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Challenges of Retailing in India

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Using Enterprise Surveys data on 1,948 retail stores in India, this note highlights the key problems and challenges faced by retailers in 41 large cities of India. Inadequate power supply, access to finance, corruption, tax rates, and land-related problems are the most important obstacles to further growth. Competition in the sector also appears to be low, reducing labor productivity. Differences in the severity of these problems across regions and retail stores of various sizes are discussed.

The retail and wholesale sector in India is one of the largest sectors, contributing 14 percent to the national gross domestic product (GDP) and 10 percent to formal employment.[1] The sector has also shown strong growth in recent years, with a compounded annual growth rate of over 8 percent during 2000-2006 (at constant prices) compared with 7 percent for the national GDP. Despite its large size, the retail and wholesale sector has received very little attention in India and elsewhere, largely due to data limitations. This note uses Enterprise Surveys' data on 1,948 retail stores in 41 large cities of India to highlight key problems and policy issues.

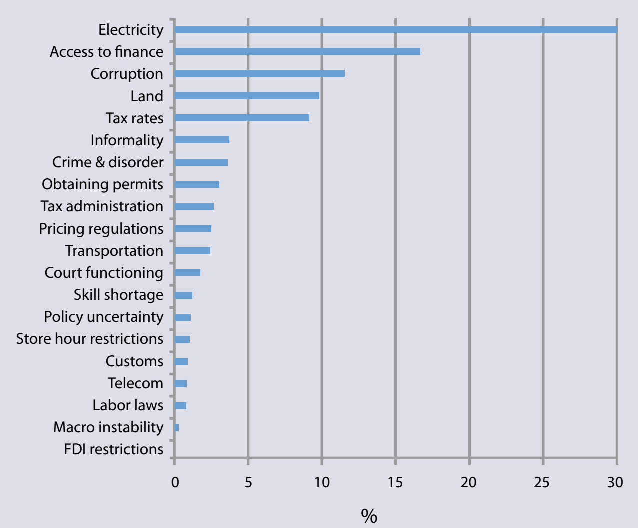
The sample consists of traditional or grocery stores (64 percent of the sample), consumer durable stores (26 percent), and modern-format stores (10 percent).[2] The median floor area of the shops equals 150 square feet, with annual sales of Rs 500,000 (US $10,309) and growing at a rate of 6.6 percent per annum. The number of employees (excluding the manager) per store averages 4.7, a figure highly inflated by a handful of large stores. About 43 percent of the stores are run by the owner/manager with no additional employees; 35 percent have 1-3 employees; and 22 percent have 4-500 employees. Over 93 percent of the stores have a single owner, and roughly half the stores use rented or leased land (as opposed to owned land).

Using these data, this note highlights the key obstacles and problems faced by Indian retailers and how the severity of the obstacles varies across rich and poor states and small and large stores. Inadequate power supply, poor access to finance, and high corruption are the three most pressing problems. The note also sheds light on the low level of competition in the sector and its consequences for the efficiency of retail stores.

Inadequate power supply is the most important obstacle to retailing

From a list of twenty obstacles, stores were asked to identify the one most important for their business (figure 1). Most stores (33 percent) identified electricity as the

Figure 1 **Obstacles to doing business faced by retailers in India**



Source: Enterprise Surveys.

Table 1 Power outages	Stores facing outages (%)	Outage incidents per month	Hours of outage per month	Losses from outages (% of annual sales)
Indian retailers				
All stores	82.9	26.9	65.1	4.6
Leading states	77.4	23	47.6	4.0
Lagging states	90.6	42.8	126.3	7.1
Ahmedabad (city with best power supply)	22.5	1.2	1.5	0.4
Gurgaon (city with worst power supply)	100	91.6	339	17.2
Retailers in ECA and Manufacturing firms in India				
Retailers, ECA	42.1	NA	4.3	0.8
Manufacturing, India	77	NA	46.2	6

Source: Enterprise Surveys.
Ahmedabad is the best performing city as far as losses due to power outages are concerned, while Gurgaon is the worst. ECA refers to 27 countries in Eastern Europe and Central Asia surveyed by Enterprise Surveys in 2005. Mfg., India relates to the survey of registered manufacturing sector conducted in 2006 Enterprise Surveys. Leading and lagging states are listed in endnote 3.

most important obstacle followed by access to finance (16.7 percent), corruption (11.5 percent), land-related problems (9.8 percent), and high taxes (9.1 percent). These top five obstacles are consistent across small and large stores as measured by the floor area of the shop. However, large stores are less concerned about finance and more concerned about taxes.

The data also show an interesting pattern across high-income (leading) and low-income (lagging) states.[3] Compared with the lagging states, fewer stores report access to finance as the single most important obstacle in the leading states (22.9 percent vs. 9.7 percent). This is also true of electricity (40.6 percent vs. 28.7 percent). The opposite holds for corruption (8 percent vs. 15.4 percent), tax rates (3.2 percent vs. 12.6 percent), and land-related problems (7.3 percent vs. 11.1 percent). We note that these comparisons do not imply that leading states perform worse in absolute terms than the lagging states in governance-related issues (corruption, taxes). Rather, with economic development, governance-related issues become greater binding constraints for stores' operations than finance and infrastructure.

Less developed states face more power outages

Table 1 confirms much better supply of electricity in leading vs. lagging states. However, we must be careful in rushing to a conclusion from this. Figure 2 shows that losses to Indian retailers per hour of power outage are much higher at initial hours of power outage. Consistent with the figure and the fact that leading states have fewer hours of power outages, an hour's reduction in power outage in the leading states implies cost saving to retailers (in absolute terms) that is about 1.93 times the same in the lagging states. Hence, on pure efficiency grounds, increasing power supply in the leading states seems more beneficial than in the lagging states.

Retained earnings is the most common source of finance

The bulk of investment in working capital is financed by the retained earnings of the stores (78 percent). Similarly, among the firms that invested in fixed capital, 82 percent of their investment was financed by the retained earnings. Is the use of external financing low because Indian retailers are credit constrained? Consider a store "credit constrained" if it wanted to borrow but did not because it thought the loan would not be approved, collateral requirements were unattainable, or the application procedures were complex.[4] About 14 percent of the stores in the full sample are credit constrained, with a high of 52 percent in the state of Bihar and a low of 6.4 percent in Maharashtra. Small stores are more likely to be credit constrained than the rest. The same holds for lagging compared with leading states, although this is largely restricted to stores of intermediate size (figure 3).

For a comparison, credit-constrained stores equal 7.6 percent in the European and Central Asia (ECA) countries. Even ECA countries, such as Moldova and Uzbekistan, that have roughly similar per capita GDP as India show fewer credit-constrained firms (4.7 and 6.6 percent, respectively).

Large stores suffer more from corruption

Inspections by government officials can result in a bribe payment or a request for one. About 40 percent of the stores in the sample were inspected during the survey year. Roughly 44 percent of these inspections culminated in a bribe payment or a request for one, with the figure rising to over 90 percent in the state of Punjab and 87 percent in Bihar. In other words, 17.4 percent of all stores surveyed either made a bribe payment to government officials or were asked for one. While there is substantial variation across states in the incidence of bribery (with or without conditioning for visits by government officials), the variation has little to do with per capita income of states or other available measures of overall development. The same holds for the frequency of inspections. Relative to small stores, the incidence of bribery is higher for large stores but this is entirely so because large stores are more frequently inspected (figure 4). Somewhat surprisingly, bribery incidence is roughly the same in leading vs. lagging states.

Non-availability of land is not the only land-related problem

Among stores that reported access to land as a moderate or bigger obstacle to doing business (32 percent), non-availability of land was identified as a contributory factor by 81 percent, unclear ownership titles by 29 percent, problematic and costly registration process by 63 percent, and difficulty in obtaining permits to use the land by 47 percent. 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 by a majority of stores. In short, a comprehensive approach toward land reforms is necessary.

Inadequate power supply, access to finance, and corruption are some of the most severe problems faced by Indian retailers.

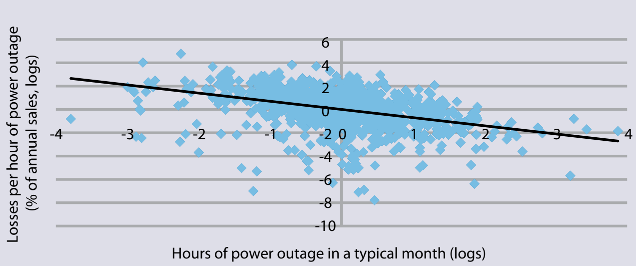
Retailing in smaller cities

The metropolitan cities of Bangalore, Chennai, Delhi, Hyderabad, Kolkata, and Mumbai have traditionally been the retailing hub of India and also the main contributors to the ongoing retailing boom. Arguably, a similar expansion of retailing activity in the relatively small non-metropolitan cities would be required if the retail sector is to make a significant impact at the macro level. There is much talk about expansion of retailing activity in the relatively smaller non-metropolitan cities of India.[5] For the business environment, the key difference between metropolitan and non-metropolitan cities lies in power supply. In non-metropolitan cities, losses due to power outages average 5.5 percent of annual sales of the stores, and hours of power outage in a typical month average 78.9. Corresponding figures for metropolitan cities are much lower, at 2.6 percent and 32.5 hours, respectively.

Competition in Indian retailing is low

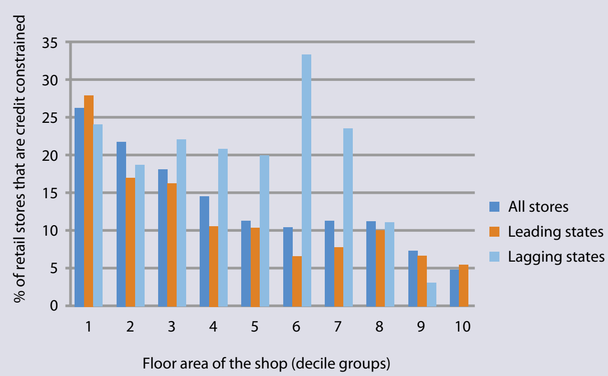
Less than 40 percent of stores reported competitive pressure as fairly important or very important for the prices of the stores' main products. The corresponding figure in ECA is 71 percent. In short, competition in Indian retailing seems low by international standards. Amin (2007) finds that pro-competitive reforms could increase labor productivity in Indian retailing by as much as 87 percent.

Figure 2 States with better power supply are likely to gain more than the rest from further improvement in power supply



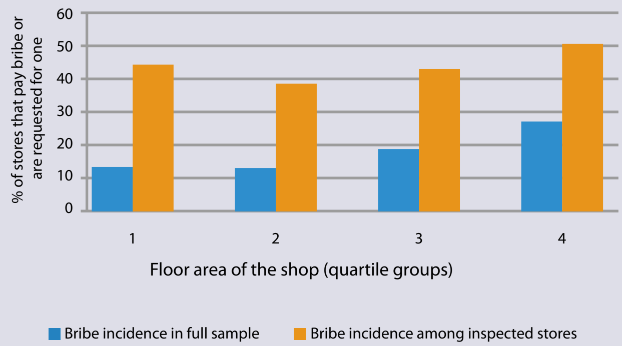
Source: Enterprise Surveys.
The figure is a partial scatter plot controlling for store-type fixed effects (traditional, consumer durable, and modern-format store), city fixed effects, and floor area of the shop. The strong negative relationship shown does not depend on the stated controls.

Figure 3 Small-sized stores are more credit constrained than large-sized stores



Source: Enterprise Surveys.
Higher values along the horizontal axis imply larger floor area. Leading and lagging states are defined in endnote 3.

Figure 4 **Large stores are more likely to pay bribes than the small-sized stores**



Source: Enterprise Surveys.
Higher values along the horizontal axis imply larger floor area.

The note attempts to highlight the main problems confronting the retail sector in 41 large cities of India. Inadequate power supply, access to finance, and corruption are some of the most severe problems faced by Indian retailers. Competition in the sector seems low, and pro-competitive reforms could improve retailing efficiency significantly.

Notes

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

2. 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.

3. States are grouped into leading, middle, and lagging states based on their level of development. The grouping is taken from Kochar et al. (2006). Leading states include Delhi, Gujarat, Karnataka, Kerala, Maharashtra, and Punjab. Lagging states are Bihar, Jharkhand, Madhya Pradesh, Orissa, and Uttar Pradesh. The remaining states are classified as the middle (income) states.

4. This is a conservative definition of credit-constrained stores because it assumes that stores that borrowed externally did not face any constraint on the amount borrowed.

5. The metropolitan cities include Bangalore, Chennai, Delhi, Hyderabad, Kolkata, and Mumbai.

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