

## IMPEDIMENTS TO RETAIL GROWTH IN INDIA

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### **Abstract**

*India's retail sector is evolving at breakneck speed, fuelled by a strong economy, favourable demographics, rising wealth levels, and the rapidly changing lifestyles and consumer aspirations of an ever growing middle class. India's cities are witnessing a paradigm shift from traditional forms of retailing into a modern organised sector; a transformation that will no doubt accelerate over the coming decade. The booming retail sector is offering significant new opportunities. However, to continue to offer consumers value, some of the core foundational blocks like supply chain, infrastructure and real estate, human resource, policy hurdles need to be removed to keep up with the pace of change. The present research paper is an attempt to look into some of these impediments to retail growth in India which need to be urgently redressed.*

**Key Words;** Retail, Infrastructure, Generic, Peaking

### **Introduction**

The Indian retail sector is at an inflection point, with organized retail poised for an approximately 35 per cent compounded annual growth rate (CAGR) for the next few years. However, valued at around USD 320 billion, the Indian retail sector is still relatively small by global standards. But India is catching up and catching up fast. For two years in a row, A.T. Kearney has ranked India at the top of the Global Retail Development Index. Several of the major Indian conglomerates have announced and are in the process of implementing major retail projects (Reliance, AV Birla Group, Tata, etc.), existing retailers continue to experiment with new formats and concepts (Pantaloon, Shopper's Stop, etc.), many of the multi-national retailers are pacing the sidelines and evaluating different ways to participate, and mall development continues at a staggering pace. What lies behind this euphoria is an omnipresent confidence in the ability of organized retail to grow along with the ongoing wealth generation amongst the middle class in India. The consumer class in India is estimated at 400 million people with a rising disposable income. About 29 per cent of the population is now urban, compared to 26 per cent in 1991, and over 50 per cent of the population is below the age of 24, and faces a job market more resilient than it has ever been before.

Indian consumerism, until the early 1990s remained a point of academic discussion due to its immense potential. Similarly, access to cheaper credit and increased disposal incomes to enjoy their aspirations for private homes, cars, and a plethora of other consumer durables was a distant dream. This however, has changed dramatically over the past decade. The Indian economy has

evidenced an unprecedented resurgence, with the GDP growth averaging close to 8% per annum placing India amongst the fastest growing economies in the world. This growth has meant an empowerment of the consumer. The transition from a protected economy to market driven regime is apparent as suspicions regarding competition from global players dissipate progressively. With domestic industries gaining confidence in their abilities, competition is no longer the deterrent that it had been. The retail landscape of the country is changing at a rapid pace with malls and multiplexes mushrooming in all major cities. In fact, having reached a substantial capacity at Tier-1 locations, the organized retail revolution is now percolating to Tier II and III cities. Retail has clearly been witnessing a transformation from neighborhood-shopping to the concept of malls and family entertainment centers. Entertainment and experience are becoming integral parts of shopping. Global industry analysts have often confirmed the country's potential as one of the most attractive emerging retail destinations in the world. It remains to be seen whether this promise is translated to add further depth to the Indian economy.

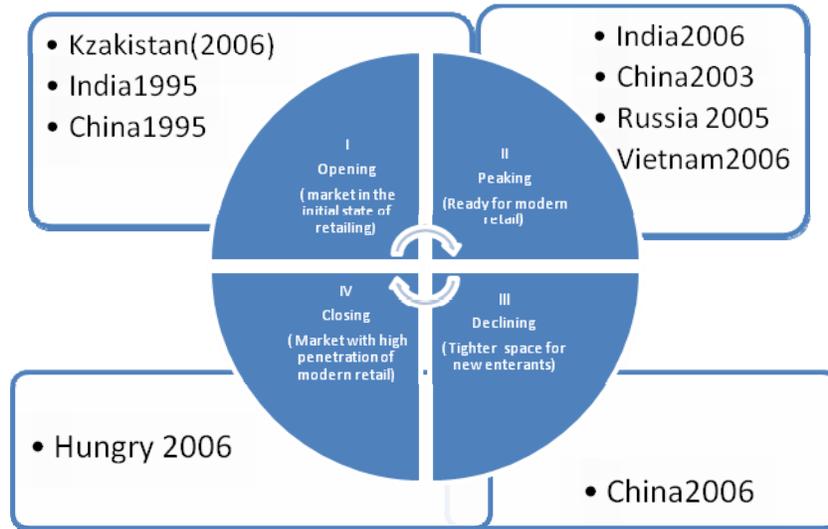
### **Stages of Retail market**

Retail markets worldwide have been observed to progress through four stages as they evolve from an emerging to a mature market, usually over the course of 5 to 10 years (**Fig. 1.1**). These stages are defined as:

1. **Opening:** A market that is just beginning its modern retail story, in all major cities.
2. **Peaking:** A market that is developing quickly and is ready for modern retail.
3. **Declining:** A market that is still big and growing, but space for new entrants is getting tighter.
4. **Closing:** A market having small window of opportunity for new entrants; such markets generally have a very high penetration of modern retail.

The figure below shows that key Asian economies, viz. India and Vietnam are in the peaking phase, while China has just tipped into declining. This means that the next one to three years are the best time for foreign retailers to enter India. They cannot wait for the government to set things in order. While the government has announced some benefits for foreign retailers by allowing them to own up to 51 per cent of a single brand retail company, the relaxed regulations do not extend to retailers that sell a variety of brands. India's government seems to be on a gradual but definite path towards allowing foreign retailers into the country. And when it takes the final steps, the peak time to enter will quickly pass, giving retailers a hope that entering now they have a distinct edge. Different global retailers are in talks to identify the best mode of entry in India.

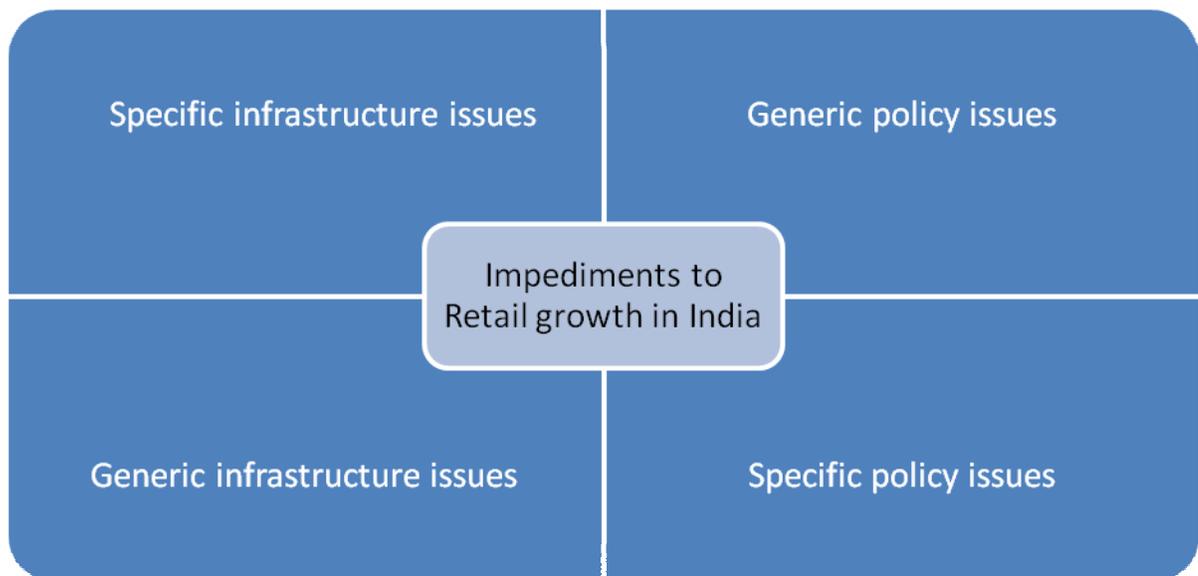
**Fig: 1.1: Stages of Retail market**



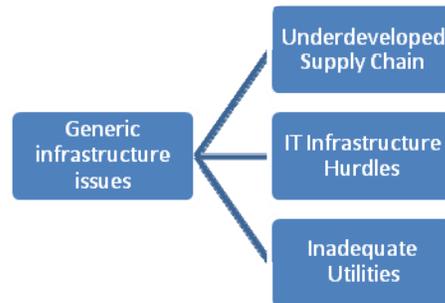
**1.3: Impediments to Retail growth in India**

The Indian retail is poised for growth is a well known fact ,but there are certain bottlenecks that need to be removed if Indian retailing needs to get on a faster growth trajectory. These bottlenecks become even more prominent in case of organized retail development. In this section, we shall identify and prioritize key issues in the way of retail growth in India. An analysis of the retail landscape across India high- lights four key issues that hinder development of the sector.

**Fig1.2: Impediments to Retail growth in India**



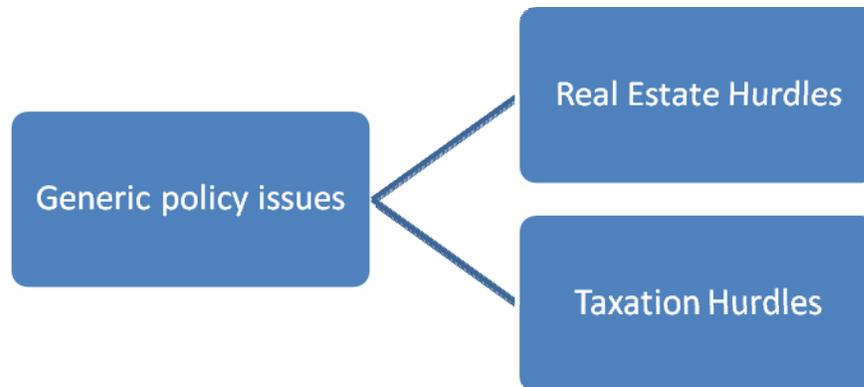
- I) **Generic infrastructure issues** – The key generic infrastructure issues are outlined below:



- a) **Underdeveloped Supply Chain**:- One of the most pressing problems faced by the Indian retail sector is that supply chain network is fragmented and is marked by the existence of a large number of intermediaries. The country lacks quality logistics infrastructure which hinders scaling up of retailing operations. Supply chain is a key bottleneck for retail sector growth. India lacks efficient and reliable logistics infrastructure in roads, rail and ports. We also have a highly fragmented trucking industry and absence of reliable, national service providers. Accordingly supply chain management (SCM) systems have very low penetration especially in the vast rural hinterland. There is also no reliable national cold chain system, leading to enormous wastages especially in rural India (unofficial loss estimates are over Rs 50,000 crore in food products alone). There are multiple benefits of proper cold storage facilities. The financial benefits can be shared between the farmer, the consumer and the retailer, thereby making organized retailing more attractive for all stakeholders. Currently each retailer is required to set up individual cold chain facilities and this makes the cost of organized retailing of mass use consumer products prohibitive. India also lacks national level distribution networks and hubs. Fragmented supplier network in rural areas lead to multiple levels of product handling. Also consumer product companies are more focused on front end distribution and hence the distribution model is more robust in urban areas with high consumer concentration.
- b) **Inadequate Utilities** - Lack of basic infrastructure like power, transport and communication creates difficulty in sustaining retail operations across the large geographical spread of country. An acute shortage of power, clean water and natural gas in urban areas are bottlenecks for large organized retailers - at times they have to pay significantly for these utilities and these additional costs are passed to the consumer. Power shortage is a major problem across India; implications range from absence of cold chains to the need for alternative power source installations. The situation in rural India is even worse for these utilities. The underdeveloped transport system is another key issue in smaller cities and towns. Local railway networks are also found mainly in the metros and large cities, and they are usually congested and unsafe at times. Unofficial estimates suggest freight facilities need to be quadrupled to meet the entire national demand.
- c) **IT Infrastructure Hurdles** –Reliable IT infrastructure is important for managing modern supply chains which are the backbone of any retailing business and India faces a

clear problem in this. Basic telecommunications and internet facilities are reliable solely in metros and large cities - the available infrastructure in rural India is grossly inadequate for meeting requirements of organized retailers in India. Use of IT infrastructure is still very nascent in India. Only some urban areas are equipped to use internet as a selling medium - this prevents international standards from entering India and are a major deterrent for large scale organized retail development.

- II) Generic policy issues** - They are issues affecting the industrial sector that are shaped by government policies. Some of these issues are :

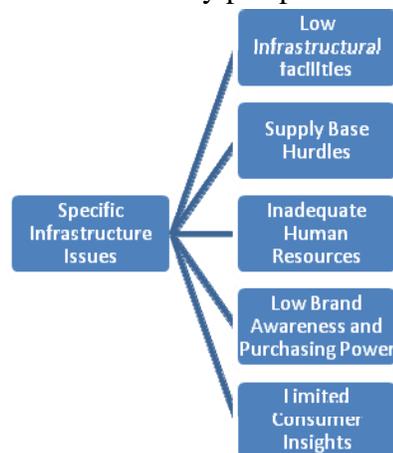


- i) Real Estate Hurdles:-** Archaic laws prevent the much needed growth in real estate development, which is imperative for retail growth. Real estate is one of the most critical issues facing organized retailers in India. This problem is particularly severe in urban areas where a lack of transparency and corrupt practices increases land cost. Another key issue is Indian land laws that have out-lived their utility. Obscure zoning laws cause confusion over use of land for commercial purposes. The brunt is borne by retailers and traders, as was shown in the recent sealing drive in Delhi. Further, landowners are likely to hike up rentals as the pro-tenant Rent Control Act prevents them from evicting unlawful tenants or illegal encroachers even after providing sufficient notice. Another issue in metros and cities is the lack of proper city planning. Inadequate planning coupled with massive influx of immigrant workers leaves them crippled for space. Most developed countries have well planned cities providing ample infrastructure for the retail trade - this ensures availability of basic space and utilities for the commercial sector. Compare this to Delhi where the master plan provides for only 16 per cent of commercial space, resulting in high speculative prices and the use of residential properties for commercial activities. A combination of the above issues drives real estate costs to as high as 10-20 per cent of net sales, forcing retailers out of prime locations. Various states are in different stages of evolution regarding real estate with no definite best practices across states. Retail forums need to drive government to remove real estate hurdles for development of organized retailing and industry in general.
- ii) Taxation Hurdles** - The tax structure in India is still complex and evolving, creating challenges for retailers. Even though there is a drive to standardize tax structures, currently there is inconsistency among states. So while most states have abolished octroi

and entry tax, few states like Karnataka, Maharashtra and Gujarat still have them. These create delays in transportation due to long queues at check posts, which is especially harmful in case of perishable goods. There are other taxation issues as well. Sales tax issues drive warehousing location choice - many companies have one company-owned distribution centre in every state to avoid paying central sales tax.

Similarly, there are issues linked to multiple points of taxation in India. For example, sales tax is levied at both central and state level. These prevent optimal supply chain models being developed and act as deterrents for organized retailing in India. Similarly non-uniform VAT regimes across states lead to differential pricing of goods and multiple taxation formats for the same goods in different states.

- II) Specific Infrastructure Issues :-** Issues that are specific to the retail sector and are also controlled by it comprise this category. Since the retail industry can affect these issues, they are very critical from the industry perspective. These are:



- a) Low Infrastructural facilities :** India is a large and highly fragmented country, with 29 states and 18 official languages. A bulk of its population, 66.1 %, lives in rural areas. The lack of adequate infrastructure makes it virtually impossible to reach this virtually untapped market. Distribution, or the lack of it, is a major hindrance for retailers in India. The lack of quality infrastructure across the country and a non-existent distribution sector results in inefficient logistics systems. Infrastructure is the weakest link in India's path to progress and there is an urgent need to address issues plaguing this area. Urbanization is driving an increasing need to upgrade or create infrastructure facilities. Transport is a major concern, with a deteriorating railway system and a limited highway network. In contrast to the global standards, the average load carried by trucks in India -around 7 tons -is very low. However, the Indian Government is presently investing heavily in the state highway system. This will help in an overall decline in logistics costs which is currently 10-12% of the total GDP. 10,000 MW of power needs to be added every year for the next decade. Growth in air passenger traffic, estimated at 20% p.a. for the next two years, necessitates quadrupling of airport capacities. Ports will witness 38% increase in tonnage in the next 2-3 years and hence, port infrastructure cannot be ignored. The lack of a distribution sector and specialized distribution companies is a major obstacle for retailers to fully utilize India's retail potential. We feel that private logistics companies offering specialized services, refrigerated transport and warehouse facilities across the country,

along with timely distribution of supplies to retail outlets will create some of the much needed back-end support for retailers to enhance operational performance. If addressed urgently and seriously, infrastructure can translate into India's biggest opportunity.

- b) **Supply Base Hurdles:** The supply base for the retail sector is fragmented due to government policies and legacy issues which prevent economies of scale in retail sector. A fragmented supply base prevents economy of scale benefits for organized retailing. Vendors are mostly small-time players with no economies of scale due to SSI advantages, leading to higher cost of manufacturing. Also, a large number of suppliers increase transaction costs - so to set-up multi-category organized retailing is a cumbersome task as backend systems need to be developed from scratch. There are also very few long-term contracts with suppliers in India compared to developed countries. The lack of supplier relationship programmes reduces supplier reliability. As a result, retailers in both urban and rural India need to keep high inventory (as high as two-three weeks in some cases) due to the high average supply time. Another issue is the lack of standardized quality assurance programmes across the country. This not only increases product returns and wastages across the system, but also presents a major credibility issue for retailers and consumer product companies.
- c) **Inadequate Human Resources –The retail industry is facing a severe shortage** of professionals, especially at the middle-management level. Areas gradually becoming critical are technology, supply chain, business development, marketing, product development and research. There is hardly any systematic effort to train manpower for the retail sector, which can create a bottleneck for growth. The inadequate availability of skilled personnel is a key bottleneck, with little help coming from government and academic institutions. The problem is extremely severe in middle management levels as historically there have been minimal skill development programs. Another concern shared by employees is the lack of adequate entry level training programs and career progression plans. The problem is very acute in rural areas, where there is no availability of trained personnel across levels. Labour laws in India prompt retailers to prefer the partial employment model, due to the difficulty in laying off employees. Retailers are therefore reluctant to introduce training schedules for employees. This creates a vicious circle that can be resolved if labour laws are made more flexible. Retailers face constraints on the number of working hours, seven day operations working time for women - these constraints vary by states and are on the whole regressive for the development of organized retailing. The retail industry itself has done little to tackle the issue. It is very fragmented and poaching within the industry is widespread across levels in an effort to hire the best talent. This leads to a very high employee turnover ratio (as high as 50 per cent in some cases) and workforce movement occurs both within industry as well as to other industries. Till date there is no significant effort to attract the best talent through active participation in undergraduate and graduate institutions. The retailers need to take the first step to correct the situation. There is urgent need for large and mid-size retailers to join hands in developing training institutes to develop talent.
- d) **Limited Consumer Insights** - There is limited knowledge about the consumer behavior
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due to limited market research conducted on the huge population in towns and rural areas. Limited consumer insights, especially in rural areas, deter scientific norm setting for organized retailing and is a competitive disadvantage. There is limited knowledge about consumers and shoppers across categories. Advanced countries have a Consumer Confidence Index that measures consumer sentiment on various business and environmental issues. In India there is limited data, implying that stores cannot be easily customized for the particular local area. There is inadequate data regarding consumption patterns that could have led to significant savings in terms of store operations, category management and merchandising functions. This is a source of competitive advantage for mom-and-pop stores, which through experience have gained good understanding of the local consumer.

Also within the data generated, there is limited government and private sector knowledge transfer of insights, leading to duplication of efforts nationally and productivity losses. Currently no region in India has made any significant progress in capturing consumer insights relevant to the retail sector that can be labelled as best practice.

Like human resources, we believe that retailers need to join hands to develop best practices in generating standing of the consumer will be a source of competitive advantage for organized retailers who can then spend dedicated time and resources on winning consumers.

- e) **Low Brand Awareness and Purchasing Power:** Organized retailers, both domestic and foreign, have pointed out that although per capita income is increasing, the purchasing power and brand awareness is still very low. Moreover, in certain segments such as food and grocery, consumers have conservative shopping habits. A large section of Indian consumers have low levels of income and they still do not prefer stocking fruits and vegetables or afford to drive down to a hypermarket located at the outskirts of the city and, therefore, prefer buying from a local vendor or Kirana Stores.

Although, since Mid-1990s, there has been a proliferation of brands, the number of brands available is still a mere fraction of what is available in rest of the world. Expansion of supermarkets depends at their ability to offer a wide range of brands under one roof. With fewer brands, Indian Super Markets are not able to enjoy an advantage over small retailers since the latter are able to deliver all the brands desired by the consumers.

- IV) **Specific policy issues** - . Certain government policies of the past have led to operational inefficiencies and made it difficult for companies to achieve economies of scale, resulting in lack of global competitiveness of Indian Manufacturing industry and slow growth of organized retailing. Some of policy impediments are:

- l) **Multi level Taxes** :Same state policies have also affected the organized retail. Restrictive zoning legislation imposed by some states limits the availability of land for retail/commercial purposes. There laws vary across states. While laws related to land conversions for commercial uses are very restrictive in Delhi, they are more flexible for example, Tamilnadu. Non-availability of government land together with fragmented private holdings makes it difficult for retailers to acquire large plots of land. Indian property market is not transparent and is marked by the lack of clear ownership/titles. Also, there is a lack of proper planning in setting up retail establishments

Indian system is quasi-federal in nature with multi-level administrative centrals of the centre, the state and the local levels. Manufacturers and retailers, therefore, face fiscal controls at different levels that have led to restrictions in inter-state and inter-district movement of goods and lack of uniformity in standards and taxes imposed by different authorities and agencies. Domestic trade in India is impeded by highly complex and elaborate sales tax system, comprising state sales tax, central sales tax, turnover tax, octroi and entry tax<sup>1</sup>. Besides, there are some taxes specific to some state, such as tobacco tax in Uttar Pradesh and professional tax in Maharashtra

- 2) **Slow Implementation of VAT:** The Government tried to do away with the existing complex, cascading type of sales tax by implementing Value-Added Tax (VAT). Developing countries such as China and Philippines have Implemented VAT and total tax t incidence on their manufacturing sector was 17 percent and 10 percent respectively in 2004, whereas, in India it was around 40 percent<sup>1</sup>. Although, after missing several deadlines, VAT has been implemented in 21 states as April 2005, eight important states including Uttar Pradesh, Rajasthan, Madhya Pradesh and Gujrat are yet to implement it. The states against VAT have raised issues such as inadequate compensations for the loss of revenue after the implementation of VAT. Organized retailers are in favour of implementation of VAT but a large section of unorganized retailers did not seem to understand the concept and/are not in its favour. The opinions about VAT also differed across various segments of retailing. The majority of unorganized players in the furniture segment were against the implementation of VAT. On the other hand, players in consumes durables segment are slowly moving towards single point tax where the products are taxed before reaching the retailers. The general awareness about VAT and how its implementation would affect the business is very low. Even if the players knew about it, the required infrastructures such as computerised billing systems are absent.
- 3) **Certain Acts are cumbersome to implement or out dated :** Unlike developed countries, India does not have any specific legislation controlling distribution trade and there is no nodal ministry to control and guide the operation of this sector, Indian trade, at operating level, is subject to laws related to hoarding of essential commodities or the laws relating to specific commodities, such as Drugs and Pharmaceuticals, Standards of Weights and Measures Act 1976, Prevention of Food Adulteration Act 1955, Agricultural Produce Marketing Act 1976, Forward Contracts Regulation Act 1952, Packaged Commodities Order, Trade and Merchandise Act, Hire Purchase Act and many others. There laws are archaic and have lost their relevance in the current modern competitive economy. Some of there regulations are mutually conflicting, for example, labeling is covered under both Weights and Measures (Packaged and Commodities) Rules (1977) and Prevention of Food Adulteration Act (1955). Again in the Essential Commodities Act (1955) the term "essential" is not clearly defined.
- 4) **Insufficient Government incentives:-** Government is yet to create any major sector specific policies to boost the retail sector. Insufficient government incentives and policy hurdles are issues that need to be taken up by retail associations and government bodies for speedy and effective resolution. The government has still not granted industry status to retail. This limits industry specific incentives to flow to the sector. Lack of government incentives reduces investor interest in the sector; the problem is worse in rural areas where investment flows are already lower.

Another key issue arises from the fact that the bulk of retailing in India is in food and

grocery. Inconsistent agriculture and fertilizer subsidies by states lead to price anomalies and variations for the same product; this leads to supply chain inefficiencies. It is imperative that the government should grant industry status to retail. Some of the world's largest companies are retailers, Indian companies are also entering the space and it is appropriate that the government should support them.

As stated earlier, the sector is facing hurdles due to lack of industry status. Financing from banks does not come by easily. This leads to extremely high interest rates for retail, pushing up capital cost, and the problem is compounded in rural areas where financing is anyway a cumbersome process. There is also no nodal government agency to frame policy and provide clearances. The retail sector has been given industry status in numerous developed countries including the USA, resulting in the formation of national government funded industry bodies.

**To conclude**, it may be said that the strategy of opening up should be backed by appropriate reform measures. India can learn from the experiences of other developed and developing countries and develop its own strategies, laws and regulations that would be in the best interest of the country. Some of the key changes that require the support of the Central and State government are:

- ✓ Grant industry status to retail
- ✓ Expand rail network density and wagon capacity
- ✓ Reform the Urban Land Ceiling and Regulation Act
- ✓ Computerize land records and make information available online Substantially reduce license requirements and offer a "single window" facility
- ✓ Overcome power shortage through privatization and infrastructure investment
- ✓ Improve management of city planning exercises, with due attention to creating adequate commercial space
- ✓ Amend labour laws to be more supportive of retail requirements (24x7x365)
- ✓ Eliminate any remaining Octroi taxes

These changes can fundamentally change the trajectory of growth to create a 'step-up' shift in the contribution of the retail sector to the Indian economy.

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