a survey to conclude that the entry of an organized retailer leads to the annual closure of about 1.7% small stores in its neighborhood. The authors note that by changing the mix of the merchandise and offering more services to consumers, small retailers were able to regain sales and profits that they initially lost when a corporate retailer entered their neighborhood.

Retail sales

Table 1 shows the Economist Intelligence Unit's (2008) estimates for total retail sales in India between 2004 and 2009. It also shows Euromonitor International's (2010) estimates for formal-sector retail sales over the same period. We infer informal-sector sales and the shares held by each sector using these two data sets. Differences in data-collection and estimation methods, and in the years in which the estimates were made, can introduce errors in the estimates. With this caveat, we can draw several important conclusions about the status of retailing in India and trends in its development.

First, total retail sales increased by approximately 70% between 2004 and 2009, from $294 billion to $496 billion. Second, sales grew over this period by about 43% for retailers in the formal sector and about 97% for retailers in the informal sector. The annual average rate of sales growth was about 11% for all retailing, 7.5% for organized retailing, and 14.5% for informal retailing. Thus, from 2004 to 2009, retail sales grew almost twice as fast in the informal sector as in the formal sector and at a substantially faster rate than India's GDP, which grew at about 8.5% over the period. Third, in 2007, total retail sales in the informal sector surpassed those of the formal sector. By 2009, the informal sector held about 56% of retail sales, 8% higher than its 48% share in 2004. These data suggest that informal retailing is more than surviving; it is flourishing. At present growth rates, the gap between formal and informal retailing will continue to widen — family-owned stores and street vendors will take a larger share of retail sales.

Since all organized retailing is part of the formal sector, we estimate retail sales for the organized sector as approximately $5 billion (3.3% of $153.63 billion) in 2003 and approximately $11 billion (5% of $218.92 billion) in 2009. The remaining sales in the formal sector, then, represent unorganized retailing. We can infer that unorganized retailing grew from about $148 billion (96.7% of $153.63 billion) in 2004 to about $208 billion (95% of $218.92 billion) in 2009. Equivalently, unorganized formal retailing grew at an average annual rate of about 6.3% from 2004 to 2009.

To summarize, the average rate of sales growth from 2004 to 2009 was about 14.5% for informal retailing, 7.5% for organized retailing, and 6.3% for unorganized formal retailing. That means that the share of sales for the last group declined. Organized retailing has grown in the last decade but at a substantially lower rate than predicted by industry analysts a few years ago. For example, Joseph et al. (2008) predicted 10% annual growth for unorganized retailing and 40–45% annual growth for organized retailing between 2008 and 2012. They projected that the share of organized retail would grow from about 4% in 2008 to 16% by 2011-12. However, the performance of the organized retail sector has fallen far short of these expectations, and future prospects are less sanguine.

There may be several reasons why sales in formal unorganized retailing grew more slowly than organized retailing and informal retailing. First, it is likely that large corporate retailers compete most directly with other retailers in the formal sector and less directly with retailers in the informal sector. For example, hypermarkets and department stores might take disproportionately more sales from mass merchandise stores and specialty stores than from kirana stores and street vendors. Second, to take advantage of growth opportunities, some formal unorganized retailers might have incorporated and registered and now are reclassified as organized businesses. For example, a privately owned appliance store might grow into a store selling a full range of durable goods, which have seen substantial demand in the last five years. It might then be reclassified as an organized retailer after it develops into a larger organization and registers as a corporation.

Still, aggregate projections of the sort discussed so far are not sufficient to meaningfully predict the need for organized retailing in the future. Retailing of durable or transportation goods requires substantially greater investment and organization than is feasible for small retailers, and, as we discuss later, these are the retailing areas that are likely to grow fastest in the next several decades. Long-term demand projections that are disaggregated by industry and rural/urban area are necessary to make reasonable assessments of both the need and the likelihood of substantial corporate investment in areas such as distribution systems and related infrastructure, the benefits of which accrue over decades.

Food sales

Groceries are a large share of retail sales. Table 2 shows Euromonitor's (2010) estimates for the share of food sales that comes from in-store food retailing. The estimates for total sales include sales by street and pushcart vendors.

Between 2004 and 2009, small grocery stores lost about 3% of market share. However, because primary demand for food has been growing, these small stores still increased sales by 22% during the same period. The sales base for these stores is so large that 22% amounted to Rs. 815 billion, or about 62% of the Rs. 1,324 billion in incremental store sales over the time period. Thus, while small stores might have gained even more sales if organized retailing had not entered the market, they still grew in a growing market. The data in Table 2 do not suggest that small food retailers are being decimated or that the entry of organized retailers has harmed the jobs and livelihoods of small retailers and their workers.

Table 3 shows sales and market shares of the key organized grocery retailers in the organized sector from 2005 through 2009. Individually, each of the firms shown has less than 1% of the market. Among them, the top five accounted for 2.3% of grocery store sales in 2009. The total share of sales for hypermarkets and supermarkets grew from Rs. 27.5 billion (about a $\frac{1}{2}$% market share) in 2004 to Rs. 177.7 billion (nearly a 3% market share) in 2009. Reardon et.al. (2010) report that the share of fresh produce in leading chain stores has risen to 10-15%, a level achieved after 15-20 years in Mexico and 40 years in USA. But profitability has eluded organized retailers. Some, including Vishal Trading and Subhiksa Trading Services, have closed. Subhiksa was once the second largest retail chain in India with about 1,600 discount food stores. Other organized retailers have incurred losses and cut back on planned expansions since 2009.

3. ADVANTAGES FOR SMALL RETAILERS

Various reasons have been given for this limited success by organized retailing in India so far: inflated expectations of retailers, unsustainably fast growth, lack of acceptance by consumers with longstanding shopping habits, lack of experience among organized retailers, lack of trained sales personnel, sharply higher store rentals, and aggressive reactions by unorganized retailers to retain customers. Almost every organized retailer now recognizes that it cannot compete with unorganized retailers in all product categories, even on prices. For example, food stores like Reliance Fresh offer lower prices on fresh produce, but their prices for packaged goods are typically higher than those of unorganized retailers because the latter typically do not charge taxes.[2]

[2]Minton, Reardon and Sutadhar (2010) report that organized retailers in Delhi sell products at the same or lower prices than unorganized retailers. This appears to be the case for fresh foods and vegetables, but the post-tax prices for processed and packaged foods is typically higher in organized retail stores.

Unorganized retailers have several other advantages: population density, the retailers' flexibility and responsiveness to consumer needs, efficient space utilization, low operating costs, and a business model that focuses on livelihood for owners rather than profits for an organization.

India has a population density of 937 people per square mile. By contrast, China and the United States have population densities of 360 and 82 people per square mile, respectively. Japan, which has 873 people per square mile, is similar to India in terms of population density, and small stores have continued to prosper in Japan. The population densities of Indian cities, and of certain neighborhoods within cities, are remarkably higher than the population density of the country. For example, Delhi has a population density of 24,197 people per square mile (comparable to New York, which has 27,532 people per square mile); Seemapuri, the densest neighborhood in Delhi, has 76,342 people per square mile. But Delhi and Seemapuri pale in comparison with Mumbai and Dharavi. Mumbai has 57,000 people per square mile and Dharavi, its densest neighborhood, is eleven times as dense as the city and has about 600,000 residents per square mile.[3]

High population density allows closely located small and large stores to coexist. Market entry by a large store may change the mix of products a small store offers to differentiate its offerings and the two types of stores may cater to different market segments, but both can survive if there are enough consumers in an area.

High population density offers other advantages to small stores. Consumers

[3]Wikipedia list of sovereign states and dependent territories by population density, http://en.wikipedia.org/wiki/List_of_countries_by_population_density. Data on population densities for Indian cities and states are from India's Ministry of Home Affairs, www.censusindia.gov.in/Census_Data_2001/ India_at_glance/density.aspx.

tend to make smaller, more frequent purchases in denser areas because they have smaller homes and cannot stock up on necessities.[4] Large stores in urban areas in India can seldom attract large numbers of distant consumers because only those with cars typically travel to a distant store. These customers are likely to make the trip to a large store infrequently because of the time and inconvenience of negotiating traffic and finding parking. In contrast, small retailers serve consumers within a small radius and, unlike closely located organized stores, take phone orders and can offer personalized services at low cost. For example, they can afford to make home deliveries because it is relatively inexpensive to send a delivery boy to ten homes that are close by. This is also why small stores can afford to make home deliveries in New York, where unskilled labor is far more expensive than it is in Indian cities.

Second, small retailers have the ability to respond in a flexible way to consumer needs. For example, a small food store might sell a single egg or a dozen, two slices of bread or a loaf, a quarter stick of butter or a kilogram, and a single-serve slice or a brick of ice cream. Paan shops are known to sell single sticks or packets of cigarettes. This flexibility in meeting micro-demand is not easily available to organized retailers.

Most small stores accept product returns, exchange damaged goods, and give credit to customers with whom they have longstanding relationships. They also know the likes and dislikes of individual customers, recommend new products to them, and adjust prices for different customers — they are true practitioners of first-degree price discrimination. Organized retailers find it difficult to provide such services, which can be important to customers,

[4]India's poor infrastructure also favors frequent purchases from small retailers because frequent power cuts and outages limit the quantity of fresh foods and dairy products that can be stored in homes with refrigerators.

especially when one considers that people build routines around and derive pleasure from the many small aspects of shopping: the daily call of a vegetable seller, haggling over price at the weekly street bazaars, the nightly paan and cigarette, and the chai shop, are all part of the rhythm of Indian life. Such rhythms may change but not quickly.

Third, small stores manage physical space far more efficiently than large ones, and space utilization is especially important in India, where real estate and rental costs are high and likely will rise, especially in urban areas. One disadvantage for large stores using a self-serve layout is that they need room to allow customers to walk through the store. Self-serve layouts in Indian stores are especially poorly managed. In some, products are placed on three or four shelves in each aisle; in others, shelves go to the ceiling, where customers cannot reach them. Fresh produce is often scattered on the floor and large boxes lie partially opened in the middle of aisles. In contrast, kirana stores and vegetable sellers typically make much better use of space with one or two people picking out and packing customer orders.

Fourth, the cost of operation is typically substantially higher for organized retailers. Unorganized retailers usually rely on family members to buy and sell products. In many cases, their stores are not physically separated from their homes. They use unskilled labor, hire no managers or sales clerks, have little loss due to stealing and pilferage, and have few overhead and utility costs.

Finally — and crucially — the main reason small retailers are in business is to make a living. They convert their homes into shops, use them to store goods, and hire casual workers when needed. Household members typically don't earn separate salaries and are concerned about family income. In contrast, organized retailers rent or buy stores, pay salaries and benefits to employees, cannot easily fire workers, and incur substantial fixed and overhead costs. Overall profitability after expenses, rather than a livelihood, is needed to keep an organized business going. These differences in means and objectives make it more likely that small retailers will survive.

4. GROWTH PATTERNS IN RETAILING

Both the Economist Intelligence Unit and Euromonitor International project that retail sales will grow at about 15% per year for at least the next five years. Joseph et al. (2008) forecasted 13% annual growth in retail sales from 2006-07 to 2011-12 with total retail sales rising from $322 billion to $590 billion over the period. They also predicted that unorganized retail sales will grow at approximately 10% per annum from $309 billion in 2006-07 to $496 billion in 2011-12, and that organized retail will grow 45–50% per year and attain a 16% share of retail sales by 2011-12.

These projections seem to be overly optimistic. As previously noted, organized retailing had grown to only about a 5% share of retail sales by 2009 and is not likely to grow at 40–45% per year. Overall retail sales are also likely to grow more slowly than projected for at least two reasons. First, retail purchases are not likely to grow as fast as household consumption, of which they are a part. Second, household consumption itself is not likely to grow as fast as GDP in India. Taken together, these two considerations suggest that the rate of overall growth in retail sales is likely to fall below the GDP growth rate for the next several years, although some retail categories such as durable goods and personal transportation (including automobiles) might grow at a faster rate. As noted previously, food retailing is likely to continue to grow at a lower rate than GDP.

Analysis by the consulting firm Goldman Sachs (2009) suggests that household consumption declines as a share of GDP until per capita GDP rises to the \$1,500–\$2,000 range. Once per capita GDP exceeds that range, household consumption increases (see the panel on the left side of Figure 2). Figure 3 shows that the share of GDP due to household consumption has slowly increased over the last several decades in developed countries like France, Germany, the United Kingdom, the United States, and Japan, but has steadily decreased in countries like India, Brazil, and China. In particular, household consumption in India has steadily declined from about 80% of GDP in the early 1970s to about 55% of GDP in 2009. We might expect it to further decline in the near future and then to begin increasing once per capita GDP passes the noted range.

The share of household expenditure devoted to retail purchases also changes in an emerging economy, as does the allocation of retail expenditures to different product categories. As per capita GDP increases, households spend disproportionately more on communications, transportation, durable goods, education, health, and recreation, and spend disproportionately less on groceries and clothing (see the panel on the right side of Figure 2). The data for India are broadly consistent with these patterns. For example, Figure 4 shows that expenditures on communications and transportation have grown rapidly since 2005-06 and expenditures on clothing, footwear, furniture, and appliances are growing faster than expenditures on food (note that the effect of the economic slowdown on growth in these categories can be seen in Figure 4). As previously noted and as shown in Figure 5, consumers' expenditures on groceries have decreased as a fraction of retail sales from 67.5% in 2005 to 61.5% in 2009. The annual rate of growth in grocery sales also decreased from

6.3% in 2005 to 2.5% in 2009. These changes are likely to persist.

In summary, we expect three broad trends in retail sales. First, overall sales will grow at a slower rate than GDP. Second, food sales are presently the largest category across all retail products but are likely to grow at a slower rate than overall sales. Food retailing is likely to become more competitive and more efficient; retailers in the informal sector may continue to enjoy the advantages already noted. Third, retailing for durable goods, automobiles, restaurants, hotels, and recreation will grow faster than it will for food and basic commodities. These businesses require large investments and are likely to further increase the presence of organized retailing in India. As the panel on the left side of Figure 6 shows, retailers of durable goods have only modestly penetrated the Indian market and can be profitably expanded for some time. How long a time is illustrated in the panel on the right side of Figure 6, which shows that the share of durable good expenditures continued to grow for more than 65 years in the United States.

5. BEYOND SELLING

The discussion so far has considered retailing in the context of where consumers shop. But the ongoing debate about retailing is not just about types of retail stores. It is also about the entire distribution system in India with retailing being only the most visible end.

Small retailers have no choice but to take distribution channels as given. They do not have the resources or power to make any changes in the supply chain. Organized retailers, in contrast, have the knowledge, ability, and resources, and their profitability depends greatly on the efficiency of the entire supplier-to-consumer distribution system. Firms like Walmart and Carrefour are successful around the world because they can extract savings by improving the productivity and efficiency of the distribution system. That same knowledge and ability can be used to improve distribution in India. However, it is that very ability that paralyzes policymakers when they hear that Walmart destroys small businesses in the United States, despite the fact that the Indian situation is not the American situation. Foe example, it is easy for someone living in rural America to drive twenty miles to a Walmart store. But a similar superstore could not survive in rural India where road access is poor, few people have cars, and most consumers cannot afford to spend as much, or carry or store as much in their homes. And as noted, urban areas have high population densities, where small stores can effectively compete against large stores.

Some organized retailers have begun investing in distribution system improvements. For example, Mukesh Ambani, chairman of Reliance Industries, envisions a system in which Reliance Retail will work closely with farmers and other rural workers, buy directly from them, and handle all aspects of distribution, including processing, transportation, warehousing, storage, and retailing. Edge Singapore (2009) reports that the company is prepared to set up its private cargo airline to bring fresh produce to its network of Reliance Fresh supermarkets. Reardon. et. al. (2010) describe how retailers like Hariyali Kisaan Bazaar and ITC Choupal Sagar have set up rural business hubs that can be used for procuring grain, milk and vegetables, and to provide one-stop shopping for farmers. A hub might have a small supermarket, an stores within a store that offers banking, insurance and heath services. Megafood parks and integrated agro-food parks have also begun to emerge in rural areas. The government acts as an infrastructure facilitator, providing water, electricity and technical assistance to farmers. A private sector firm anchors the park and invites processors and retailers to invest in various operations and services at the park.

Still, there are many important areas of distribution in India that are in need of serious improvement. Consider cold storage. With an annual yield of about 180 million tons, India is the second largest producer of fruits and vegetables in the world. But it has only 23.6 million tons of cold storage and 80% of that is used for potatoes. About 25–30% of fruits and vegetables and 5–7% of food grains spoil. Estimated post-harvest losses are Rs. 1 trillion per year with 57% of that due to avoidable waste. Still, investments in cold storage chains have remained insignificant despite the government allowing 100% FDI (Department of Industrial Policy and Promotion 2010).

A similar situation exists with respect to warehousing. Halarnkar and Randhawa (2010) report that insufficient warehousing capacity resulted in 17.8 million tons of wheat and rice being stored under tarpaulin in India in 2010 with about 10 million tons at risk of rotting. In Punjab, 49,000 tons of food grain were unfit for consumption after being left out through three monsoons and were to be destroyed. Appalled by the situation, the Supreme Court of India ordered in August 2010 that the government must give food grain it cannot store to the poor for free (Sinha 2010). But even this policy is difficult to implement because the cost of transporting the grain to people who need it is high. Meanwhile, the cost of food has risen sharply.[5]

Logistics costs can be as high as 10% of sales for some organized retailers in India. Overall, logistics costs are around 14% of GDP in India, which is much higher than 8% of GDP in the United States (Technopak Retail Outlook

[5] Basu (2010) notes that poor food grain storage alone is not the reason for large price increases and that lowering prices will require a redesign of the mechanisms by which India acquires and releases food to the market.

2008). The reason is that the Indian distribution system is both wasteful and inefficient. For example, the cost of moving a cargo container one kilometer is 50% higher in India than in the United States (Manoj 2008). V. Shunmugam, chief economist at the commodity exchange MCX in Mumbai, India, offers an example: The government procures wheat at $23.50 per 100 kilograms in Madhya Pradesh; transporting it to Tamil Nadu adds between $11.50 and $13.50 depending on whether road or rail transport is used (Knowledge at Wharton 2010).

Currently, about 77% of India's goods are transported by road and that number is expected to rise to about 85% in the near future. However, the road-transportation system is largely unorganized and fragmented. Operators who have twenty or more trucks are responsible for only 6% of the traffic. The vast majority of the traffic comes from small businessmen with just a few trucks (Sriram et al. 2006). There are few economies of scale or scope.

The most visible example of inefficiency and corruption is the public distribution syste m, which runs about 478,000 fair-price shops. It is the largest retail chain in the world and is meant to provide subsidized food to the poor in India (Knowledge at Wharton 2010). But as the Wadhwa committee (2009) reports, there is large-scale corruption in the public distribution system. Estimates are that two-thirds of the grain destined for distribution to the poor is stolen or adulterated (Economist 2010).[6] The government's response is to increase food subsidies, which rose by 65% in 2009-10 to more than $15.6 billion or Rs. 72,000 crores (Financial Express 2010).[7] In the longer run, such

[6]Minten e.t al. (2010) report that two-third of the Fair Price Shops that distribute subsidized rice in Delhi were found to be closed during regular opening hours.

[7]The subsidy, given by the Central Government to procurement agencies like the Food Corporation of India, covers the difference between the buying and selling price. To ensure that farmers get at least the minimum support price and that food is available at a below-

massive subsidies provide no lasting systemwide benefit capable of reducing costs for all retailers and prices for all consumers. We are not suggesting that the poor should not be given subsidized food. Instead, the long-term solution is to replace subsidies with an efficient and productive distribution system that can operate at much lower cost and benefit producers and consumers.

Again, the organized retailing sector can bring about improvements in each of the areas noted because it has the means, knowledge, and need to do so. By working directly with producers, it can dramatically improve the incomes of the poor, including farmers, who typically earn a third of the final price for their products. In contrast, the international norm is that two-thirds of the final price is earned by farmers. Why the difference? It comes in part from the Indian distribution system's higher costs and greater waste and in part because wholesale markets, which are regulated by state agricultural produce and market committees, operate as monopolies. Farmers are often at the mercy of wholesalers, and even simple systems of grading and sorting produce are not common in the country. Firms like Walmart and Reliance are keen to invest in farm-to-consumer delivery systems, which are not automatically bad for Indian farmers or consumers. The business model for these firms is to squeeze out every penny by making the supply chain lean and efficient, a good thing if, in the process, the country gets a modern distribution system and the benefits can be shared with farmers and small retailers. Bajaj (2010) reports that some multinational firms like Walmart are helping farmers to improve their growing and harvesting practices (Bajaj 2010). These firms can also bring both financial investment and experience in improving supply-chain

market price to the poor, government procurement agencies buy food at above-market costs and sell it at below-market prices.

productivity and efficiency, which can benefit small and large retailers in India.

6. LONG-TERM CONSIDERATIONS

The preceding discussion about the benefits of improving the distribution system would be worthwhile even if India was not expected to change in any significant way in the next twenty years. But the need for a more modern distribution system becomes urgent when we consider the ways in which the country is expected to change. The most significant changes from the perspective of retailing are (1) the magnitude of the expected increase in demand over the next twenty years, and (2) the rapid and ongoing urbanization of the country.

Regarding long-term demand, if India's GDP grows at an average annual rate of even 7% per annum for the next twenty years, it will multiply by a factor of about four by 2030. If retailing accounts for even 30% of GDP, the increase in retail sales between 2010 and 2030 will exceed a trillion dollars. This is far too large to be accommodated entirely by unorganized retailers or to be left alone with no significant effort to improve the productivity and efficiency of the distribution and retailing system in India.

Second, as Figure 7 shows, economic growth has historically been closely related to urbanization. In his 2005 Independence Day speech to the nation, Prime Minister Manmohan Singh observed that a third of India's population lives in urban areas today and, "keeping in mind the speed at which urbanization is taking place, the day is not far off when over 50% of India's population will be residing in urban areas" (Singh 2005). More income and wealth is likely to be concentrated in urban areas, which in turn will affect where and how retailing grows.

According to census reports, the number of people living in Indian cities grew from 290 million in 2001 to 340 million in 2008. India has the second largest number of urban dwellers in the world. Furthermore, only 20% of the population increase in cities is due to migration; the rest comes from the expansion of city boundaries or the reclassification of rural areas. From 2001 through 2008, India's urban population grew 58% faster than the population of the country as a whole.

A study by the McKinsey Global Institute (2010) predicts that by the year 2030 India will have a population of 1.47 billion and 40% of the population will live in urban areas. Thus, the urban population will grow to about 590 million, roughly 250 million more than recorded in the 2008 census. The number of cities with more than a million residents is projected to increase from 42 in 2010 to 68 in 2030. Six cities are expected to have populations of 10 million or more. Mumbai's population is expected to exceed 33 million, Delhi's population to exceed 25 million, and Kolkata's population to exceed 22 million. The McKinsey study also projects that the urban share of GDP will rise to 69% by 2030, up from 58% in 2008, and that about 120 million new urban jobs will be created between 2008 and 2030.[8] The number of urban households earning less than Rs. 90,000 per year is expected to fall below 20%, and the number of people earning between Rs. 200,000 and Rs. 1 million per year is expected to increase fourfold from 32 million to 147 million. In contrast, 75% of urban populations today are in the lowest income segment with average earnings of about Rs. 80 (about $1.80) per day.

These forecasts, even if only approximately correct, have significant im-

[8]The analysis assumes annual GDP growth of 7.4% per year between 2008 and 2030 with urban GDP growing 8.3% per year and rural GDP growing 5.9% per year.

plications for retailing. First, they imply that retailing will not grow evenly; rather, it will grow at a higher rate in urban areas that can accommodate and will require both organized and unorganized retailers. For example, the number of modern retail outlets in Delhi has more than doubled in each of the last three years (Minten, Reardon and Sutradhar 2010). Second, urban retailing is likely to remain the strategic focus of organized retailers because there will be increasingly more numerous and more affluent consumers to serve in that market. Third, rural economic growth will require stimulus. Some of it can come from organized retailers investing in a variety of supply-chain activities in rural areas, such as food processing, storage and warehousing, and transportation and shipment hubs. Some of these investments are likely to be made in rural areas close to towns and cities (e.g., warehousing), others will be close to farmers and suppliers (e.g., food processing, storage), and still others will be at locations that make sense from a logistical standpoint (e.g., trans-shipment points and distribution hubs).

7. POTENTIAL PROBLEMS

There are some inherent advantages of size that benefit organized retailers. Concerns have been voiced about whether large retailers would be able to create artificial shortages and price volatility. Mechanisms to limit such power are desirable (Singh 2010). Large retailers can also obtain favorable terms from manufacturers and other suppliers that smaller retailers cannot. And only large retailers can bypass conventional distribution channels, use information technology to organize ordering and order processing systems, and benefit from lower logistical and transaction costs owning to economies of scale and better supply-chain practices. Efforts are being made by small retailers to form cooperatives so that they can obtain similar benefits. Bhartiya Udyog Vyapar Mandal, the largest national-level association of kirana stores, is leading one such effort that is focused on negotiating better prices from manufacturers, bypassing middlemen, and obtaining financing at terms that are otherwise available only to large organizations (Dave 2008). More such efforts need to be developed and promoted.

There is a need to limit the extent to which corporate retailers can obtain special privileges, such as access to desired locations to set up stores. Corporate retailers are making some of the largest and most expensive deals in metropolitan centers. However, there is no ceiling on the size or number of commercial outlets that may be started in a given commercial zone once they comply with some basic criteria of breadth of road. The central government has no control over this matter, and state governments have yet to devise policies related to these issues. Concern has also arisen about enforcement of existing regulations governing operation issues such as opening and closing hours. Some large stores remain open for ten or eleven hours a day, including Sundays.

It is necessary to consider the possibility of implicit collusion among organized retailers, who might carve up and share parts of a larger market and use tactics such as predatory pricing to drive out small retailers (Joseph et al. 2008, Parliamentary Standing Committee on Commerce 2009). Similarly, organized retailers can hold significant power over channels of distribution. For example, a large retailer could lock out specific suppliers or make onerous demands from small manufacturers who depend on it for business. Concerns about the adverse effects of monopoly and monopsony power have arisen in many contexts across countries and industries, and need to be anticipated and addressed by policy makers in the context of retailing in India (Kalhan and Franz 2009).

There are significant concerns that organized retailers in the food industry might transfer business risks onto suppliers and growers (Singh 2010). For example, organized retailers might initially offer incentives for contract farming, share know-how, arrange or give credit at favorable terms, offer higher prices, and give price guarantees. Subsequently, they might force farmers to plant certain crops and/or particular seeds, require over-fertilization, and emphasize the selection of produce that meets storage and shipment requirements rather than the nutritional needs of consumers. Gopalakrishnan and Sreenivasa (2009) note that corporate food provision can adversely affect land productivity, food security, price stability, employment and credit.

The use of greater mechanization, leading to layoffs and possible exploitation of farm laborers, also is a concern. Contract farming is expected to favor large farmers, potentially driving subsistence farmers to leave their farms and become laborers. At the same time, there is a need to educate and train an adequate number of retail workers for the organized sector. It is essential to educate and train the massive numbers of young people expected to join the work force, and to retrain millions of others who might be displaced from farming and enter such sectors as retailing and manufacturing over the next twenty years.

These are significant issues that policymakers need to address using a mix of incentives and regulations that ensure competition in the distribution system and thereby prevent excesses and exploitation. For example, information systems are critical to management of modern supply chains because they affect how suppliers are linked to retailers, orders are taken and processed, and inventories are managed. Information systems should be required to use common, interoperable standards, provide open access to buyers and suppliers across retail chains and cooperatives, and foster competition among large organized retailers.

8. CONCLUSIONS

No one has a crystal ball that can perfectly predict how organized retailing will grow in India, but it is likely that it will have a useful and important place. It is not likely that small retailers will disappear from India. Both large and small retailers can and should coexist to serve different consumer segments and needs, and to contribute in complementary ways to the economic development of the country.

It is understandable that owners of small stores view corporate retailers as a great threat. No one likes competition, especially from a stronger force. But as we have argued, growth in demand is likely to be large, and increasing population density, especially in urban areas, will require the coexistence of small and large retailers.

As always, policymaking must be based on a balanced assessment of the present and future needs of different groups in society. In the short run, small retailing as a whole is not only surviving but thriving, and large corporate retailers are finding it difficult to become profitable. In the long run, large corporate retailers can survive if they improve systemwide efficiency and productivity in the distribution chain, something that the country needs and that can benefit small retailers as long as appropriate incentives and regulations are provided. The economic growth of rural areas will become a bigger concern, and policymakers should find ways to direct investments by corporate retailers to benefit the rural economy and citizens.

There are several issues associated with potential misuse of power that will require careful consideration by policymakers to keep both consumer markets and distribution systems competitive and open. Lessons learned from developed markets should be used in formulating domestic policy in India.

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Table 1: Estimated retail sales and market shares for formal and informal retail sectors in India: 2004-2009

Year	2004	2005	2006	2007	2008	2009
Total sales	294	331	359	448	481	496
Formal sector sales	153.63	167.50	182.72	198.61	211.54	218.92
Informal sector sales	140.37	163.50	176.28	249.39	269.46	277.08
Formal sector share	52.25	50.60	50.90	44.33	43.98	44.14
Informal sector share	47.75	49.40	49.10	55.67	56.02	55.86

Sales are in billions of dollars

Note: Assumes $1=Rs 46

Source: Estimates of total sales are from Economist Intelligence Unit (2008); estimates of formal sector sales are from Euromonitor (2010).

Table 2: Sales and share of in-store grocery retailing from 2004-2009

Sales in Rupees billion

	2004	2005	2006	2007	2008	2009
Hypermarkets	5.4	10.5	21.9	40.1	84.3	105.3
Supermarkets	22.1	28.3	39.6	75.3	97.9	72.4
Food/Drink/Tobacco Specialists	999.7	1,069.70	1,139.20	1,207.60	1,274.00	1,325.00
Small Grocery Retailers	3,661.30	3,882.20	4,097.00	4,264.80	4,375.40	4,476.10
Other Grocery Retailers	228.3	236.3	243.3	250.2	256.4	262
Total Grocery Retailers	4,916.80	5,227.00	5,541.10	5,837.90	6,088.00	6,240.80

Share of sales

	2004	2005	2006	2007	2008	2009
Hypermarkets	0.11	0.20	0.40	0.69	1.38	1.69
Supermarkets	0.45	0.54	0.71	1.29	1.61	1.16
Food/Drink/Tobacco Specialists	20.33	20.46	20.56	20.69	20.93	21.23
Small Grocery Retailers	74.47	74.27	73.94	73.05	71.87	71.72
Other Grocery Retailers	4.64	4.52	4.39	4.29	4.21	4.20
Total Grocery Retailers	4916.80	5227.00	5541.10	5837.90	6088.00	6240.80

Source: Euromonitor (2010).

Table 3: Market shares of grocery retailers in the organized sector from 2005 to 2009

Company	2005	2006	2007	2008	2009
Pantaloon Retail India Ltd.	0.2	0.3	0.5	0.7	0.8
Reliance Retail Ltd.	-	0	0.3	0.5	0.6
Spencer's Retail Ltd.	-	0.1	0.2	0.5	0.5
Aditya Birla Retail Ltd.	-	-	0.1	0.2	0.2
Mother Dairy Fruit & Vegetable Ltd.	0.1	0.1	0.1	0.1	0.2
Subhiksha Trading Services Pvt Ltd.	0.1	0.1	0.3	0.5	-
Total	0.4	0.6	1.5	2.5	2.3

Source: Euromonitor (2010).

Figure 1: Classification of retailers in India

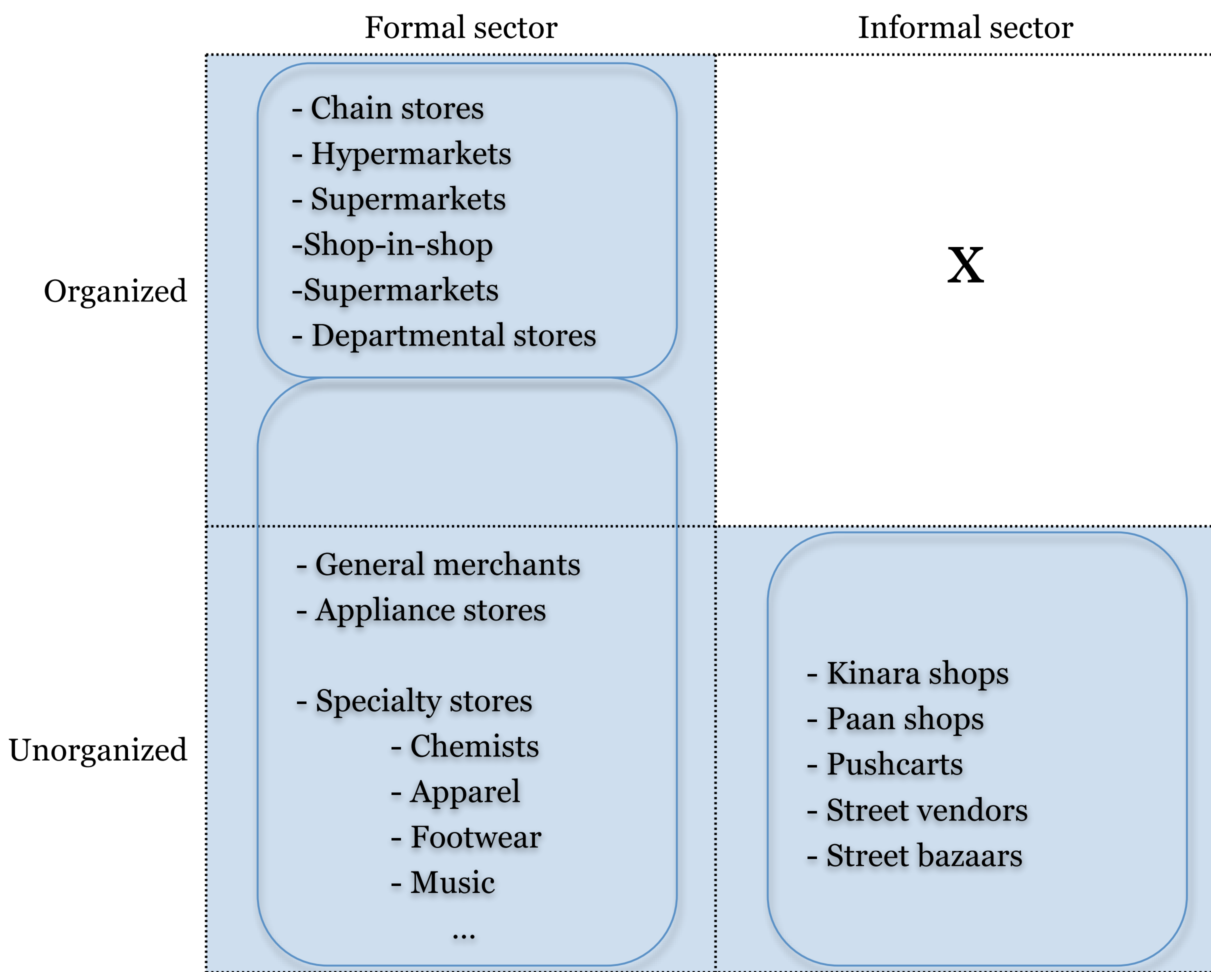
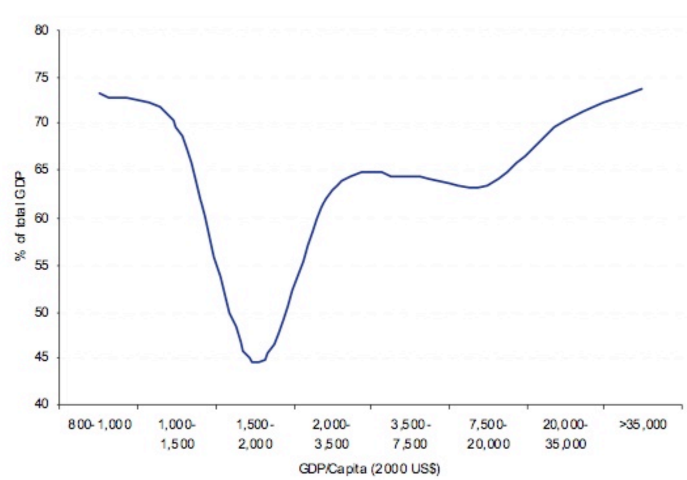


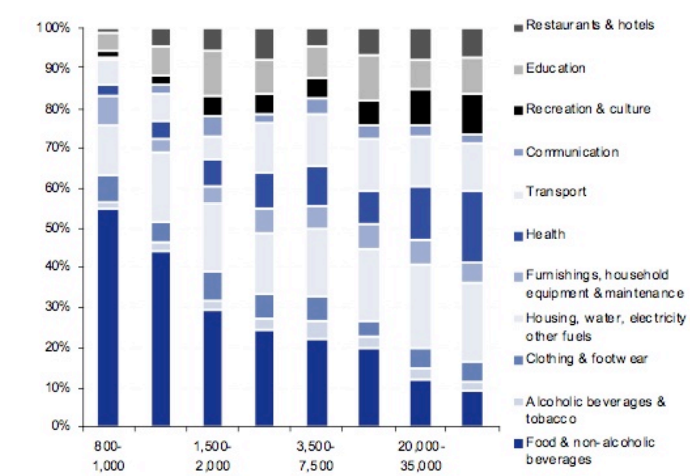
Figure 2: Changing structure of consumption

Share of consumption into total GDP, average of countries in each wealth band



Source: National Accounts, World Bank.

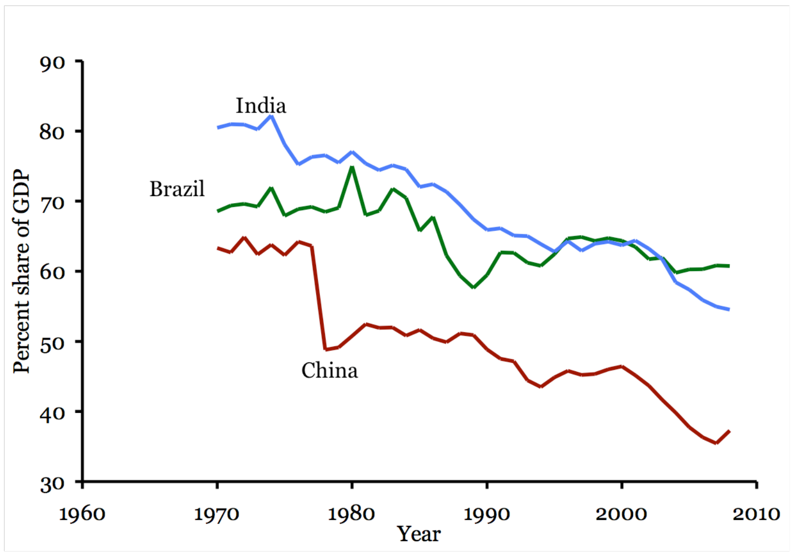
Share of consumption directed to major categories, averages of countries in each wealth band



Source: National Accounts, World Bank.

Source: Goldman Sachs (2009), "The BRICs Nifty 50: The EM & DM winners," November 4.

Figure 3: Household consumption as share of GDP for India and other selected emerging and developed economies



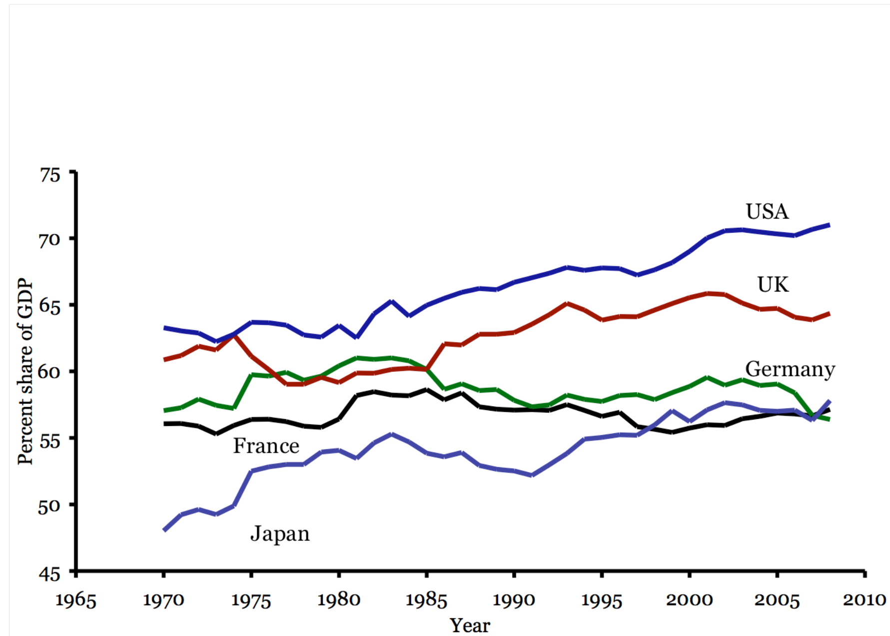
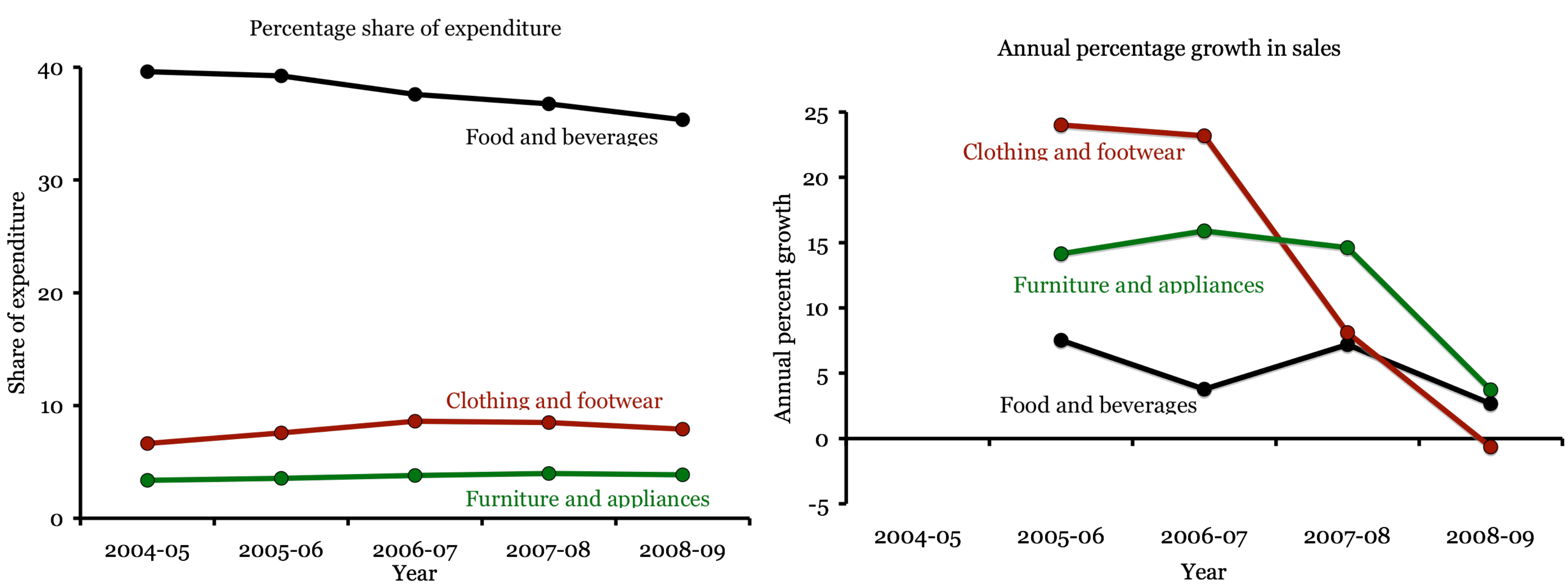


Figure 4: Share of private consumption and annual growth rates for selected product categories
(at constant 1999-2000 prices)

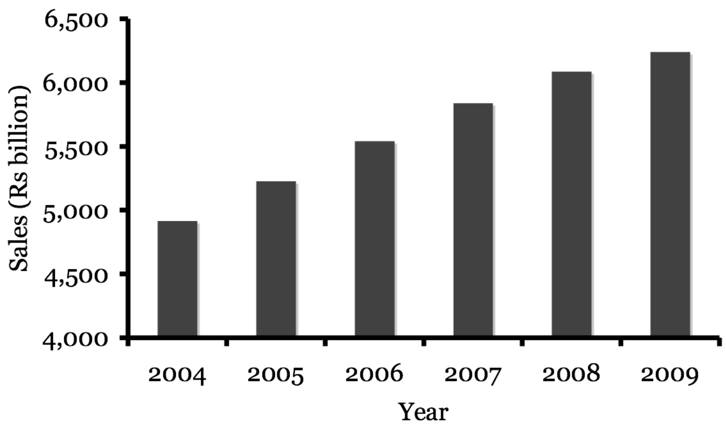


Source: Foreign Direct Investment (FDI) in multi-brand retail trading, discussion paper, Department of Industrial Policy and Promotion, 2010

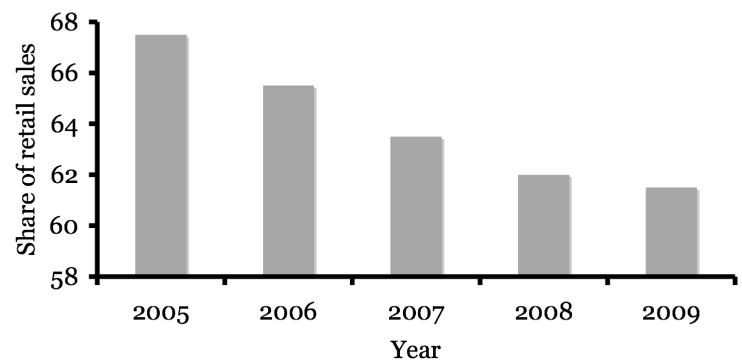
Figure 5: Groceries are a decreasing share of formal-sector retail sales

	2004	2005	2006	2007	2008	2009
Retail grocery sales	4,916.80	5,227.00	5,541.10	5,837.90	6,088.00	6,240.80
Annual growth rate		6.31	6.01	5.36	4.28	2.51

Grocery sales formal sector



Grocery share of retail sales in the formal sector



	2005	2006	2007	2008	2009
Grocery share	67.5	65.5	63.5	62	61.5
Non-grocery share	32.5	34.5	36.5	38	38.5

Figure 6: Two patterns of durable goods sales

Penetration of durable goods in India

Product	2005	2006	2007	2008
Color TV Set	25.2	27.4	29.5	31.7
Cassette/Radio Player	30.9	29.6	28.4	27.1
Washing Machine	15.6	17	18.4	19.8
Mobile Telephone	6.8	10.2	13.1	15.6
Refrigerator	15.3	16	16.6	17.3
Microwave Oven	12	13.1	14.1	15
B&W TV Set	21	18.3	16.2	14.6
Freezer	7.3	8.5	9.5	10.5
Hi-Fi Stereo	6.5	7.8	8.9	10
Personal Computer	3	3.5	4.2	5.1
Passenger Car	2.7	3	3.3	3.6
DVD Player/Recorder	0.9	1.1	1.4	1.8
Air Conditioner	1	1.2	1.4	1.6
Dishwasher	0.2	0.3	0.4	0.4

Source: Euromonitor 2010

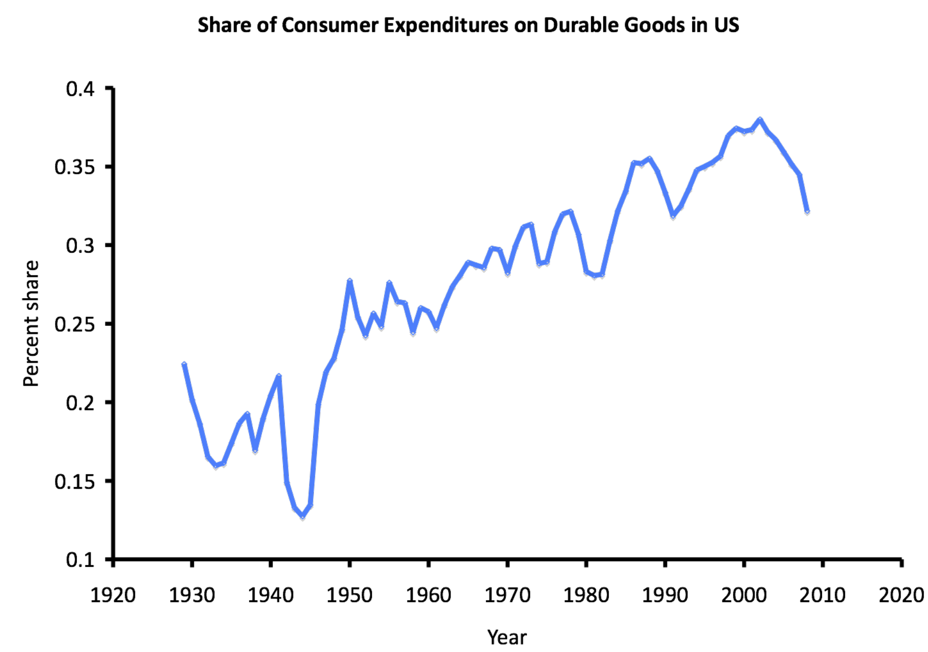
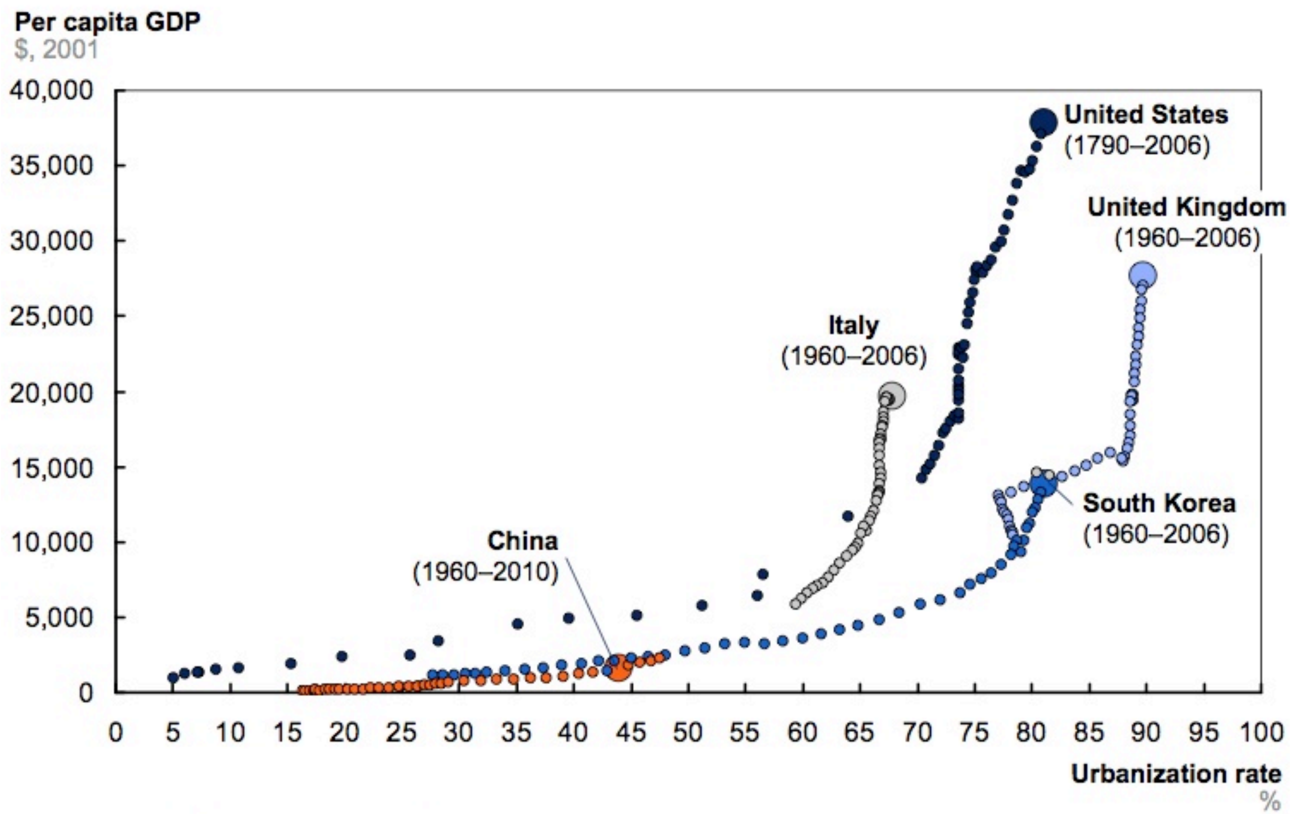


Figure 7: Relationship between urbanization rate and per capita GDP



Note: Definitions of urbanization states differ across countries.
SOURCE: World Development Indicators; EU KLEMS database; McKinsey Global Institute analysis