Impact of FDI in Retail on Micro, Small & Medium Enterprises of India

CAIT

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Confederation of All India traders,
New Delhi
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Preface

FDI in retail trade has wider ramifications on Indian economy. The decision to open FDI gates has not just impacted the traditional shops and traders, but also the manufacturers, especially the small scale manufacturers. The relationship between small shop keeper, supplier and the manufacturer is quite symbiotic. All these stakeholders understand the requirement of Indian consumers and thus operates closely to satisfy and fulfill the needs of consumers.

With opening of FDI in retail, the MSME sector faces the challenge of survival. This book attempts to highlight the major challenges and threats faced by Indian MSME sector. Confederation of ALL India Traders would welcome a debate so that the ill effects of FDI in Retail trade can be highlighted more vigorously.

I would like to thank_______________ for their contribution towards understanding the issue of MSME and helping in conceptualizing the book. Confederation's research unit needs special acknowledgement for providing leadership and insight to larger issues related to trade and national economic issues concerning industries, stakeholders and all citizens.

New Delhi Praveen Khandelwal
Executive Summary
- In the year 2012, the Indian retail sector is estimated to be Rs. 18,673 billion and it accounts for around 15 percent of GDP and 8 percent of total employment.
- It accounts for roughly 15 percent of GDP.
- MSME sector of India is considered as the backbone of economy contributing to 45% of the industrial output.
- MSME accounts for 40% of India's exports.
- MSME employs more than 60 million population.
- MSME create 1.3 million jobs every year.
- MSME produce more than 8000 quality products for the Indian and international markets.
- MSMEs have been globally considered as an engine of economic growth and as key instruments for promoting equitable development.
- The major advantage of the sector is its employment potential at low capital cost.
- The labour intensity of the MSME sector is much higher than that of large enterprises.

- MSMEs constitute more than 90% of total enterprises in most of the economies and are credited with generating the highest rates of employment growth and account for a major share of industrial production and exports.

- MSME has a growth rate of more than 10 percent till 2010-11, while the growth rate was around 19 percent in 2011-12.

- MSME faces a survival challenge as the current policy of FDI in retail do not offer any protection to Indian MSME.

- The option to source cheaper goods from other manufacturing countries and large industries makes the situation of Indian MSME miserable.
INTRODUCTION

Retail sector plays an important role in national economy. In India retail trade assumes significance not just because of its contribution to national economy, but also because our present retail trade system has evolved gradually over past several centuries, thus having an instinct socio-economic and emotional bonding with various strata of population of India. In the year 2012, the Indian retail sector is estimated to be Rs. 18,673 billion and it accounts for around 15 percent of GDP and 8 percent of total employment. The sector is highly fragmented with about 96 percent of the stores in the unorganized sector. The local neighborhood stores, popularly known as Kirana stores, number around 12 million spread across 5,000 towns and 600,000 villages throughout India. These are mostly family owned with family labor. At the bottom of the pyramid is millions of pavement stalls in India.¹

Boston Consulting Group² (2012) estimated that the retail sales were $ 471 billion with 7 percent share for the organized retail ($ 34 billion) in 2011. It also shows that by 2020 the size of the organized retail to be around $ 260 billion with a penetration of 21 percent. Increasing middle class incomes and use of automobiles, refrigerators, credit cards and adoption of technology for supply chain is expected to shift the balance in favor of organized retail in metros and small towns.

Government of India in Nov 2011, with its executive order opened the gates of

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¹Murali Patibandla (2012), Foreign Direct Investment in India’s Retail Sector: Some Issues, working paper no: 366, Indian Institute of Management Bangalore

multibrand retail trade for foreign direct investment. Due to severe criticism, government was forced to put this policy in abeyance within few days. FDI in multibrand retail has been debated by both the proponents as well as opponents in last one year. Confederation of All India Traders has scientifically exposed the hollow claim of government and its supporters point by point through international and nation experiences, data and facts.

In most of the recent debates on FDI in retail has deeply focused on the retailers, infrastructure, farmers, employment, inflation and consumers. In order to understand the ill effects of FDI, we must understand that any attempt to look at the issue just from the aspect of retail traders or farmers is nothing but a clear attempt to divide the population of India, in the name of prosperity. This book looks on the dynamics and the impact of foreign direct investment in retail on Micro, Small and Medium Enterprises (MSME). It is in continuation of CAIT's endeavor to counter FDI in Retail's claim and also aims to make people aware the about the ill effect of FDI in Retail on small and medium enterprises of the country.

MSME sector of India is considered as the backbone of economy contributing to 45% of the industrial output, 40% of India's exports, employing 60 million people, create 1.3 million jobs every year and produce more than 8000 quality products for the Indian and international markets.

Micro, small and medium enterprises forms the back bone of our country. It not just produces and supplies goods to traders and end consumers, but also help India becoming self-reliant. Our micro, small scale and medium industries, supports millions of populations, who are struggling very hard to lead a respectable social life. Just like the traders who are the direct victims of government decision to introduce FDI in multi brand retail, the people

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http://www.eisbc.org/Definition_of_Indian_SMEs.aspx
engaged with micro, small and medium enterprises, especially the cottage industries and other smaller manufacturing units are at the risk of job loss and closure of business.

**Definition of MSME in India**

As per the latest definition, the MSME are classified as:

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<th>Description</th>
<th>INR Description</th>
<th>USD($) Description</th>
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<tbody>
<tr>
<td>Micro Enterprises</td>
<td>upto Rs. 25 lakhs</td>
<td>upto $ 62,500</td>
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<tr>
<td>Small Enterprises</td>
<td>above Rs. 25 lakhs &amp;</td>
<td>above $ 62,500 &amp;</td>
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<td></td>
<td>upto Rs. 5 crores</td>
<td>upto $ 1.25 million</td>
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<tr>
<td>Medium Enterprises</td>
<td>above Rs. 5 crores &amp;</td>
<td>above $ 1.25 million &amp;</td>
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<tr>
<td></td>
<td>upto Rs. 10 crores</td>
<td>upto $ 2.5 million</td>
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**Manufacturing Enterprises Based on Investment in Plant & Machinery**

**Service Enterprises Based on Investment in Equipments**

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**Significance of MSME Sector in Indian Economy**

MSMEs have been globally considered as an engine of economic growth and as key instruments for promoting equitable development. The major advantage of the sector is its employment potential at low capital cost. The
labour intensity of the MSME sector is much higher than that of large enterprises. MSMEs constitute more than 90% of total enterprises in most of the economies and are credited with generating the highest rates of employment growth and account for a major share of industrial production and exports. In India too, MSMEs play an essential role in the overall industrial economy of the country. In recent years, the MSME sector has consistently registered higher growth rate compared with the overall industrial sector. With its agility and dynamism, the sector has shown admirable innovativeness and adaptability to survive the recent economic downturn and recession.

The Micro, Small and Medium Enterprises (MSMEs) play a pivotal role in the economic and social development of the country, often acting as a nursery of entrepreneurship. This sector also plays a key role in the development of the economy with their effective, efficient, flexible and innovative entrepreneurial spirit. The MSME sector contributes significantly to the country's manufacturing output, employment and exports and is credited with generating the highest employment growth as well as accounting for a major share of industrial production and exports.

MSME helps in discouraging monopolistic practices of production and marketing, and actively contributes to growth of national economy along with opportunity creation for accumulation of foreign exchange earning in national reserves. Since independence, MSME sector has played a pivotal role in national economic development.

Indian SMEs also play a significant role for nation development through high contribution to Domestic Production, Significant Export Earnings, Low Investment Requirements, Operational Flexibility, Location Wise Mobility,

[^1]: http://www.dnb.co.in/SME_cluster_series2012_Indore/PDF/MSMEs_in_India.pdf
Low Intensive Imports, Capacities to Develop Appropriate Indigenous Technology, Import Substitution, Contribution towards Defense Production, Technology Oriented Industries, Competitiveness in Domestic and Export Markets and Generate new entrepreneurs by providing knowledge and training.

MSME has a growth rate of more than 10 percent till 2010-11, while the growth rate was around 19 percent in 2011-12. As per MSME census (registered units), a total 15.64 lakhs of enterprises falls under the category of MSME, out of which about 46 percent operates from rural area, while some 14 percent are owned and operated by women entrepreneurs. Amongst all, Micro enterprises constitutes the highest number, 14.85 lakhs (94.94 %), followed by 0.76 lakhs (4.89 %) and 0.03 lakhs (0.17 %), small and medium enterprises respectively. Out of total enterprises, around 66% of enterprises are engaged with manufacturing only.

Micro enterprises offer employment to 65.34 lakhs population while, small and medium enterprises offer employment to 25.43 and 4.32 lakhs respectively. The net worth of MSME sector is around Rs. 4,15,303 crores.

The MSME sector in India is highly heterogeneous in terms of the size of the enterprises, variety of products and services, and levels of technology. The sector not only plays a critical role in providing employment opportunities at comparatively lower capital cost than large industries but also helps in industrialisation of rural and backward areas, reducing regional imbalances and assuring more equitable distribution of national income and wealth. MSMEs complement large industries as ancillary units and contribute

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1Entrepreneurs Memorandum, Part 2, Data on MSME Sector, Development Commissioner, MSME, Government of India, New Delhi.
Impact of FDI in Retail on MSME

The recent government policy decision to permit 100% foreign direct investment in retail segment particularly in the multi-brand arena and 51% in single brand has not gone down well with small and medium entrepreneurs, cutting across party lines. Moreover with governments flip flop on the policy guidelines and provisions, the MSME is sector is the most worried lot.

In order to protect the interest of MSME sector, government in year 2011, announced in the floor of Parliament about mandatory 30 percent sourcing from MSME. In respect of proposals involving FDI beyond 51%, sourcing of 30%, of the value of goods purchased, will be done from India, preferably from MSMEs, village and cottage industries, artisans and craftsmen, in all sectors, where it is feasible. The quantum of domestic sourcing will be self-certified by the company, to be subsequently checked, by statutory auditors, from the duly certified accounts which the company will be required to maintain. For the purpose of ascertaining the sourcing requirement, the relevant entity would be the company, incorporated in India, which is the recipient of FDI for the purpose of carrying out single-brand product retail trading. This clause was still accepted by industry and its apex bodies. CII on also supported the government decision of mandatory 30 percent sourcing from Indian micro and small (SME) units by the foreign single-brand retailers, who wish to hold more than 51 percent stake in their units in this country.

It believed that the mandatory 30 per cent sourcing from Indian micro and

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8 http://post.jagran.com/FDI-in-single-brand-CII-favours-compulsory-sourcing-from-MSEs-1327670429
small industry will give a fillip to the small scale businesses and would also assist SMEs to achieve higher growth in sales, size of the industry, capacity addition, increased contracts/orders, qualitative improvements and products branding, technology upgradation, employment etc9. However in September 2012, government while notifying the executive order changed its own position.

Anand Sharma, Union Commerce Minister,

Sourcing of a minimum of 30 per cent from Indian micro and small industry having capital investment of not more than $1 million is mandatory, and there is no compromise on it10.

Mandatory provision became suggested provision, meaning the foreign investors are not bound to purchase anything from Indian manufacturers. It is foolish to expect foreign retail chains to make local purchase when they can easily import cheap goods from other parts of the world and market the same at cheaper price.

With the opening of retail trade space in India, the traditional retail ecology is bound to be disturbed and the ill effects are going to set in. The traditional retailer will face a survival challenge from resourceful mega retail chains, which are not just capable of investment of money, but are also capable to control the market economics and fundamentals.

Now the question is if the move to open FDI gates for retail sector will have only one victim the traders or shopkeepers or will it also go beyond the realm of shopkeepers, particularly those who supplies goods and services to these shopkeepers. It is the MSME, which constitutes and contributes as the

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backend driver of economy by manufacturing goods and making India self-reliant. No major study has focused on the impact of foreign funded mega retail on Indian MSME. Government and its supporters are firm that FDI in retail will help Indian industries as our demands are local, so obviously the choice of supplier and manufacturer by these mega retail chains will be local. Still the question remains unanswered, especially on MSME, which is very vulnerable as this sector do not operates on huge investment and revenue margin. Any threat to this sector will not just mean loss to entrepreneur but will also mean survival question for millions of population who are actively involved with this sector.

MSME sector is already a worried lot, though it has so far not come forward like traders to vehemently protest against the government's decision to introduce FDI in retail. Some people believe that there is relatively lesser threat and more opportunity for MSME after the arrival of foreign led retail chains. They firmly believe that first it is the Indian MSME which understand the pulse of nation thus producing what Indian consumer needs. Besides it is the MSME which can assure better margins to the big retail chains. Biter in comparison to big Indian industrial houses. Thus the big retail giants such as Wal-Mart, Carrefour and Tesco would need to take supplies from MSMEs in order to cater the needs of Indian consumers, offer relatively goods at competitive price and maintain their own operating profits.

However it is not as simple and straight forward where the manufacturers and consumers are the happiest lot. Mega retail chains attempts to offer similar kind of products and services at all places and stores, which eventually mean they need to have similar supplies throughout their area of operations. It also means that manufacturers needs to ensure the volume expectation of the retail chains, as in order to offer similar products at every store, there should be
abundant volumes. Now this is a trick situation, especially when we are dealing with MSME. As explained earlier, MSME accounts for almost 40 percent share in total production, but since all these units are independent and each one of them has its unique process and product offerings. This will definitely be a challenge for MSME and the big retailer, as they cannot meet each other's expectation. Thus in such situation, the big retailers will have to look for alternates which can supply them similar goods in volumes. Such volumes can only be ensured by large scale industries. Thus it will be a win situation for large scale industries.

With the diminishing market space, closure of small retail shops and outlets, the MSME sector will eventually face the dark reality of losing the business. Also it's not just the volume issue, where the MSME will not be able to fit as per the expectation of the mega chains, even the payment terms and cycles will not suit the existing structure. Big retailers look for a larger credit cycle. MSME suppliers due to revenue crunch and lack of investment opportunities are not in the position to accept and adapt to delayed payments cycles. Delay in payments will have catastrophic impact on the survival of enterprises. Hence despite a rosy picture presented by the government and its advisors, the MSME sector will not be able to reap any benefit by mega retail operated by mega foreign investments.

There is no concrete study on how much existing domestic big retailers source from the Indian market. However, people in the industry believe that it could be as high as 70%. In addition, the asset limit of Rs 50 m would include many big suppliers in the list as well. Hence, even the right implementation of the protection law does not ensure and secure the existing business of micro and small players. Moreover, there is a question mark on the actual implementation of this law in its true spirit. To
avoid the Rs 50 m limit, big suppliers may always split their businesses and can eat away the pie of micro and small players\(^\text{11}\).

**Opposition to FDI in Retail by MSME Leaders and Stakeholders**

A Sakthivel\(^\text{12}\), President, Apparel Export Promotion Council (AEPC)

If the government does not put mandatory sourcing conditions then the foreign retailers will buy garment and apparels from Bangladesh and sell in their stores here as India allows duty free imports of textile products from that country.

Atma Ram Gupta, president of Federation of Rajasthan Traders and Industries (FORTI)

Today micro, small and medium enterprises (MSME) provide at least 70 per cent of goods to the retail industry. But the provision to buy 30 per cent of its products from MSME will affect the business of this sector. Instead of encouraging it will lead to southwards\(^\text{13}\).

P D Sharma, president of the Apex Chamber of Commerce Undertakings, it is being claimed that FDI in multi-brand retail will benefit SMEs (since 30 per cent of sourcing will be from them), it is well-known that developed countries cite extraneous factors as excuses for not purchasing from Indian manufacturers...factors such as “use of child labour and violations of human rights” by


\(^{13}\)http://smehorizon.sulekha.com/retail-fdi-move-worries_sme-viewsitem_6038
manufacturers are cited as grounds for rejecting the products of Indian companies…In recent years a new trend has been seen mainly in the European countries. Labels are fixed on products showing the quantity (in grams) of carbon dioxide emissions associated with making and transporting them. This began in the year 2007 in Britain and the trend is catching up fast…Considering these factors it would be difficult for the SME sector to benefit from FDI in multi brand retail…Indian SME sector will find it tough to compete with its counterparts in other countries, because of high costs. Indian SMEs get capital at a high cost, they obtain raw materials through cartelized mechanisms and transaction costs in India are high. Obviously, no global retailer will purchase costly products from Indian industry.\(^\text{14}\).

SME Chamber of India, which represents more than 45,000 small entrepreneurs, is not in favour of allowing foreign retailers into the country. According to Chandrakant Salunkhe, President,

Going by the proposed FDI norms, top cities and towns are covered where foreign retailers can set up their stores. However, a substantial chunk of SMEs are based out of small towns and villages who have been catering to local businesses and at most few malls in nearby town.

The chamber's bigger fear, is that the foreign retailers will import most their products, as is the practice among most foreign carmakers.

If you look at the auto industry, its just players such as Bajaj and Tata Motors that source products from our members which have small businesses. Most international firms import most of their products and source just 5-7% of auto parts from our companies. So we fear that foreign retailers might do the same thing once FDI is allowed\textsuperscript{15}.

Rohit Mehta, President, Southern Gujarat Chamber of Commerce & Industry (SGCCI)

FDI in retail is appreciable move but as MSMEs are considered the major contributor of country's economy, so to a certain extent the government should take their interest in account. Dilution of sourcing norms for FDI in multi-brand retail too will be very disheartening. There should a level-playing field for SMEs\textsuperscript{16}.

SMEs have already expressed their disappointment with the government's decision to do away with mandatory 30 per cent sourcing from small and medium firms in single brand retail. Mugil Arasu, CEO, Premier Polymers

Although the move may boost country's economy, but for small enterprises the decision of removing the earlier proposed clause of making mandatory 30 per cent sourcing from SMEs comes as a sad note…that the entry of foreign giants will bring in cheapest products to Indian markets and thereby make India uncompetitive in global arena\textsuperscript{17}.

\textsuperscript{17}ibid
Echoing similar views and opposing the move vehemently, VG Martin, CEO, Chennai Go Green

I strongly oppose the entry of foreign retailers in India. Investments from global retailers will not help much to elevate the sagging economy of India, rather such engagements will worsen the situations in the country. Besides such reforms, the central government should come up with a slew of reforms aimed to encourage small entrepreneurs in the country.\textsuperscript{18}

While announcing landmark FDI announcements, government diluted 30\% sourcing rule from 'small industries' in single-brand retail. The Indian SMEs have strongly displayed their dissatisfaction over government's 'so-called' policy reform.

Jyotika Parag Karve, Proprietor of 97 Art and Ideas

According to me, the relaxation would definitely impact the SMEs. The 'guaranteed' business will now be taken away by the big companies. Also, the big companies and small-scale industries will be competing at the same level, which will surely hit the growth momentum of the SMEs. This decision is not in favour of the SMEs, government needs to realise that they contribute a significant portion to the Indian GDP.\textsuperscript{19}

Another SME, Tradelink Services, provider of transmission components too opines that dilution of the mandatory sourcing norm in single-brand retail amid economic meltdown is not the right step as it will hamper growth prospects. Michael X Gomez, Proprietor,

\textsuperscript{18}ibid
Obviously, this dilution of 30% mandatory sourcing is in favour of big companies such as IKEA. The overall SME industry will be hit. From a practical point of view, the Indian SMEs won't grow and in fact, a foreign MNC will decide the growth of small scale industries. This is not a reform step.\(^\text{20}\)

Union MSME Minister Vayalar Ravi too wrote to Prime Minister Dr Manmohan Singh and expressed his opposition to the dilution of 30% mandatory sourcing rule that mandates foreign-owned single brand retailers to buy goods from SMEs.

In January, Centre stressed on 30% sourcing to be mandatorily done from SMEs/ village and cottage industries artisans and craftsmen. The small scale industries feel that Centre's sudden 'u-turn' from its previous stance would impact the business.

Meanwhile, the foreign single-brand retail players eyeing to enter India welcomed government's decision to dilute the sourcing norms in case of FDI in the sector. The big players have taken a sigh of relief as the 30% sourcing can be done from any Indian company. The need to source from small industries was reportedly causing problems for the foreign players like furniture giant IKEA, which is eyeing investment in India.\(^\text{21}\)

As Wal-Mart expanded, it brought its business models to other parts of the world, it depressed labour standards in its stores, pushed SMEs and socially responsible employers out of business and created a far-reaching global sourcing system that

\(^{20}\)ibid

pits workers earning poverty wages in sourcing countries against each other\textsuperscript{22}.

Conclusion

It is clear that the governments policy of FDI in retail do not hold any water. This policy is not just detrimental for traditional small shopkeepers but also to a wider section of population, including MSME. With the onset of FDI in retail, gradually, Indians will lose its command over internal trade and manufacturing. The situation is not exactly the repetition of history, though in modified form, where we have a resourceful and rich foreign trader, offering glittered goods and services to Indian consumers. From trader, the same people turned in manufacturer and importer of cheaper goods manufactured at different countries. All these eventually mean a self-reliant country and economy to become dependent economy which gets impacted by the whims and fancy of a mega investor, besides leading to mass unemployment, destruction of indication traditional industry base, death of local and tradition knowledge regarding manufacturing and extension of many current goods from the shelves in the names of standards, quality and quantity. Do we want such things to happen in India? We must ensure that the back bone of India which is trade by small shopkeepers and the supply by the MSME remains intact, inorder to keep the nation's interest and sovereignty.

\textsuperscript{22}Wal-Mart facts FDI lobbyists may not like you to know, A report claims the largest retailer's presence in other markets has hurt small businesses, retail workers and farmers (2012), http://www.business-standard.com/india/news/wal-mart-facts-fdi-lobbyists-may-not-like-you-to-know/183849/on