


6-2

A Revolution in the Making: The Case of Agro-Food Retailing in India

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Executive Summary

Recent discussions of global agro-food systems have turned the spotlight on food retailing. Observers concur that globalization has been accompanied by, and may have aided, retail concentration in agro-food markets. This transformation, especially in developing countries, has been nothing short of a revolution.

Until now, India has been conspicuous as an exception to the rule. Only around 2 percent of all retail trade in India is in the organized sector. The food retail sector is likely even more fragmented and continues to be a complex mosaic of diverse small-scale actors, including itinerant vendors, government outlets, cooperative markets, and small-scale corner stores.

This fragmented retail sector was attributable in large part to the policy framework. So far, foreign direct investment (FDI), a critical driver of retail transformation in other countries, has been disallowed in the retail sector. Laws putting ceilings on urban land use limit the physical space available to giant retail stores. In addition, domestic trade in agricultural produce was tightly regulated. Post-harvest practices related to storage and transportation, as well as logistical bottlenecks, have also stood in the way of large-scale investments in the sector. Yet these factors might be changing now. Growing urban consumerism and the rise of a newly wealthy professional middle class that values shopping experience and convenience have spurred a growth in demand for processed and branded ready-to-eat convenience foods. In the absence of FDI, domestic businesses have responded powerfully to this demand and intensified their focus on food retailing. Meanwhile, with India ranked the top destination for global retail investment for the second consecutive year, multinationals are seeking ways, other than FDI, to enter the Indian market.

Advocates enthuse, rightly, over the efficiencies that large-scale investments would bring. At the same time, there is considerable concern that the emergence of supermarkets, especially if it leads to retail concentration, might have distressing implications for a large constituency of poor actors along the entire chain—small and poor farmers, informal traders, and retailers, as well as poorer consumers. Retail transformation raises important questions about the relative position of farmers in the supply

chain. Although consumers are the presumed beneficiaries of supermarkets, because of improvements in quality, safety, and choice, it is not clear if supermarkets will be able to serve the poorer segments of the population. As for small traders, the emergence of large-scale retailers with deep pockets could dismantle their livelihoods if they succeed in weaning away small traders' clientele. In short, it is not clear if supermarkets will be part of a solution to poverty or part of the problem.

Clearly, two issues merit careful scrutiny. First, how will the efficiency gains from this transformation be distributed across actors? Second, what is the nature of costs associated with the displacement of livelihoods that such a transformation would entail? Given these considerations, should the government enable or aid such a transformation by reconfiguring domestic policies and opening up FDI in retailing?

Your assignment is to recommend to the Government of India a set of policies to be pursued to guide future developments in the food retail sector, taking into account the interests of the different stakeholder groups.

Background

The Global Context

Recent discussion of global agro-food systems has turned the spotlight on food retailing, and with good reason. There is widespread agreement today that across the developing world, retail sector transformation is spearheading fundamental changes in food systems and that these changes have happened with stunning rapidity, often within the span of a decade.

Consider this. In the 1980s there were few large-scale food retailers and almost no supermarkets¹ in

¹ There is no universally accepted definition of a supermarket, and definitions probably vary across countries. It is typically defined based on store space (300–4,000 square meters), number of checkout counters (more than three or four), and/or sales volume. In the United States, for instance, any full-line self-service grocery store generating a sales volume of US\$2 million or more annually might be called a supermarket. For the purpose

most developing countries. By 2002, supermarkets claimed close to two-thirds of the share of food sales in parts of Latin America; more than half in East and Southeast Asia, Central Europe, and South Africa; and almost a fifth in countries such as China. In fact, in China food retailing was completely controlled by the government until 1990, and there were no supermarkets. By 2003, supermarkets accounted for 30 percent of the urban food market share, and their sales revenue is growing at 30–40 percent a year—faster than in most other developing countries (Hu et al. 2004). Some Latin American countries offer similarly dramatic examples. In Argentina, supermarkets' share of retail food sales was 60 percent by 2003; in Brazil, 75 percent. These figures are close to the 75–80 percent share in the United States and France. Remarkably, what took five decades to happen in the United States has taken a mere decade in these countries (Reardon 2006).

It is interesting too that this transformation of the agro-food marketing chain has come in waves across the regions through a spatial diffusion that mimics the "flying geese" phenomenon.² It started with the richer countries in Latin America during the early 1990s. Next, came East and Southeast Asia and Central Europe. The third wave, in the late 1990s and after, hit the poorer, smaller countries of Central America and Southeast Asia, as well as Southern and then Eastern Africa. By 2003, the share of supermarkets in food retail sales in Taiwan and the Czech Republic had reached 55 percent. Similarly, in Chile, Costa Rica, the Philippines, South Africa, and Thailand, supermarkets were capturing half of the food retail market in 2003. The fourth wave, which has only just begun, is in the poorer countries of South Asia and West Africa.

The idea of such a change is not new. Historical experience suggests that as countries develop, markets transform from fragmented local markets to larger centralized markets. This process typically originates in the dry goods sector before

encompassing fresh produce, including fruits, vegetables, and dairy.³ Yet in terms of speed and transformative power, what developing countries are experiencing today is nothing short of a revolution. In particular, this transformation has taken an unfamiliar path because it is grafted onto agrarian systems that have often not made the transition to "modernized" industrial agriculture. It is also taking place in the context of immense poverty and deprivation. In 2001 as much as 21 percent of the population in developing countries lived in "extreme" poverty, on less than US\$1 a day (World Bank 2004). Supermarkets are apparently no longer a rich-country phenomenon. There is hence considerable concern that the emergence of supermarkets, especially if it leads to retail concentration, might have distressing implications for a large constituency of poor actors along the entire chain, from farmer to consumer. In short, it is not clear at all if supermarkets will be part of a solution to poverty or part of the problem.⁴

Until now, India, like South Asia itself, did not enter these discussions. Untouched by these global waves, India was an exception to the rule. Recent events, however, suggest that these waves have reached Indian shores. Rated in 2006 as the number one destination for global investment in the retail sector—for the second consecutive year⁵—India now finds itself conspicuous on the radar screens of investors. Quite independently of global retail trends, the agro-food sector has begun to attract domestic investments from Indian corporate houses on a scale that suggests that this may well be a revolution in the making.

This case study takes a critical look at this change. While mapping the institutional and policy setting of the contemporary agro-food sector in India, this study attempts to go beyond the much-publicized advantages of this transformation related to efficiency gains along the supply chain and to train a lens on its less obvious and possibly more

of this case study, supermarket refers to the entire class of large-format retailers and includes hypermarkets, discount stores, and supermarkets.

²The flying geese paradigm has been applied in several contexts. It has been used, for example, to explain the catching-up process of "latecomer" economies—in particular, of the sequential appearance and development of industries in a particular developing country. It is most famously associated with Akamatsu (1962).

³ For factors that drive this transformation, see Reardon et al. (2003).

⁴Timmer (forthcoming) takes up this question in some detail.

⁵This rating comes from A. T. Kearney's *Global Retail Development Index* (A. T. Kearney 2006). This index is typically composed of 25–30 different variables capturing four aspects of retail development: market attractiveness, country risk, time pressure, and market saturation.

troubling implications. Its scope is seriously limited by the paucity of data and systematic research. The study is hence necessarily speculative, going only so far as to lay out the issues and drawing on studies elsewhere as illustrations. Indeed, this paper raises more questions than it answers. Yet this lack of research itself makes it important to examine this phenomenon.

The Retail Mosaic of India: The Story So Far

India has in the past earned the epithet of “lumbering elephant” for being slow in just about everything that advocates of globalization care about. This is true of the retail sector as well. For some years now, India has been conspicuous as an outlier.

India’s retail sector today continues to be highly fragmented. It is a complex mosaic of diverse small-scale actors, including itinerant vendors, government outlets, cooperative markets, and small-scale corner stores, most of which are in the informal sector. As recently as 2002, only 2 percent of all retail (food and nonfood) trade in India was in the organized sector—the figure is put at 5 percent in the food sector. Compare this with India’s Asian neighbors, and the nature of the Indian retail landscape becomes clear. The share of the organized sector in Malaysia, for instance, is put at 50 percent; in Thailand, 40 percent; and in the Philippines, 35 percent (Sasi 2004).

The Indian retail sector, food and nonfood together, employs an estimated 8 percent of the work force—the most people after agriculture. Estimates also suggest that India has not only the highest number of retail outlets in the world (at 12 million), but also the greatest density of retailers, at 11 per 1,000 people. In terms of size, only 4 percent of all retailers operate in spaces larger than 400 square feet. Consequently, in per capita terms, availability of retail space in India is among the lowest in the world, at 2 square feet per capita. This is in deep contrast with the 19 square feet per capita in the United States (KSA Technopak 2005). These characteristics are mirrored in the food-retailing sector, which by all accounts is even more fragmented than the nonfood sector. The informal segment of the retail sector in India thus comprises a large number of small-scale, low-investment retailers, each serving a small catchment of consumers.

Despite this umbrella category, the informal retail sector is actually quite diverse, comprising a wide profile of actors. At one end are itinerant vendors and handcart vendors, especially for fresh fruits and vegetables. They form the last link in a long chain of intermediaries. Typically, they procure produce in wholesale markets and go door-to-door selling these goods. Their margins are often thin, and they operate with little capital. Often, these vendors have long-term relationships with buyers, in some cases even straddling generations.

Vendors also congregate in street vegetable markets (plaza markets) or by the roadside. Although reminiscent of the farmers’ markets of the West, these vendors function as pure intermediaries. In both cases, the transaction between consumer and vendors is a social relationship rather than a purely economic one, something that characterizes most traditional modes of exchange. It is difficult to say how many such vendors there are in the country as a whole, given that there is no systematic enumeration.

Then there are the corner stores (called *kirana*) that sell groceries, dry goods, and a limited range of nonfood items. An estimated 5 million of them dot the retail landscape of India. The majority of food and food products are retailed through these neighborhood stores, which typically operate in an area of 200 square feet and sell 500 to 800 stock keeping units (SKUs).⁶ Like the vendors, they usually have a loyal local clientele, many of whom buy on credit. Many of these stores offer home delivery services within a certain distance.

Alongside these neighborhood stores is a network of cooperative stores. Typically these stores are owned jointly by producers and state agencies and operated and managed by state agencies. Some are specifically for vegetables, like the Safal chain in Delhi or HOPCOMS in Bangalore.⁷ Dairy products

⁶SKUs are the smallest unit of any product for which accounts are kept and counted. In a typical supermarket the number of SKUs is on the order of 15,000.

⁷HOPCOMS, for instance, has a total membership of 11,680 farmers who own 9 percent of the shares. A state agency owns 90 percent of the shares, and 1 percent is owned by cooperative banks and nongovernmental organizations (NGOs). HOPCOMS ran 231 stores in Bangalore as of 2005; and Safal, 279 in Delhi. Safal has made forays into processing and developing export markets.

in particular have always been dominated by outlets of producer-cooperatives and operate under the aegis of the National Dairy Development Board of India. This board engineered a “White Revolution” in dairy production under Operation Flood. There are also more broad-based grocery and cooperative departmental stores (which sell groceries—only dry goods—and household and personal items) run by Civil Supplies Departments.⁸ These entities were started with state patronage in the early 1960s at a time when shortages of basic goods were common. The objective of the Civil Supplies Corporations is expressly to provide “Common Man’s Needs at Affordable Prices.” Most are responsible for drawing on the state’s stock of food staples and serve as channels for some government food schemes.

There have also been experiments with farmers’ markets in some cities. The stated objective of these initiatives is to sidestep the exploitative terms of sale between farmers and traders by enabling farmers to sell directly to consumers. Several of these markets continue to function and have been regarded as successful on many counts. One example is the Rythu Bazaars in Andhra Pradesh, which were established in 1999.

Since the late 1990s a class of supermarket-style food stores has emerged, especially in cities in southern India. In contrast with traditional stores, these stores stock both dry and wet goods and often offer value-added or convenience products and ready-to-cook items, like pancake batter and cut vegetables. Most often, these supermarket-style stores are local businesses that have no or few branches and are typically owned by entrepreneurs who make medium-scale investments.

Because India is a vast and diverse country, there are significant regional and rural-urban differences in the particular mix of retail institutions. For instance, until recently, cities in the south have had more supermarket-style stores than have north Indian cities. Similarly, small towns and vast stretches of rural India are served predominantly by neighborhood stores and vendors.

⁸ Civil Supplies Departments are designated wings within the government that oversee the functioning of the Civil Supplies Corporations.

Policy Issues

Why Has India Been Different?

Given this complex retail mosaic in India, why has change, specifically defragmentation, in the retail sector been so slow in its coming? Starting with broad-based economic reforms in 1991, perhaps even earlier, there was a pronounced increase in private participation in many sectors of the Indian economy—the striking examples being telecommunications and information technology. At the same time, socioeconomic parameters—such as diversifying diets and growing urban incomes—that provide the enabling conditions for such growth were likely already present in the 1990s. Why then did large-scale food retailing, barring a few cases, not emerge?

The answer to this paradox lies in a combination of factors. On the one hand are issues relating to the policy environment; on the other hand are demand-side issues.

One factor driving retail market development has been the flow of foreign direct investment into developing countries.⁹ When retail markets in developed countries reach saturation, large-scale retailers in these countries begin to look at other markets to invest and operate in. In several developing countries, the opening up of economies to FDI spawned investment in food retailing. In Latin America, for instance, the food retail sector is increasingly and overwhelmingly operated by multinationals, and 70–80 percent of the top five chains are multinationals. In most cases, a handful of multinationals like Ahold, Carrefour, and Wal-Mart and smaller chains such as Casino and Metro Makro have dominated this transformation within countries (Reardon and Berdegue 2002). Regional multinationals such as Dairy Farm International (Hong Kong) and Shoprite (South Africa) have played this role too. Where FDI has not been directly involved, it has nevertheless influenced the transformation through participation in joint ventures; in China, for instance, Lianhua (the Shanghai-based retailer) partnered with Carrefour.

⁹ FDI refers to long-term investment in an enterprise by a firm in an economy other than the one in which it is based. It typically comprises a parent enterprise and the affiliate in the recipient country, with control resting with the former.

In the case of India, FDI has been disallowed in the retail sector and continues to be prohibited. The government has repeatedly staved off pressure from different quarters to change this policy.

India has allowed foreign participation only in wholesale cash and carry operations, single-brand retailing, franchising and joint ventures, and licensing arrangements. In 2006 the Indian government permitted only up to 51 percent foreign investment in single-brand retailing. Owing to this policy framework, multinationals could engage in only a limited way. Thus, FDI restrictions largely explain the absence of large foreign retailers in India.

Although FDI restrictions are a valid explanation, it has been argued that this cannot be an *adequate* explanation for the absence of large retailers per se, because India does not lack domestic capital. Yet throughout much of the 1990s, there were few large-scale investments in the retail sector. Some retailers grew steadily and successfully served a niche market in urban centers, such as Food World. One of the pioneers in supermarket-style food retailing in India, Food World was started in 1996 by the RPG Group, later collaborating with Dairy International of the Jardine Matheson Group. Food World was one of the first retail players in India to introduce "modern" inventory management systems and develop its own private label. Similar ventures were mostly confined to the southern states. For much of the 1990s, there were only a handful of such retailers. Until about 2000–2001, Chennai had five organized food and grocery retail chains, whereas other big cities such as Bangalore, Delhi, and Mumbai averaged only two to three such chains (Anand and Nambiar n.d.).

Several Indian corporate houses had been eyeing the food retail trade, but they perceived that the policy environment, among other things, was not entirely conducive.¹⁰ For instance, industry sources often cited urban real estate laws as a constraint on operations; the Urban Land Ceiling Act limits the physical space available to businesses. Industries also claimed that the many taxes and octroi levied on organized retailing complicated operations.

¹⁰ The following is typical of the sentiment among retail industry observers: "New retailing formats such as mass merchandising, hypermarkets, and warehouse clubs have not yet happened because of rules that prevent the development of organized retailing" (*Businessline* 2002).

The other aspect of policy that has confined large businesses is in the area of procurement and agroprocessing. Here, potential investors had to contend with several issues. Corporate involvement in agricultural production and trade has traditionally been severely curtailed in India. As in retailing, FDI was disallowed, except in tea plantations. The highly fragmented supply chain, coupled with the lack of high-quality infrastructure, meant that food retailing posed an extraordinary logistical challenge. Of those early entrants that took up food retailing in the 1990s, some exited soon after, ostensibly because of logistical problems (Nanz, for example, closed down in 1999).¹¹

There was also a perception that demand was not large enough to support the scaling up of operations—something that is critical given thin margins on groceries. Although urban incomes, especially among the middle class, were rising and consumption patterns changing, the trend had only just begun and had yet to gather momentum. Furthermore, given strong and resilient regional preferences for consumption baskets, the consumers themselves were too heterogeneous to be served by large supermarkets. In fact, large-scale retailers that recently entered the market acknowledge this heterogeneity: "The product offering in two stores 12 kilometers away is totally different" (A. T. Kearney 2005, 4). For this reason many of the supermarket-style ventures have confined themselves to a particular region within India, even particular cities. For example, the RPG Group's Food World, Nilgiris, Margin Free, Giant, Varkey's, and Subhiksha all operate in southern cities; Sabka Bazaar operates in the capital region of Delhi; Haiko and Radhakrishna Foodland are Mumbai-centric; and Adani has been Ahmedabad-based (Anand and Nambiar n.d.).

The Beginnings of a Revolution

Despite the early languor of retail transformation, much of this has changed, especially since 2001. It seems that the Indian retail sector has taken flight.

On the demand side, there is no denying that most of the socioeconomic parameters that drive the growth of organized retail food marketing are

¹¹ Nanz was promoted by the Delhi-based Escorts Group, the U.S.-based Marsh Supermarkets, and Nanz AG of Germany.

present in India today more than ever before. The average Indian household spends around half of total household income on food. Diets have diversified considerably in favor of new foods, including other cuisines. There is broad agreement that since liberalization and economic reforms in 1991, a marked shift has taken place in the mindset of the Indian consumer from need-based shopping to lifestyle shopping. Twenty-four percent of India's population falls in the 20- to 34-year-old age group (A. T. Kearney 2005) and seems to spend more freely than the previous generation did. High incomes fueled by tertiary sector growth have also created a new professional middle class that has begun to find intrinsic value in shopping experiences and consumer choice. This attitude permeates all areas, including food. This class has greater mobility and more contact with other countries and cultures, so that urban upper-class consumers look more like one another than before, blurring sociocultural boundaries. Urban lifestyles have changed perceptibly, and the growth in urban consumerism and a new "way of life" translates directly into huge potential demand for branded, packaged, and ready-to-eat foods. At the same time, there is rising concern about food safety among these classes, raising demand for foods and beverages that are hygienic, safe, and trustworthy. The growth of the bottled water industry in India, for instance, is testimony to this fact.

Mainly on account of these trends, the food retail sector in India today is worth about US\$200 billion. Given that organized retail has been registering growth rates of approximately 40 percent a year over the past three years, it is expected to grow to US\$460–470 billion by 2010 (CII and McKinsey and Company 1997).

Simultaneously, there has been a reorientation of government policy. This has its roots in the economy-wide reforms that began in 1991. Over the decade since, there has been a gradual change in policy in favor of greater private sector participation in different sectors. Recent policy changes for food processing have spawned the growth of that industry, both for export and for the domestic market. Policy changes have also provided some enabling conditions for retailers in terms of logistics and supply chain management (see Box 1 for examples).

Box 1: Recent Policy Initiatives in the Food-Processing Industry

- Most processed food items were exempted from licensing under the Industries (Development and Regulation) Act, 1951, except items reserved for the small-scale sector and alcoholic beverages.
- Food-processing industries were included in the list of priority sectors for bank lending in 1999.
- Automatic approval for foreign equity up to 100 percent is available for most processed food items except alcohol, beer, and those reserved for the small-scale sector, subject to certain conditions.
- The excise duty on processed fruits and vegetables was lowered from 16 percent to 0 percent in the 2001–2002 budget.
- Licensing powers were delegated to regional offices under the Fruit Products Order, 1955.

Budget of 2004–2005

- Under the Income Tax Act, the government allowed a deduction of 100 percent of profits for five years and 25 percent of profits for the next five years for new agroprocessing industries set up to process, preserve, and package fruits and vegetables.
- The excise duty of 16 percent on dairy machinery was reduced to zero to help promote the dairy-processing industry. The excise duty on meat, poultry, and fish was reduced from 16 percent to 8 percent.

Budget of 2005–2006

- The customs duty on refrigerated vans was reduced from 20 percent to 10 percent.

Source: Ministry of Food Processing Industries 2006.

Domestic firms have started responding strongly to this latent demand, helped along by a more conducive policy environment. The star entrant has been Reliance, a leading Indian conglomerate with no prior agribusiness experience, which announced that it would invest US\$3.4 billion to become the country's largest modern retailer by establishing a chain of 1,575 stores by March 2007. Hypercity Retail, a subsidiary of K Raheja Corp Group, plans

to open 55 hypermarkets by 2015, and Bharati is set to follow with similar plans. Besides these examples of recent ventures and corporate expansion plans, several other enterprises have expressed similar ambitions, pointing to the immensity of the transformation currently underway.

Meanwhile, foreign investors are exploring ways to overcome policy obstacles to operating in India. Wal-Mart is considering opening a Sam's Club wholesale business through a joint venture and selling strictly to other retailers. This strategy skirts the issue of not being able to sell directly to consumers and establishes a presence in the local market. Tesco is planning to enter the market through a partnership with Home Care Retail Mart Pvt. Ltd. and expects to open 50 stores by 2010.

Organized food retailing is still in its infancy.¹² For instance, food retailers in India today are quite different from their counterparts in the developed world. Indian retailers have extremely high average SKUs for fruits and vegetables relative to their western counterparts, mainly on account of their heterogeneous clientele with particular cultural and regional preferences. Store areas are not particularly large—anywhere between 2,000 and 10,000 square feet. Arrangements for sourcing vary across actors. Some retailers choose to buy from the wholesale market, whereas others have dedicated suppliers, small and large. Investments at the front end and in consumer interface, observers concur, have been tremendous. The extent of investment in the back end, in terms of on-farm handling, storage, and transport, has been lower. One exception is Metro, which made deep investments in building a high-quality supply chain to support its operations. Observers suggest that whereas some retailers have adopted a “big bang” approach and sought to maximize the number of new outlets and spatial reach, others have adopted a measured approach and focused on putting reliable supply chains in place. Metro, with only two stores in operation in over five years, is often cited as an example of the latter approach.

With the fledgling transformation in flux, a shakeup is inevitable and impending. How it unfolds is a matter of current interest. For instance, in some urban neighborhoods, where there was just 1

food retailer five years ago, now there are 10. In some of these outlets, turnover of merchandise has fallen by half in the face of competition; others are even losing money. Observers predict that in the near future, retailers will end up carving out niches for themselves within the food retail sector or will reposition themselves and consolidate. Only time will tell.

Stakeholders

So far, the discussion of the retail transformation in India's agro-food sector has been largely celebratory, at least in the popular media. Yet this complex transformation is bound to have both winners and losers. Clearly, two issues merit careful scrutiny. First, how will the efficiency gains from this transformation be distributed among actors? Will it be equitable, or will the rents be cornered by those with greater economic power? Second, what kinds of costs will be associated with the displacement of livelihoods that such a transformation will entail?

Policy makers clearly recognize the importance of these issues. In a speech in early 2005, Union Minister of Commerce and Industry Kamal Nath told a gathering of business leaders, “If any of you have come here to hear from me whether or not the Government is about to announce FDI in the retail sector, you are going to be disappointed.... The nature of the retail sector in India is too complex for a hasty decision to be taken in this regard” (Nath 2005). It is therefore imperative to examine the exact nature of potential gains and losses to the different stakeholders.

Indian corporate houses would stand to gain the most, especially given current FDI regulations. Recent years have seen a concerted effort by industry groups such as Federation of Indian Chamber of Commerce and Industry (FICCI) and the Confederation of Indian Industry (CII) to secure important changes in retailing policy. Their pitch to the government centers largely on efficiency gains from the technological changes brought about by large-scale retailers.

This approach could be a way to address the huge waste in Indian agriculture. Figures suggest that as much as 30 percent of produce is wasted annually, and only a fraction of agricultural produce is processed—as low as 2 percent for horticultural

¹² This entire section is based on information gathered from conversations with industry observers in Bangalore, Chennai, and Hyderabad during March–April 2007.

crops (Ministry of Food Processing Industries 2006).¹³ Investment in cold storage and processing by large-scale retailers would redress this situation and lead to huge efficiency gains. Industry groups also argue that retailing is a highly labor-intensive sector and would generate employment. Some also claim that larger retailers would bring in more tax revenue and conform to labor laws, because it is much easier to monitor and enforce these regulations for large retailers than it is for the informal retail sector, which is diffuse and small in scale.

The supporting and ancillary sectors, such as processing, cold storage, and transport, constitute the other group of stakeholders. Large investments in these facilities, especially in the rural areas, would be welcome in the context of a weak rural industrial base if they generate employment.

As far as FDI policy goes, domestic industrial groups have been somewhat more divided. Some lobbying groups recognize that Indian industry would likely benefit from joint ventures with foreign counterparts, which would bring in new, state-of-the-art technology and larger investments. Industry observers suggest that Indian retailers have an advantage over foreign retailers because success in the retail trade in India has a significant component relating to home-ground advantage—that is, understanding the heterogeneity and particular characteristics of the Indian consumer—not to mention that Indian retailers have a head start. In fact, the swiftness with which Indian businesses are entering the retail sector suggests they recognize this! On the other hand, some fear that domestic firms might lose out to larger foreign retailers.¹⁴

This concern is universally true for another stakeholder group—small traders, who form a large constituency.¹⁵ As expected, they have been at the forefront of protests against large retailers with

deep pockets. When Metro, the German cash-and-carry wholesaler, opened an outlet in Bangalore, the “Silicon Valley” of India, the joke went that it probably saw more protesters than customers. Whereas retail traders often have professional associations that enable some sort of collective action, itinerant vendors have little power or voice, let alone say, in matters of policy. They are diffuse and operate at a small level, and although they network with one another, they rarely have collective lobbying power.¹⁶

The nature of actors in the informal retail sector in India merits attention. It is often mentioned that the retail sector serves as a receptacle for the self-employed. A large section of this group has few employable skills and turns to retailing produce or groceries for lack of better opportunities. Although not true across the board, this is certainly true of itinerant vendors and street vendors. From this perspective, a supermarket that captures their clientele could simply dismantle their livelihoods. As it is, this group has in the past suffered the consequences of city-level actions, such as forced evacuations.¹⁷ It is also difficult to imagine that they will be absorbed into the formal retail sector in any way, given their lack of marketable skills. There are supermarkets, however, that incorporate vendors. A retail format called store-within-store (adopted by Fabmall, for instance) accommodates existing vendors within the supermarket, providing them with not only store space, but also equipment like refrigerators. Similarly, Safal’s chain of fruit and vegetable outlets in Bangalore serves as a supplier to vendors in the morning and an open shop to individual buyers during the day. These formats may aid rather than displace local vendors.

Consumers, another stakeholder group, are of course central to the discussion on retailing. They are often used prominently as mascots for the retail industry to tout consumer benefits such as greater choice, higher quality, and improved shopping experiences. Moreover, the emergence of supermarkets, with their sophisticated supply chains, ensures safe products that conform, typically, to recognized grades and quality standards.

¹³ The figure is higher for livestock produce.

¹⁴ For instance, Indian retail groups, such as the RPG Group and the Pantaloon Group, have expressed their strong opposition to allowing more FDI into Indian retailing, especially majority foreign ownership. They argue that the sector is still at an early stage of development and multinationals such as Wal-Mart would swamp local players, especially the *kirana* owners (*Business Standard* 2005).

¹⁵ For an interesting discussion on the effect on existing retailers, see Reardon and Hopkins (2006).

¹⁶ India does have a National Association of Street Vendors of India (NASVI) that has been active in this area.

¹⁷ A National Policy of Urban Street Vendors was adopted in January 2004 to address these issues.

This conformity is perhaps the hallmark of supermarket-style food retailing and is particularly important in India, where food-borne diseases and rampant adulteration by unscrupulous dealers are prevalent.

On the question of price, however, the benefits may not be as widespread. Consumers straddle the entire spectrum of socioeconomic classes in India and are therefore highly heterogeneous. It may well be that the ones who are most likely to benefit from supermarkets are the urban middle and upper-middle classes. This group has emerged from the post-liberalized India with the greatest spending power. The less visible, but certainly much larger, class of consumers consists of the poorer segment of the population. It is difficult to say how supermarkets will change things for them.

Only a few supermarkets in India have made claims of cheaper food. Specialized discount chains like Subhiksha, which focus on own-brand retailing of grains and pulses, are indeed much cheaper. Food World claims that its produce is 15 percent cheaper than alternative sources. Most other retailers, however, have focused on exploiting consumers' willingness to pay for convenience, choice, or a high-quality shopping experience.¹⁸ It is difficult to imagine these supermarkets catering to low-income groups. Over time, however, given the high contestability of retail markets, it is conceivable that supermarkets will indeed offer lower prices across the board.

In a country like India, this situation still leaves the issue of social access. Will supermarkets coexist with traditional food retail markets that will continue to serve the excluded segment? It is difficult to say. If, for instance, consumers patronizing the informal retailers are wooed into supermarkets, it would jeopardize the survival of the former. In that case, poorer consumers may be hurt by the coming of supermarkets.

¹⁸Apna Bazar, which started with a middle-class image, recently repositioned itself as an upper-middle-class shopping venue, suggesting a shift to serving the upper end of the consumer spectrum. Even Subhiksha aims to be the principal store of purchase for at least 40 percent of all consumers living within 500–750 meters of the store. This suggests a strategy that is targeting a subsection of the population and not all.

Retail power also raises important questions about the relative position of farmers, and "manufacturers" more generally, in the agro-food supply chain. Questions about the supply chain are especially relevant in the context of India, where the industrialization of agriculture is happening in tandem with the retail transformation, and these questions have attracted the most attention from researchers. Studies of the Indian case, however, are relatively scarce at present. Vertical linkages are sometimes beneficial to small, poor farmers, and at other times they are not. The effects of vertical linkages for small farmers seem to vary across crops and regions and with the exact nature of arrangements.

In India, procurement strategies cover the entire spectrum. At one end, for instance, is Bharti's Field Fresh, which contracts only with large farmers cultivating a minimum of 1,000 acres. Its executive explained, "I can manage ten or twenty farmers, but not thousands" (Witsoe 2006, 18). On the other hand, Choupal Fresh plans to source from small farmers with as little as one acre under cultivation. Others procure from wholesale markets as well as farmers. Systematic research would yield a clearer picture of this aspect of the agro-food industry.

Irrespective of whom retailers purchase from, these sources face one common problem: Strategic decisions at the retail end can have sudden and costly impacts on producers up the commodity chain. For instance, given that retail markets can be highly contested, retailers face pressure to keep procurement costs low.¹⁹ If the retailers are monopsonists at the farmer's end, they achieve this by driving down the price paid to the farmer. This issue is of course an empirical one, valid in some instances and not in others. In a country like India, however, with a huge population of small farmers, this risk to farmers must be an important consideration.

Although the coming of supermarkets clearly has both positive and negative ramifications, the issue is complicated by a woeful lack of data and research. In India, more than elsewhere, there is not much

¹⁹Timmer (forthcoming) addresses the issue of contestability, pointing out that it is a key aspect. By extension, it is important to have contestability not only at the consumer end, but also at the procurement end.

clarity on how these developments will affect the different stakeholders, partly because the phenomenon is so recent.

Policy Options

For the government, this retail transformation presents a confounding problem. As control over the agro-food chain devolves to large-scale private sector players with deep pockets, several critical questions emerge at various levels.

On the one hand, the ongoing agrarian crisis and the erosion of rural livelihoods are pressing concerns. In that context, and given the enormous postharvest wastage, the emerging food retail scenario could solve some problems—it could ensure postharvest efficiency in supply chain management and stable markets for farmers. It can also be an instrument for bringing about changes in cropping patterns, agronomic practices, pesticide use, and harvesting techniques, with important implications for farm incomes. Modern supply chains would also ensure traceability, and with monitoring, contribute to safe food that measures up to recognized quality standards. The retail sector would generate employment along the entire supply chain, including in intermediate sectors such as cold storage and transport. Needless to say, consumers would presumably benefit not only from having greater selection of produce and shopping experiences, but also from having access to high-quality produce.

At the same time, there are those who would almost surely be hurt—wholesale traders, retailers, itinerant vendors, and even poor consumers. As for farmers, it is not clear how much of the efficiency gains would in fact accrue to them. How can the government negotiate this?

At one level, the issue is to what degree the government should *enable* such a transformation. This issue relates to two sets of policies. First, should it press on and ultimately open up retailing to foreign investment? Second, disregarding FDI, should it reconfigure domestic policies, including those related to urban real estate and agricultural marketing, to allow businesses to link up and scale up operations?

At another level, how should the government address the livelihood issues of those who might be swept away by these changes? Should its policy be compensatory so that it helps them cope, or should it enable players in the informal retail sector or farmers to be part of this change?

A third critical question pertains to institutional diversity. Regardless of how inclusive this retail transformation may be, is the preservation of institutional diversity in agro-food marketing channels desirable for its own sake, as an end in itself? If so, what kinds of policy instruments can ensure that diversity is preserved?

Opening up FDI in retailing, many fear, is the thin end of the wedge. With it will come, inevitably, the tendency toward concentration. Historically, a period of mushrooming supermarket ventures first generates a highly contested market; in the second phase, there is a shake-up that promotes a trend toward consolidation in the sector. In Latin America the top five chains in each country control 65 percent of the supermarket sector, compared with 40 percent in the United States and 72 percent in France (Reardon and Berdegue 2002). This consolidation can happen in two ways: Foreign chains can acquire local chains, or larger domestic chains can acquire smaller chains and independents. Alternatively, consolidation can occur through development of new outlets. Both processes have happened in Latin America. FDI is thus bound to amplify and hasten the process of consolidation, owing to the sheer amount of capital available to large multinationals. In the first eight months of 2002, for example, five top global retailers spent US\$120 million to build new stores in Thailand. During 2002 Wal-Mart spent US\$660 million in Mexico (Reardon 2006). Multinationals have already begun acquiring Indian firms in the food-processing industry,²⁰ and this process could occur in food retailing as well, as a prelude to consolidation. On the other hand, it is clear that even in the absence of FDI, the retail revolution has

²⁰ MTR, a family-owned concern, was bought out in 2006 by Norway's Orkla for US\$100 million. Nilgiris in Bangalore sold a majority stake to Actis for US\$65 million, and Barista was acquired by Lavazza of Italy for US\$125 million. At the same time, Indian enterprises were acquiring foreign brands: for example, Tata acquired Tetley for US\$430 million in 2000, Eight O'Clock coffee for US\$220 million in 2006, and Energy Brands, Inc., for US\$677 million in 2006.

well and truly begun and India's domestic firms are not particularly capital constrained. Opening up retailing to FDI would only accentuate the trend and not alter it in any significant way.

The next question pertains to the policy environment for domestic industry. Can the government incorporate this retail transformation, driven by the private sector, into its broader agenda of poverty alleviation and food security? If so, how?

The arguments straddle both positive and negative responses to this question. If supermarkets are to aid poverty alleviation rather than obstruct it, then they need to be inclusive of the poor—not only the poor farmer, but also the poor consumer and poor trader.

Few would disagree that many informal sector food retailers need better livelihoods and that it is desirable to enable them to achieve this goal, if necessary by helping them exit this sector. Whether supermarkets can do this in a positive way, however, is the critical question. If supermarkets do in fact crowd out the vendors, these people are unlikely to be absorbed into the sector as employees. A recent entrant to food retailing, Reliance, announced that its strategy is to employ students and housewives in addition to hiring employees from other retailers. On the other hand, firms such as Food World have specifically trained youth from economically weaker segments of the population as staff. In terms of aggregate employment effects, studies suggest that the traditional retail channels are far more labor intensive than the formal retail sector. A study of retail food channels in Vietnam found that every metric ton of vegetables sold accounted for three times as much employment for street vendors as for supermarket staff (Asian Development Bank 2004). If this is true in India, it makes a strong case for supporting the informal retail sector, improving the condition of informal actors, and indeed maintaining the institutional diversity of the food retailing sector.

Experience in Latin America suggests that small traditional stores and plaza markets have been losers. In the six largest countries of South America, there was a marked shrinkage in plaza markets in the 1990s: 64,198 small shops went out of business in Argentina between 1984 and 1993, and 5,420 in Chile between 1991 and 1995. The

exceptions were fruit and vegetable specialty shops (Reardon and Berdegue 2002). One cannot assume that smaller traders will be able to make the necessary investments to be able to compete with large-scale retailers. On the other hand, they do not always fail. Farina et al. (2004), for instance, document that in Brazil the number of traditional retailers and independent supermarkets increased by 33 percent and 7 percent, respectively, between 1994 and 2002, whereas the number of chain retail stores declined by 21 percent. In India, industry observers point out that informal food retailers are very resilient and may have risen to the challenge. Some informal retailers have upgraded their store-fronts, improved in-store displays and customer service, and adopted more sophisticated stock management and billing procedures. These changes show that traditional retailers can adapt, and even thrive, against the odds.

As for consumers, supermarkets in India have focused exclusively on niche markets in urban areas catering to the upper middle class. There is some evidence that poor consumers in developing countries, including Vietnam, rarely have access to supermarkets owing to distance as well as higher prices. In other countries, however, supermarkets tend over time to cater to poorer sections and serve non-urban centers, often by developing satellite chains with different formats (such as Shoprite in Zambia). About 40 percent of Chile's smaller towns now have supermarkets, as do many small to medium-sized towns even in low-income countries such as Kenya. In China, supermarkets are now spreading beyond the top 60 cities. The fact remains, however, that as long as there is a large segment of extremely poor people, supermarkets will find it a challenge to reach out to them. In this context, will the retail channels, public and private, that already serve them survive and continue to do so?

Finally, what about small farmers? To what extent do supermarkets procure from local producers as opposed to importing from other countries? Also, to what extent are small and marginal farmers included in the supply chains of the retail food sector?

The evidence on domestic and small farmer participation in the supermarket-driven food chains is mixed. Reardon and Berdegue (2002) estimated that supermarkets in Latin America buy 2.5 times

more fruits and vegetables from local producers than all the exports of produce from Latin America to the rest of the world. On the other hand, Shoprite Checkers in Zambia has been criticized for sourcing supplies through its parent company in South Africa rather than from Zambian producers (Mpundu 2005). In general, evidence suggests a range of procurement systems, from total reliance on traditional wholesalers delivering to individual stores (for small chains), to outsourced, decentralized procurement systems (for small to medium-sized chains), to procurement from large-scale, specialized wholesalers or processors (Berdegue et al. 2005). Some studies find that supermarkets tend to source from large-scale processors in order to reduce transaction costs, because those processors possess adequate logistics and transportation capacity and are able to meet the private standards of the retailer. For example, the Xiaobaiyang chain in Beijing is known to have shifted from 1,000 to 300 processed food suppliers in two years as it centralized its procurement system (Hu et al. 2004). Similarly, leading Russian chains focus only on a handful of foreign and domestic suppliers for dairy products (Dries and Reardon 2005). Some other studies show substantial involvement of small growers (such as for tomatoes in Nicaragua and Guatemala and lettuce in Guatemala). Nonetheless, small farmers who do not have the capital to meet the requirements of supermarkets tend to be excluded, as illustrated in studies of potatoes in Ecuador (Zamora 2004) and vegetable producers in Thailand (Boselie 2002).

Also, the net benefit to the farmer of selling to supermarkets rather than to traditional markets is not always higher. For Guatemalan tomato farmers, Hernandez et al. (2004) show that there is not much difference in net return between selling to wholesalers that sell to supermarkets and selling to wholesalers that sell to traditional retailers. There is a perception, however, that the market risk is lower when a farmer enters a relationship with a wholesaler dedicated to the upper-tier market, such as supermarkets. For growers to enter these markets, it appears that farmers' associations or cooperatives tend to be necessary to reduce transaction costs, but these do not guarantee market access.

Conversations with farmers in southern India suggest diverse outcomes. In some areas farmers are

immensely pleased with the advent of retail food buyers, who pay them competitive prices and have had a disciplining effect on the commission agents and wholesalers. In other places farmers are disenchanted with these buyers for reneging on oral commitments to buy and forcing prices down. What is certain, however, is that supply chain issues are critical in a country where smallholders predominate. Given this mixed evidence, it is difficult to draw up a prognosis for the small farmer in India.

Although the empirical evidence clearly offers several lessons and insights, the government walks a tightrope and must weigh the potential benefits of such transformation against its possible negative consequences—and find a way to make supermarkets a part of the change it seeks to bring. As more research on these various aspects of agro-food retailing filter in, the situation should become clearer. No wonder then that the minister in his 2005 speech to business groups appealed for caution in policy making, and against haste.

Assignment

Your assignment is to recommend to the Government of India a set of policies to be pursued to guide future developments in the food retail sector, taking into account the interests of the different stakeholder groups.

Additional Readings

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