FDI - The Hijack of Indian Retail Market

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INTRODUCTION

Foreign Direct Investment (FDI) flows have increased substantially in the last two decades. This has been a result of the reduction of barriers to FDI, considerable improvements in transportation and communication technologies, and the direct policy measures implemented by many governments to attract FDI. These developments have motivated the appearance of a large number of empirical papers that test the expected benefits that FDI inflows are assumed to bring to the host countries. Based on the result of these studies, it is also possible to assess the economic benefits of the governmental incentives to attract multinational enterprises (MNEs). Increased FDI inflows to a country can create several economic effects. Among others, FDI can affect labour and capital markets, trade patterns and economic growth.

India has the highest shop density in the world, with 11 outlets per 1000 people. This number is very high compared to the international average. It is the high level of decentralization in Indian market that keeps all these businesses running and can serve as a model for the future markets of the world. The Government is seeking different options, keeping in view the existing social framework of India and will ensure that the entry of global retail giants does not displace the existing employment in the retail business. In other countries, nowhere these corporations have thought about the people, society and the ecology. For example, the entry of the giant corporate retail in India's food market will have a direct impact on India's 650 million farmers and 40 million people employed in retail.

REVIEW OF LITERATURE

If China, with its newfound faith in capitalism, can embrace and attract substantial volumes of FDI, why can't India, which is blessed with western institutions and capitalist organizations? Those who advocate that India should attract increased volumes of FDI argue that, "in terms of foreign investment, it is the direct investment that should be actively sought for and doors should be thrown wide open to FDI. FDI brings huge advantages (new capital, technology, managerial expertise, and access to foreign markets) with little or no downside (Bajpai and Sachs, 2000, p. 1). Admittedly, FDI is a potent instrument of development. But sweeping generalizations such as FDI brings huge advantages, it has no downsides and throwing doors wide open would necessarily attract increased volumes of FDI are suspicious statements.

Why do firms go abroad? Why do they choose to invest in specific locations? The literature on these issues emphasizes three main elements, which guide the FDI decision process of TNCs (Transnational Corporations). John Dunning (1973) neatly synthesizes these elements in the well-known eclectic paradigm or the OLI explanation of FDI. For a TNC to invest successfully abroad, it must possess advantages which no other firm posses (O), the country it wishes to invest in should offer location advantages (L), and it must be capable of internalizing operations (I). Internalization is synonymous with the ability of firms to exercise control over operations essential for the exploitation of ownership and location advantages.

The cumbersome and complex nature of the regulatory framework during those years has been extensively analyzed (Kidron, 1965; Kumar, 1994). The policy framework specifies industries in which both foreign financial and technical participation were allowed, those in which only technical collaboration was permitted, and those in which neither technical nor financial participation was allowed. This sort of a selective approach governing the degree of foreign participation in industry reflects the desire to delimit foreign ownership and control to industries of the economy in which its contribution was deemed to be essential.

WHY FDI?

1) Improves competition.
2) Develops the market.
3) Greater level of exports due to increased sourcing by major players:

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4) Sourcing by Wal-Mart from China improved multifold after FDI was permitted in China.
5) Similar increase in sourcing observed for metros in India.
6) Provides access to global markets for Indian producers.

- **Investment in Technology**

1) Cold storage chains solve the perennial problem of wastage.
2) Greater investment in the food processing sector technology.
3) Better operations in production cycle and distribution.

- **Better lifestyle**

1) Greater level of wages paid by international players.
2) More product variety.
3) Newer product categories.
4) Economies of scale to help lower consumer price.
5) Increased purchasing capacity of consumers.

- **Manpower and skill development**

1) Through retail training and
2) Greater managerial talent inflow from other countries

- **Tourism Development**

1) A strong retailing sector boosts tourism as seen from the experience of Singapore and Dubai.

- **Investment in whole supply chain**

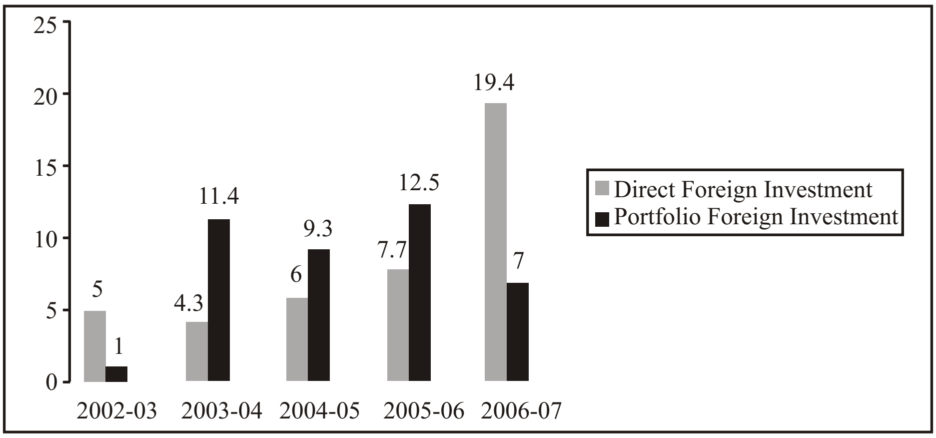
1) Improved product basket from India for exports.

- **Long term benefits**

1) Upgradation of agriculture.
2) Development of efficient small and medium size industries.

FDI IN INDIA

Chart No.1: Foreign Investment (In Billion $)



Source: Reserve Bank of India

The strong macro economic fundamentals, growing size of the economy and improving investment climate has attracted global corporations to invest in India. A major outcome of the economic reforms process aimed at opening up the economy and embracing globalization has led to tremendous increase in Foreign Direct investment inflows into India. According to A.T. Kearney, India ranks second in the world in attracting FDI.

FDI IN THE RETAIL SECTOR

Industry experts are sensitive to the point that local markets have an edge over the retail investors in India as they have unique advantages such as an understanding of local needs and extended services like home delivery. And the further upsurge is anticipated in the retail sector as the Government allowed up to 51% FDI in single brand retail outlets. As the FDI influence on the Indian retail sector sets in, the total size of the retail trade is expected to grow extensively in the coming years and the consumer segments patronizing the big malls will create frenzy for organized retailing, predicting a growth of 25-30 per cent per annum over the next decade. Moreover, Indian retail chains would get integrated with global supply chains, since FDI will bring in technology, quality standards and marketing, thereby leading to new economic opportunities and creating more employment generation.

Industry trends for retail sector indicate that organized retailing has a major impact on controlling inflation because large organized retailers are able to buy directly from producers at most competitive prices. World Bank attributes the opening of the retail sector to FDI to be beneficial for India in terms of price and availability of products as it would give a boost to food products, textiles and garments, leather products, etc., to benefit from large-scale procurement by international chains, and in turn, creating job opportunities at various levels.

As foreign investors exploring the potentials in the retail sector are keen on developing malls in India, the size of organized retailing is expected to touch $30 billion by 2010 or approximately 10 per cent of the total. This has initiated market-entry announcement from some retailers and has signaled to international retailers about India's seriousness in promoting the sector. While there are reports of international retailers like Wal-Mart analyzing business opportunities in India; Reliance, the largest Indian conglomerate is investing $3.4 billion to become India's largest contemporary retailer. There are also reports of investments for 'Hypercity Retail' by K.Raheja Group to establish 55 hypermarkets by 2015. All these factors will contribute in taking the Indian retail business to unexpected growth, based on the consumer preference for shopping.

HIJACK PLANS OF CORPORATE RETAILERS

1) Reliance: Rs. 30,000 cr ($ 6.67 bn) investment to set up multiple retail formats with expected sales of Rs. 90,000+ cr ($ 20 bn) by 2009-10. The company plans thousands of stores across 784 cities and towns.

2) Bharti Group: Plans Rs. 31,500 cr (US$ 7 bn) investment in creating retail network in the country including 100 hyper malls and several hundred small stores.

3) Pantaloon: Expansion into all possible formats of retail across categories and segments. 30 mn sq.ft by 2010, foray in insurance, real estate and consumer finance, the turnover is expected to touch Rs. 30,000 cr ($ 6.67 bn) in 2010-11.

4) RPG: Planning IPO, 450+ Music World, 50+ Spencer's hyper covering 4 mn sq ft by 2010.

5) Lifestyle: Rs. 450+ cr ($ 90 mn) investment in next 5 years to expand on Max Hypermarkets & value retail stores, Home & Lifestyle Centres.

6) Rahejas: Shoppers' Stop, Crossword, Inorbit Mall, 'Home Stop' and recently lunched hypermarket named 'Hypercity'. Plan to open 55 hypermarkets across India by 2015.

7) Piramyd: 1.75 mn sq ft of retail space and 150 stores in next 5 years.

8) Trent: Trent to open 27 more stores across its retail formats adding 1 mn sq ft of space in the next 12 DLF malls.

9) Trinethra: Recently acquired by the AV Birla group, Trinethra (currently with two formats - Trinethra and Fabmall) plans 220 stores with a turnover of over Rs. 300 cr ($667 mn) in the fiscal year 2007-08.

10) Vishal Group : Plans include an IPO and investment close to Rs. 1250 cr ($ 278 mn) by 2010, targeting 220 outlets, taking its cumulative retail space to 5 mn sq ft and sales turnover of Rs. 5000 cr ($ 1 bn+). With 50+ new stores getting ready in the fiscal year 2007-08, the chain is investing Rs. 300 cr (66.67 mn) with sales target of over Rs. 700 cr ($155.6 mn). Vishal Retail is a retailer focused on the lower-to-middle income group, with presence mainly in tier III locations.

IMPACT OF CORPORATE ENTRY INTO RETAIL

- **IMPACT ON SHOPKEEPERS, TRADERS AND HAWKERS**

After farming, retailing is India's major occupation. Census 2001 provides the most authentic data on people involved in retail. According to it, there were 269 lakh 'main' and 24 lakh marginal workers in wholesale and retail trade. That is, nearly three crore people depend on trade– 1.1 crore in the urban and 1.9 crore in the rural areas. Of the total, nearly 1.7 crore are not even matriculates. Thus, the livelihood of more than 30 million is involved and if we count the dependents, in the form of children and others, at least 120 million will be impacted by the retail revolution created by the large corporations. The growth of global giants is destroying the self-organized small retail in India**.** We are following a trend that increases the divide between the rich and the poor and history has shown that these divides have always led to social unrest and political turmoil in a nation.

- **IMPACT ON FARMERS**

Wal-Mart is presenting itself as a friend and liberator of farmers and it refers to small traders as middleman, as if they are not giant middleman. Walmart is monopolistic (a situation when there is one buyer and too many sellers) buyers who in due course of time will drive down procurement prices of agricultural and manufactured products. It claims that they are paying more to the farmers, but the truth is that they are at present procuring from the existing *mandis* all across the nation, and not straight from the farmers, so there is no question of paying better returns to the farmers.

- **IMPACT ON WORKERS, SUPPLIERS & EXISTING INDUSTRIES**

Another threat is that the opening of a giant pipeline of cheaply sourced goods from China, Thailand, ASEAN, etc., could lead to unfair competition and livelihood losses on a massive scale in India. Currently, if Wal-Mart were a country, they would rank as China's 6th largest trading partner. As they and others seek to enter India, there are no regulations insisting that products are Indian made. However, on the other hand, as corporate retail-both domestic and foreign-grows in India, they have more power over local manufacturers. Because large corporations like Wal-Mart are able to buy in such bulk, they contract with only a selected list of manufacturers, and are then able to exert pressure on them over time to cut costs. This directly translates to workers working longer hours for less pay and the closing of factories that cannot keep up with the competition.

- **IMPACT ON ENVIRONMENT AND HEALTH**

1) Climate Change

Climate change due to air pollution is already becoming a threat to human life. Temperatures are rising, sea level is rising and glaciers are melting. The imperative in the context of climate change is to prevent increased use of fossil fuels. Hawkers, *rediwala* (hawkers) and *kirana stores (local grocery store)* is the solution to climate change. Bharti-Walmart model will increase fossil fuel use and carbon emissions. Further destabilizing the climate, the super market lorries will consume huge amount of fuel and lead to enormous pollution. Even if we go by conservative estimates, the super market lorries in India will generate more than 7 million tonnes of carbon dioxide per year, adding more problems to the already fragile environment of the country.

2) Excessive Pesticides

The giant retail chains have their own standards of buying farm produce. It's very difficult for a farmer to produce fruits and vegetable which fits into the standards of giant retail chains, so they are forced to use excessive insecticides and pesticides. Once these farm produce come to the retail giants, they sell it throughout the year, by preserving them in cold storage, but in the process, a lot of preservatives are also added to the food. So at the end, when a consumer gets a “preserved” vegetable from these giant stores, it is full of toxic material harmful for consumption.

3) Packaging

Packaging of food creates a huge amount of waste in the already polluted cities. At a time when every city in the country is struggling to solve the problems of solid wastes, increase in the packaging waste due to the mall culture will add to their woes. The existing land fills are getting filled and then, more land of the poor farmers will be acquired to make landfills for Wal-Mart's packaging waste.

CASE STUDY

MAHAMAZA.COM - REACHING THE RURAL HINTERLAND

A business model which sells INR 15 million worth Nokia phones in one month, 3000 cycles in 3 months, 28 brands across 15 industries and services 275,000 dealers. The company in question, Mahamaza, ended the year with a turnover of INR 1.2 billion. The Mahamaza model is quite simple. Any person wishing to be a dealer can sign up with Mahamaza by making a one-time payment (around INR 5,000). Then, the dealer gets orders from his town or villages and places these orders with Mahamaza. The company further consolidates orders and gets discounts from durables and FMCG companies due to its bulk buying. A part of this discount is passed to the dealer as his commission. People in rural areas like Medak in Andhra Pradesh and Abhohar in Punjab are buying cellphones and are inquiring about Plasma TVs.

RESEARCH FINDINGS ON WAL-MART

Wal-Mart is the largest corporation in the world. Their annual revenue of over $ 350 billion is larger than the entire Indian retail market. They are currently banned from entering into India, but are trying to come in through the back-door by signing a Joint Venture with Bharti Enterprises (AirTel). They have not yet signed the deal. They must be stopped.

- A study by Kenneth Stone of Iowa State University found that some rural towns in the USA lost 47% of their retail trade after the opening up of a Wal-Mart.
- A study by Stephan J. Goetz of the Pennsylvania State University and Hema Swaminathan of the International Center for Research on Women found that countries in the USA where Wal-Marts are located experienced increases in family poverty as compared to similar counties where there was no Wal-Mart
- The Congressional Research Department of the Representative George Miller in the USA put together a compendium of Wal-Mart's labor abuses in that country.
- Another study by David Neumark, Junfu Zhang, and Stephen Ciccarella found that Wal-Mart decreased employment by 2-4%, and reduced wages by 5%.
- An article in Workforce Management describes how Wal-Mart has a turnover of 600,000 associates per year, accusations of wholesale discrimination against women, and violations of overtime laws.

FACT SHEET ON WAL-MART

- Wal-Mart recently had to close down its business in Germany and Korea as it was found to be indulging in Predatory Pricing' (selling at lower price than its cost price) which is not allowed in these countries.
- Wal-Mart is facing a class lawsuit for pay discrimination against 1.5 million female US employees after a court approved the action. A federal appeals court upheld a 2004 ruling giving the lawsuit class action status, sanctioning claims from up to 1.5 million current and former staff. The original lawsuit was filed in 2001 by six women who either worked for Wal-Mart or had done so in the past.
- Wal-Mart ordered to pay millions as compensation to workers. Wal-Mart was ordered to pay at least $78m in compensation to workers who were forced to work during breaks. A jury in a Pennsylvania court decided that Wal-Mart broke a state law by refusing to pay staff for the extra work they did. The class action was brought by about 1, 87,000 staff who worked for Wal-Mart between March 1997 and May 2006.
- Wal-Mart is notorious for its anti union practices and does not allow union right to workers all over the world. Only recently, they have been forced by the Chinese Government to allow union in China where workers are sweating day in and out to produce goods for Wal-Mart at low cost.
- Human Rights Watch documents the U.S.-based retail giant Wal-Mart's anti-union practices in the United States. In the report entitled, “Discounting Rights: Wal-Mart's Violation of US Workers' Right to Freedom of Association,” Human Rights Watch found “that while many American companies use weak US laws to stop workers from organizing, the retail giant's aggressiveness of its anti-union apparatus stands out for the sheer magnitude and power”. The Human Rights Watch investigation reveals that Wal-Mart begins to indoctrinate workers and managers to oppose unions from the moment they are hired. Managers receive explicit instructions on keeping out unions, many of which are found in the company's 'Manager's Toolbox,' a self-described guide to managers on 'how to remain union free in the event union organizers choose your facility as their next target'.
- Main supplying factories feel the pressure of shrinking profit margins with Wal-Mart and pass on that pressure to the unorganized labour in the factories who earn a very low wage and can be made to do unpaid overtime work. Average wages of workers in Bangalore supplier factories supplying to Wal-Mart are lower than in factories not supplying to Wal-Mart.

WORLDWIDE RESISTANCE

- In September 2005, citizens of Rotterdam, Holland protested against Wal-Mart entering into the city.
- In China, 10,000 young women went on strike at a Wal-Mart factory demanding better working conditions and the right to organize.
- In Canada, Wal-Mart employees voted to unionize; subsequently, Wal-Mart closed down the store. Hundreds of Canadians demonstrated against the mega-retailer.

- In the US, over 300 communities have successfully fought the entry of a Wal-Mart store into their communities. National campaigns targeted Wal-Mart were launched in 2005.

RESTRICTIONS ON MNCs

- China had initially restricted FDI in retailing to only Joint Ventures at 49% foreign holding and only at specified locations subject to a ceiling on the number of stores.
- Malaysia, Indonesia, Thailand and Japan have enforced zoning restrictions for mega retailers.
- There are minimal capital requirements for foreign retailers in Sri Lanka.
- The Philippines has imposed "sourcing" and reciprocity requirements on foreign retailers.
- In Japan, mega-retailers must seek the views and permission of small local stores before opening a new store.
- In the US, major cities such as Los Angeles, California, Chicago and New York City have restricted the opening of Wal-Mart stores within city limits.
- France enacted the Raffairin Act that regulates the growth of hypermarkets larger than 300 square feet.
- In Thailand, the government set up an assistance fund for local retailers due to the impact of mega retailers.

INTERNATIONAL RETAILERS

With international brands like Tommy Hilfiger, Esprit and Puma (that have entered the country) growing well over 100 per cent, many others are also planning to foray into the Indian retail market. India's vast middle class, with its expanding purchasing power and its almost untapped retail industry, are key attractions for global retail giants wanting to enter newer markets.

- The world's largest retailer, Wal-Mart, has tied-up with Sunil Mittal's Bharti Enterprises to enter Indian retail market.
- Microsoft's first shop-in-shop pilot has been launched with the Tata Group subsidiary Infiniti Retail's multi-brand consumer durables retail format, Croma.
- The Walt Disney Company, consumer product retailing arm of global animation giant, will soon add 135 new stores to its existing 15 stores.
- World's leading coffee chain, Starbucks' enters India through a tie-up with the country's leading multiplex operator PVR Limited.
- Apple Inc. has entered into an exclusive marketing and distribution deal with Reliance Retail through "iStore by Reliance Digital".
- The UK-based international coffee chain, Costa Coffee, planned to double the number of retail outlets by the end of 2008.

Some of the international players that have already entered India include McDonald's, Pizza Hut, Dominos, Levis, Lee, Nike, Adidas, TGIF, Benetton, Swarovski, Sony, Sharp, Kodak, Medicine Shoppe among others.

RETAIL REFORM

The Government allows 100 per cent foreign direct investment (FDI) in cash and carry through the automatic route and 51 per cent FDI in single a brand. Besides, the franchise route is available for big operators. To further attract global retailers, the economic survey (2007-08) has suggested a share for foreign equity in all retail trade and 100 per cent in respect of luxury brands and other specialised retail chains.

FDI is not permitted in retail trade sector, except in:

- Private labels
- Hi-Tech items / items requiring specialized after sales service.
- Medical and diagnostic items
- Items sourced from the Indian small sector (manufactured with technology provided by the foreign collaborators)
- For 2 year test marketing (simultaneous commencement of investment in manufacturing facility required)

CONCLUSIONS & RECOMMENDATIONS

1. The retail sector in India is severely constrained **by limited availability of bank finance**. The Government and RBI need to evolve suitable lending policies that will enable retailers in the organized and unorganized sectors to expand

and improve efficiencies. Policies that encourage unorganized sector retailers to migrate to the organized sector by investing in space and equipment should be encouraged.

2. A **National Commission** must be established to study the problems of the retail sector and to evolve policies that will enable it to cope with FDI as and when it comes.

3. The proposed National Commission should evolve a clear set of **conditionalities on giant foreign retailers** on the procurement of farm produce, domestically manufactured merchandise and imported goods. These conditionalities must be aimed at encouraging the purchase of goods in the domestic market, state the minimum space, size and specify details like construction and storage standards, the ratio of floor space to parking space etc. Giant shopping **centres** must not add to our existing urban snarl.

4. Entry of foreign players must be **gradual and with social safeguards** so that the effects of the labor dislocation can be analyzed & policies can be fine tuned. Initially, allow them to set up supermarkets only in metros. Make the costs of entry high and according to specific norms and regulations so that the retailer cannot immediately indulge in 'predatory' pricing.

5. In order to address the dislocation issue, it becomes imperative to develop and **improve the manufacturing sector** in India. There has been a substantial fall in employment by the manufacturing sector, to the extent of 4.06 lakhs over the period 1998 to 2001, while its contribution to the GDP has grown at an average rate of only 3.7%.

6. The government must actively encourage setting up of **co-operative stores** to procure and stock their consumer goods and commodities from small producers. This will address the dual problem of limited promotion and marketing ability, as well as market penetration for the retailer. The government can also facilitate the setting up of warehousing units and cold chains, thereby lowering the capital costs for the small retailers.

7. According to IndiaInfoline.com, **agro products and food processing sector in India is responsible for $69.4 billion out of the total $180 billion retail secto**r (these are 2001 figures). This is more than just a sizeable portion of the pie and what makes it even more significant is the fact that in this segment, returns are likely to be much higher for any retailer. Prices for perishable goods like vegetables, fruits, etc. are not fixed (as opposed to, say branded textiles) and therefore, this is where economies of scale are likely to kick in and benefit the consumer in the form of lower prices. But due attention must be given to the producer too. Often, the producer loses out, for example, when the goods are procured at Rs.2 and ultimately sold to the consumer at about Rs.15 as in the case of tomatoes now. The Government themselves can tap into the opportunities of this segment, rather than letting it be lost to foreign players.

8. Set up an **Agricultural Perishable Produce Commission (APPC)** to ensure that procurement prices for perishable commodities are fair to farmers and that they are not distorted with relation to market prices.

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