

Retailing in India: Assessing the Investment Climate

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1. Introduction: overview and data description

The retail and wholesale sector in India accounts for about 14% of GDP and over a quarter of the value added in all services sectors. In terms of employment, the sector is the second largest employer (after agriculture) providing over 10% of all formal jobs in the country.¹ The sector has also shown strong growth in recent years, with an average annual growth rate of 7.3% over the 1990s compared with 5.9% in the 1980s and 4.3% during 1950-1979. These numbers tell the story in the formal sector. But an estimated 95% of the sector's activity takes place in the informal sector that is not accounted for in the official figures.

Despite its large size, the retail and wholesale sector has received relatively little attention from academicians and policy makers in India and elsewhere. One reason for this is the lack of reliable data. We use data collected by the World Bank's Enterprise Surveys in 2005-2006. The data consist of a stratified random sample of 1,948 retail stores operating in the formal sector and located in 16 major states and 41 large cities of India.² Roughly, 64% of the stores in the sample are traditional stores, 26% consumer

* World Bank, Washington, DC. *The findings, interpretations and conclusions expressed in this paper are entirely those of the author. They do not necessarily represent the views of the International Bank for Reconstruction and Development/World Bank and its affiliated organizations, or those of the Executive Directors of the World Bank or the governments they represent.*

¹ These estimates are based on National Accounts Statistics and taken from Gordon and Gupta (2004).

² The sampling frame for the survey was the list of retail stores regularly interviewed by AC Nielson for inventory verification on behalf of distributors of branded goods. This list covers stores in 41 cities across India for three major industry segments: Fast Moving Consumer Goods (FMCG) stores (traditional stores), consumer durable stores and the modern format stores. The sample was stratified according to segment-specific criteria. FMCG stores were stratified based on turnover, number of salesmen, number of FMCG product and the presence of cooling equipment. Consumer durable and modern format stores were stratified

durable stores and the rest 10% are modern format stores.³ Table 1 provides summary statistics on the surveyed stores.

The Enterprise survey sheds light on a number of problems faced by the retailers in the cities surveyed. The present paper analyzes the key problems that include access to finance, electricity, corruption and access to land. We also look at some of the emerging issues such as competitiveness of the sector, labor laws and employment generation in the context of large vs. small stores.

2. Obstacles to doing business

The survey reports on 19 different potential obstacles to doing business. Examples include availability of electricity, access to finance, corruption, tax rates, restrictions of store hour operations, etc. For each of these, stores report whether they are no obstacle, minor, moderate, major or very severe obstacle to their businesses. Figure 1 shows the percentage of stores that report the various obstacles as serious (major or very severe) in the full sample. In another question, stores were shown the list of all the 19 obstacles and asked to identify the most serious, second and the third most serious obstacle. Figure 2 shows how stores rank the various obstacles.

Figures 1 and 2 reveal a consistent picture. Electricity, access to finance, corruption, access to land and high taxes are perceived as the most important obstacles.

based on turnover. The sample size was determined so as to minimize the standard error in the sample variables, given the available resources for each surveying stratum. Once the sample size was determined, the sample was allocated to strata using Neymann's allocation rule. More information about the survey and methodology is available at www.enterprisesurveys.org.

³ Cities in the sample include (in alphabetical order): Ahmedabad, Bangalore, Bhopal, Bhubaneswar, Chandigarh, Chennai, Coimbatore, Cuttack, Delhi, Dhanbad, Faridabad, Ghaziabad, Greater Mumbai, Guntur, Gurgaon, Gwalior, Hubli-Dharwad, Hyderabad, Indore, Jaipur, Jamshedpur, Kanpur, Kochi, Kolkata, Kota, Kozhikode, Lucknow, Ludhiana, Madurai, Mangalore, Mysore, Nagpur, Nashik, Noida, Patna, Pune, Surat, Vadodara, Vijayawada and Vishakhapatnam.

By far, inadequate power supply (electricity) is the single most important obstacle. Roughly, 27.3% of the stores report inadequate power supply as a serious obstacle and an additional 21% as a moderate obstacle. Similarly, 30.1% of the stores find power supply as the most serious obstacle and an additional 24% as the second or third most serious obstacle. Looking at the objective measures of the quality of power supply, we find that 83% of the stores experienced at least one power outage over the last one year (fiscal year 2005-2006), on average there are 31 incidents of power outages in a typical month and losses due to power outages equal 4.6% of annual sales for an average store. For stores that did experience at least one incident of outage, losses average 5.8% of annual sales. As evident from Table 1, there is substantial variation in these numbers across states. 64.8% of the stores in Haryana, 59.1% in U.P and 40.4% in Punjab find power supply as a serious obstacle compared with only 3% in Kerala, 3.3% in Orissa and 5.6% in Tamil Nadu (column 1, Panel B, Table 1). Similarly, losses due to power supply (as % of annual sales) are as high as 14.2% in Haryana, 10.2% in Uttar Pradesh and 8.2% in Bihar. The best performing states here are Gujarat, Orissa and Andhra Pradesh which show losses of less than 2% (column 7, Panel A, Table 1). For an international comparison, we use EBRD and World Bank's Business Environment and Enterprise Performance (BEEPS, 2005) survey which was conducted in 27 Eastern European countries and the World Bank's survey of retailers in Argentina and Mexico (Enterprise Surveys, 2006). Compared with 83% of retailers in India, only 42% of the retailers in the BEEPS countries, 49% in Argentina and 29% in Mexico report one or more incident of power outage in the survey year. Losses from power outages as a percentage of annual sales averaged a mere 0.85% in the BEEPS countries, 1.2% in Argentina and 2.9% in Mexico

compared with 4.6% in India. For the set of BEEPS countries, Poland, Russia and Turkey show these losses at 0.07, 0.56 and 0.02%, respectively. Only 2 out of the 27 BEEPS countries performed worse than India reporting losses at 5.7% (Georgia) and 12.2% (Albania). These numbers suggest that India lags behind many other emerging economies in the quality of power supply and corrective measures are needed on a priority basis.

Access to finance is a serious obstacle for 17.5% of the stores and a moderate obstacle for another 16%. It is the most serious obstacle for about 17% and amongst the top 3 constraints for 33% of the stores. Although 64% of the stores have a checking or savings account, only 22% have an overdraft facility. Further, on an average, 82% of the investment in fixed capital and 74% of working capital is financed through retained earnings of the stores. Remaining sources of finance for working capital include 1.5% (private commercial banks), 5.2% (state-owned banks and government agencies), 6.5% (family and friends), 6.2% (credit from suppliers and customers) and 0.93% (money lenders and other informal sources). Corresponding figures for investment in fixed assets are 5.3, 4.9, 3.0, 0.6 and 1.1%, respectively. Is the use of external finance low because Indian retailers are credit constrained? In a series of questions, stores were asked the main reason for not borrowing from external sources. Using these questions, we define a store as “credit constrained” if it did not borrow because collateral requirements for loans were unattainable, application procedures were complex or the store thought that the loan would not be approved. Note that this is a conservative definition of credit constrained stores because it assumes that stores who borrowed externally did not face any constraint on the amount they could borrow. Estimates show that over 13% of the stores in the full sample are credit constrained. The figure is as high as 21% for the smallest 25% of the

stores (with floor area of the shop less than 100 sq. feet). Across states, credit constrained stores range between 6.4% (Maharashtra) and 52% (Bihar). The full distribution by state is reported in column 6 of Panel A, Table 1. As a comparison, credit constrained stores equal 7.8% in the BEEPS countries, 5.3% in Argentina and 13.1% in Mexico. Only 4 of the 27 BEEPS countries (Belarus, Czech Republic, Georgia and Azerbaijan) show a higher percentage of credit constrained stores than India. The findings suggest that the financial structure of retail stores in India is still rudimentary and that proper access to finance is a serious challenge for small stores and also for some states such as Jharkhand, Orissa and Bihar.

Corruption in the form of bribery is ranked among the top 3 constraints by our retailers. Specifically, 22.7% of the stores report corruption as a serious obstacle and an additional 15% a moderate obstacle. Further, 11.5% of the stores rank corruption as the single most important obstacle and an additional 17.6% as the second or the third most serious obstacle. In one question, stores were asked if they were inspected by tax, labor, fire and building safety and other government officials and if an informal payment (bribe) was expected or given during such inspections. About 40% of the stores in the full sample were inspected. 46% of these inspections culminated in a bribe payment or a request for one (henceforth, incidence of bribe). That is, over 18% of the stores in the full sample experienced at least one incident of being asked for a bribe. For the largest 25% of the stores (floor area greater than 300 sq. feet), the figure is as high as 26%. Columns 8 and 9 in Panel A of Table 1 show the variation across states. At the high end, 32.8% of the stores in Madhya Pradesh, 29.5% in Bihar and 27.5% in Punjab report an incidence of bribe compared with 5.5% in Haryana, 7.5% in Rajasthan and 8% in Gujarat. These

numbers may not appear to be too high but the main reason for this is the low level of inspections. As the retail sector modernizes and is subject to increasing scrutiny by the government, bribe incidence may increase substantially. For example, for the sample of stores that were inspected, bribe incidence averages about 43% in the full sample, over 90% in Punjab, 87% in Bihar, 72.7% in Jharkhand and 68.6% in Delhi (column 9, Panel A, Table 1). Similar estimates for other countries are available only for retailers in Mexico and Argentina and that too for bribe payments to tax officials alone. Roughly, 47% of the stores in Argentina and 42% in Mexico report inspections by tax officials compared with 27% in India. Only 2% of the tax inspections in Argentina and 12% in Mexico culminated into an incidence of bribe compared with 45% in India. A number of studies have shown that corruption has a sharp detrimental effect on firm performance, growth and investment.⁴ The numbers above suggest that this may be true for retailing in India.

Much of the discussion on land-related problems is focused on making more land available to retailers. The Enterprise survey reveals that non-availability of land is not the only (land-related) problem confronting Indian retailers. For the sample of stores that reported access to land as a moderate or bigger obstacle to doing business (32% in the full sample), non-availability of land was identified as a contributory factor by 81%, unclear ownership titles by 29%, problematic and costly registration process by 63% and difficulty in obtaining permits and licenses to use the land by 47%. In fact, in some states such as Haryana, Madhya Pradesh and Maharashtra, costly registration process is identified as a bigger problem than the non-availability of land. In short, a comprehensive approach towards land reforms is necessary.

⁴ See, for example, Svensson and Fisman (2007).

3. What are the priorities?

Which of the challenges described above is most pressing depends on where a business is located, and how big it is? Column 5 in Panel A of Table 1 lists the most important reform by state and store-size based on the most serious obstacle identified by the stores. Better power supply is the most important reform for eight states: Bihar, Delhi, Haryana, Kerala, Madhya Pradesh, Maharashtra, Tamil Nadu and Uttar Pradesh. Improving access to finance emerges as the top reform for Andhra Pradesh, West Bengal, Jharkhand and Orissa. The priority for Karnataka is land reform and reducing corruption for Punjab, Rajasthan and Gujarat.

Our analysis would be incomplete without some mention of small vs. large retailers. We define “small” retailers (or stores) as those with shop area less than 100 sq. feet (25% of the sample) while the rest are “large” retailers. In terms of the priority reform, access to finance is more important and power supply less so for small compared with the large retailers. Table 1 shows that 25.4% of the small retailers report access to finance and an equal number of them report inadequate power supply as the most serious problem. This is followed by access to land (13.1%) and corruption (11.7%). High tax rate is the most serious obstacle for a mere 4.5% of these stores. Corresponding figures for the sample of large retailers are: 13.4 (finance), 30.2 (power), 8.3 (land), 10.9 (corruption) and 10% (high taxes). The contrast between small and large retailers is particularly sharp at the state level. For example, in Orissa, 75% of the small retailers report access to finance as the most important problem compared with 34.7% of the large retailers. In Karnataka, access to land is the most serious problem for 33.3% of the small

retailers compared with 24.3% for the large retailers. These findings clearly show that the priority reform varies across states and also depends on the target group: small, large or all retailers.

4. Emerging issues: Labor regulation and competition

We looked at a number of issues covered in the survey and found a few surprises. First, there is not much talk amongst policy makers about labor laws in retailing although these are laid out in detail in the Shops and Establishments Act of the various states. Are labor laws actually enforced and if so, do they constitute an obstacle for store owners? The survey reveals that 27% of the stores find labor laws as an obstacle (minor or more) and 9% as a moderate or serious obstacle. At the high end, 53% of the stores in West Bengal, 44% in Rajasthan, 39% in Maharashtra and 33% in Delhi report labor laws as a problem. Corresponding figures for labor laws as more than a minor problem are 25, 12, 10 and 17%, respectively. These numbers are even bigger for the relatively larger stores in the sample. In short, while labor laws are not the most pressing problem cited by retailers, they cannot be neglected either.

Very little is known about the level of competition in retailing. India boasts of one of the highest densities of retail shops in the world and its young and educated buyers are considered tough customers putting pressure on seller's margins. However, the retail sector in India is also highly fragmented lowering the level of competition between retailers. In one survey question, stores were asked how important is competition from other retailers for the prices of the store's main product. Responses were recorded as not at all important, slightly important, fairly important and very important. Less than 40% of

the stores reported the competitive pressure as fairly important or very important. Corresponding figure for Argentina equals 73% and 66% for Mexico. For the BEEPS countries, it averages 71% ranging between 45% (Kazakhstan) and 89% (Albania). Amin (2007) finds that pro-competitive reforms could increase labor productivity in Indian retailing by as much as 87% of the current level. We also find an interesting spatial pattern of competition that contradicts popular belief. That is, competition seems to be lower in the richer and larger cities. Amin (2008) argues that the opportunity cost of time spent shopping is higher in the richer and larger cities. This lowers consumer search efforts for best prices reducing competition between retailers. Hence, pro-competitive reforms should be especially directed towards the richer and larger cities.

5. Employment: Small vs. large stores

The advent of modern retailing in the country characterized by large supermarkets and hypermarkets has brought to fore a number of contentious issues. Perhaps, the most contentious of these is the likely effect on employment generation in the sector. For the pessimists, the argument is based on two assumptions: (i) modern large sized retailers will take business from the small and traditional retailers, and (ii) the switch from small to large retailers will lower total employment because the latter generate less employment per unit of sales or business activity. The optimists believe that one or both these assumptions are misplaced as hence the fear over employment. Our data suggests mixed results. Figure 3 shows that the relationship between employment per unit of sales and total sales is strong and negative.⁵ This validates point (i) above. However, we don't find

⁵ Regression results show that on an average, a one percentage point increase in annual sales leads to a 0.60 percentage point decrease in employment to sales ratio, significant at less than 1% level.

much evidence of point (ii) above. Figure 4 shows the relationship between the growth rate (in total sales) of small and large retailers. The relationship is clearly positive. Hence, it is unlikely that large retailers are growing by displacing small retailers. What seems more likely is that common external factors are driving the expansion of small and large retailers.⁶ We must caution that a more rigorous analysis is necessary to validate or contradict our claim.

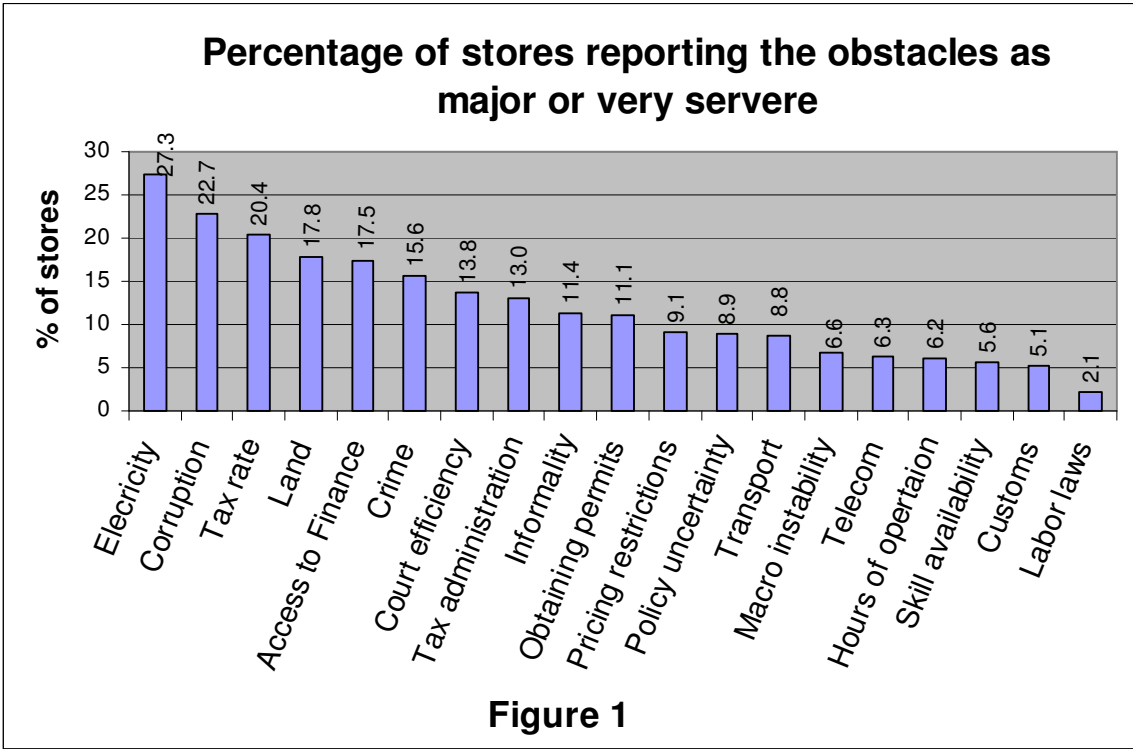
6. Conclusion

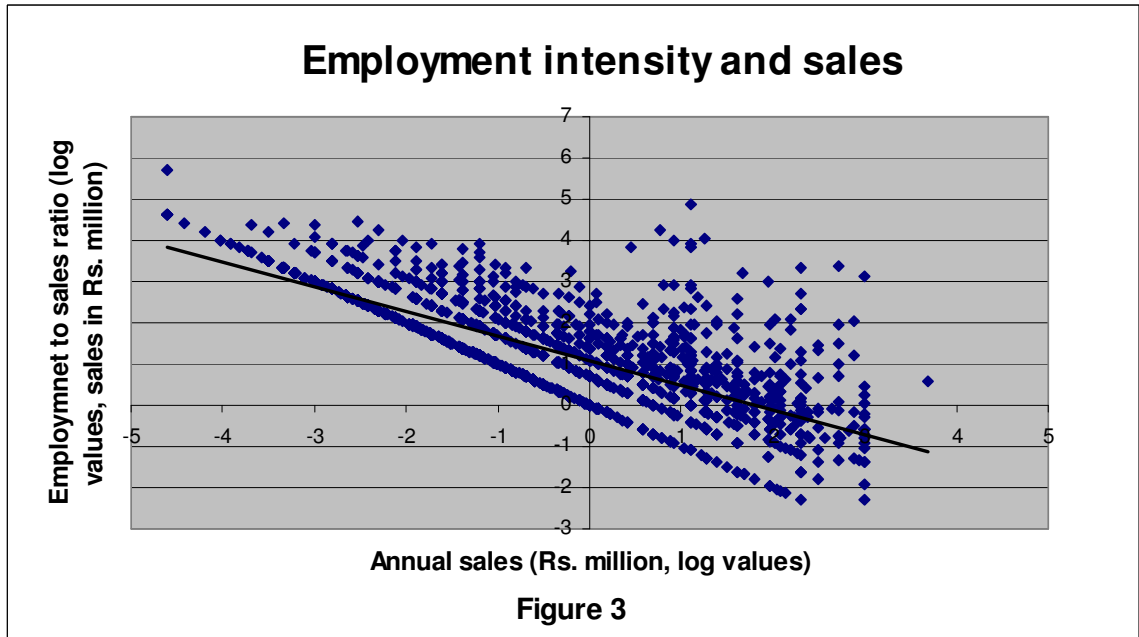
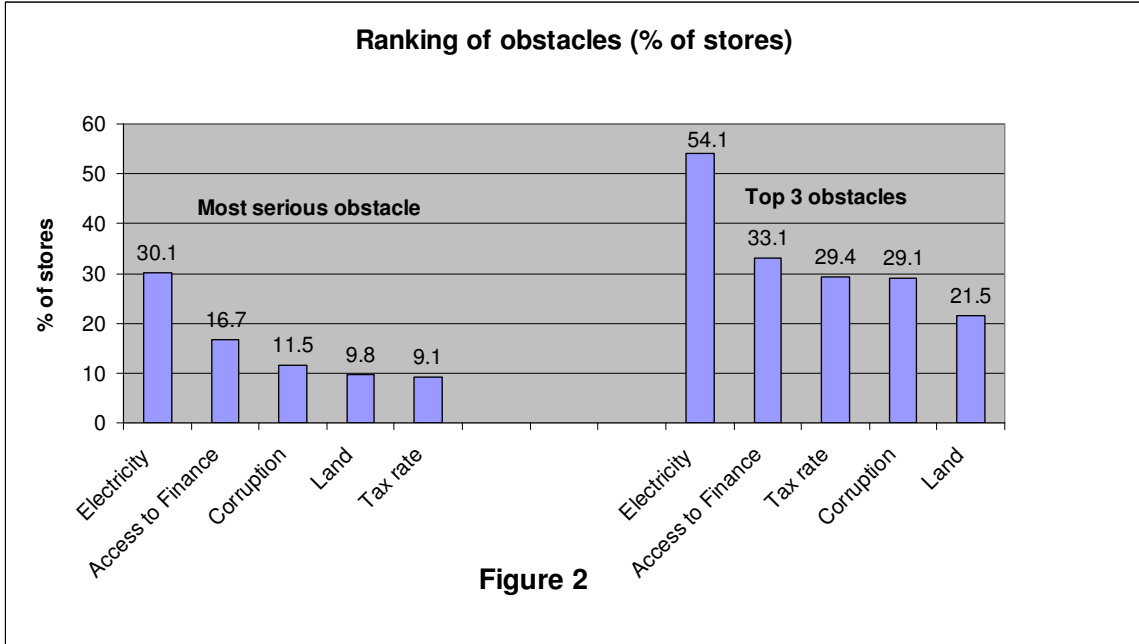
The paper attempts to highlight the main problems confronting the retail sector in 41 large cities of India. The analysis reveals that inadequate power supply, access to finance and corruption are the three most severe problems. We have also shown that while labor laws are not too important an obstacle, they are beginning to make their presence felt. Competition in the sector is also low by international comparisons and pro-competitive reforms could hold the key for a significant improvement in retailing efficiency in the country. Lastly, we find little evidence of a negative effect of large on small retailers.

References

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⁶ Our results do not change qualitatively if we use alternative cut-off levels for small vs. large stores.





Sales growth by city: small vs. large stores

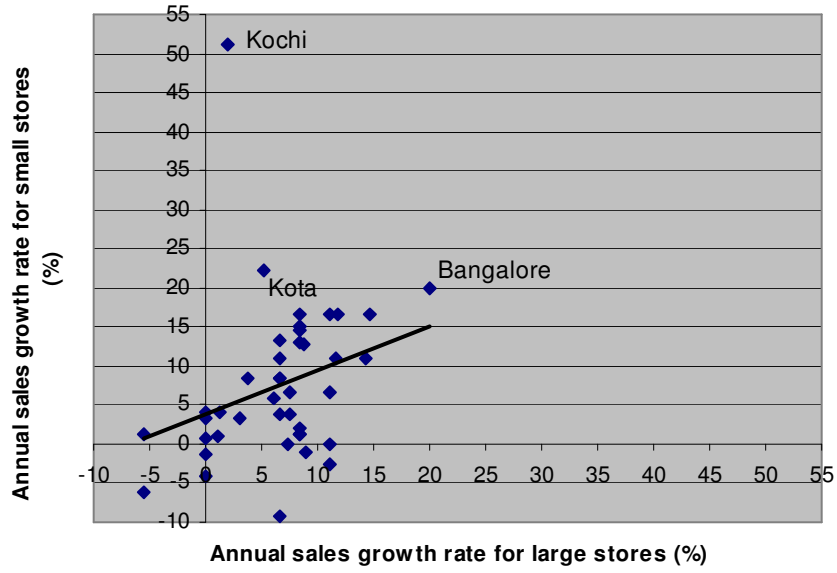


Figure 4

Table 1: Main indicators and obstacles

Panel A: Main indicators									
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
State	Obs.	Floor area (sq. feet)	Annual sales (Rs'000)	Sales growth (% annual)	Most serious obstacle	Credit constrained (% of stores)	Loss due to power outages (% of annual sales)	Bribe incidence (% of stores)	Bribe incidence (% of inspected stores)
AP	140	180	600	8.3	Finance	19.6	1.2	10.7	28.8
W. Bengal	130	110	360	3.3	Finance	13.1	1.9	17.7	23.0
Bihar	44	102	360	6.7	Electricity	52.3	10.2	29.5	86.7
Delhi	110	120	300	3.0	Electricity	12.7	6.2	21.8	68.6
Gujarat	175	175	360	6.7	Corruption	9.2	0.7	8.1	41.2
Haryana	55	100	290	6.7	Electricity	7.3	14.2	5.5	37.5
Jharkhand	63	108	300	6.7	Finance	23.8	8.0	12.7	72.7
Karnataka	188	150	500	14.7	Land	19.8	4.4	25.0	37.6
Kerala	69	300	2200	3.4	Electricity	8.7	1.9	20.2	35.0
MP	116	150	550	8.3	Electricity	7.6	6.3	32.8	44.2
Maharashtra	286	200	710	8.3	Electricity	6.4	5.5	15.4	57.9
Orissa	61	150	700	0.0	Finance	20.7	1.3	26.2	43.2
Punjab	109	150	600	5.7	Corruption	11.9	3.9	27.5	90.9
Rajasthan	66	200	730	8.3	Corruption	9.1	2.9	7.6	18.5
TN	161	150	700	6.5	Electricity	14.9	1.7	16.1	40.6
UP	175	120	156	6.7	Electricity	9.9	8.2	10.0	56.7
All states	1948	150	500	6.6	Electricity	13.4	4.6	17.4	43.6
Small stores	444	50	180	6.7	Finance, Electricity	21.4	4.0	13.2	43.6
Large stores	1504	200	720	6.7	Electricity	9.7	4.8	18.6	43.6
Panel B: % of stores reporting various obstacles as major or very severe									
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	
State	Electricity	Finance	Land	Corruption	Tax rate	Crime	Court efficiency	Tax administration	
AP	16.4	23.9	26.7	6.8	19.5	13.4	4.7	15.4	
W. Bengal	26.9	41.1	20.3	33.6	50.0	37.7	25.8	20.9	
Bihar	20.9	26.8	20.0	10.5	0.0	2.3	0.0	5.7	
Delhi	39.1	11.6	13.3	13.4	12.5	4.7	2.9	20.5	
Gujarat	19.1	9.7	7.0	22.2	21.5	14.5	12.2	17.2	
Haryana	64.8	12.7	16.4	16.4	7.3	1.8	3.8	5.5	
Jharkhand	35.5	22.2	33.9	34.4	38.6	28.6	19.0	38.6	
Karnataka	19.5	21.6	28.6	22.0	21.8	17.0	3.6	16.8	
Kerala	3.0	0.0	7.2	1.5	6.0	7.2	0.0	3.0	
MP	35.3	17.4	13.0	18.6	17.9	21.6	15.4	19.6	
Maharashtra	27.6	9.0	11.8	26.1	21.2	8.2	11.1	15.7	
Orissa	3.3	9.8	8.9	9.4	2.1	0.0	6.3	12.8	
Punjab	40.4	34.6	33.6	67.3	37.1	42.2	46.5	31.6	
Rajasthan	25.8	18.2	9.2	40.9	19.7	19.7	39.4	6.1	
TN	5.6	15.3	19.0	4.5	4.8	0.7	2.0	2.0	
UP	59.1	11.5	17.2	26.6	15.7	22.7	20.8	13.6	
All states	27.3	17.5	17.8	22.7	20.4	15.7	13.8	15.7	
Small stores	25.2	23.0	20.0	20.1	14.8	16.7	11.6	11.2	
Large stores	27.7	15.9	17.3	23.5	21.6	15.0	14.4	16.8	

1) "Small stores" are those with floor area of the shop less than 100 sq. feet while the rest are "large stores".

2) AP: Andhra Pradesh, MP: Madhya Pradesh; TN: Tamil Nadu, UP: Uttar Pradesh.

3) Median values reported for floor area, annual sales and sales growth in Panel A.