

Cautious moves towards greater FDI in retail

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The retail sector in India is highly fragmented and organized retail in the country is at a nascent stage. Recently, however, it has emerged from the shadows and become one of the most talked-about sectors in the economy.

India ranks first in terms of emerging market potential in retail and is now considered a top-priority market for many international retailers.

Retail in India

Foreign direct investment (FDI) restrictions in the retail sector have not deterred prominent international players from setting up shop in India.

Many foreign companies entered the Indian market in one of three ways: Franchise agreements, cash and carry wholesale trading or strategic licensing agreements.

Franchising has been the most widely used entry route by international retailers. Fast food chains like Domino's, known for its pizza, entered India through the master franchise route while Pizza Hut entered India with a regional franchise strategy.

FDI up to 100% is permitted for cash-and-carry wholesale trading. Setting up a wholesale trading outlet involves building a large distribution infrastructure to assist local manufacturers. The business model is built in such a way that the wholesaler deals with smaller retailers and not individual consumers. Metro AG of Germany was one of the first significant global players to enter India through this route. Other large international retailers plan to follow it into the country using a similar approach.

The third approach, the strategic licensing agreement, requires a foreign company to enter into a licensing agreement with a domestic retailer. Mango, the well-known Spanish ap-

parel brand, entered India through this route by entering into an agreement with Piramyd, a departmental store in Mumbai.

Single-brand retail

The Indian Government has finally taken baby steps towards opening up the retail sector to foreign investment.

In a recent announcement, the government stated its intention to permit foreign investment of up to 51% in "single-brand" retail. The remaining 49% would have to be owned by Indian concerns.

Permission of the Foreign Investment Promotion Board, the agency responsible for approving foreign investments into the country, is required before any investment is made.

A number of guidelines have been put forward for investment in single-brand retail outlets and were included in Press Note 3 (2006 Series). These guidelines note that:

- Products to be sold should be of a single brand.
- Products should be sold under the same brand internationally.
- Single-brand product retailing would cover only products which are branded during manufacturing.

Impact

For brands that adopt the franchising route as a matter of policy, the new single-brand guidelines are not likely to make much of a difference.

Most would have preferred that the government liberalize rules for maximizing their royalty and franchise fees but they must still rely on innovative structuring of franchise arrangements to maximize their returns.

Consumer durable majors such as LG and Samsung, which have exclu-

sive stores owned by franchisees, are unlikely to shift from their preferred route right away.

The argument put forward to allow FDI in single-brand retail trade is that sale of such goods would cater to a select clientele, different from those served by small retailers and the local "kirana" shops.

The stipulation that it will be for single-brand shops does not mean that these stores will be allowed to sell only a single product, rather they will be allowed to sell a variety of products under a single brand name.

Foreign firms are prohibited from setting up outlets with multi-brand retail formats, although they are allowed to hold 100% equity in wholesale cash and carry business.

The retail sector is one area in which policy makers are moving very cautiously towards considering more access to FDI.

The government has opted to allow foreign investment in the retail sector in a phased manner.

In spite of the caution, it is moving forward so as to avoid the danger of going against the commitments made to the World Trade Organization.

FDI in the retail sector means amplified employment for the new generation. Also, with prices at department stores comparatively low, customers may benefit. If customers pay less, they will end up saving more, which in turn may lead to other more profitable investment, thus advancing the economy.

The process should be gradual to help people acclimatize.

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