FDI in India's Retail Trade

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Opponents of the entry of foreign direct invest-ment (FDI) in retail trade generally point to its adverse impact on employment. This is indeed an important issue, as around 40 million people are engaged in retail trade in India, and even a small percentage loss of employment in this sector amounts to lakhs of unemployed.[1] At the same time, it is necessary to take note of certain other issues as well, in particular the nature of the relations which international retailing giants establish with their suppliers, and their implications for workers and cultivators in countries like India.

Though FDI in retail trade is as yet restricted, the Government of India has a more liberal policy towards wholesale trade, franchising, and commission agents' services, thus preparing the ground for FDI in retail as well. Foreign retailers have already started operations in India through various routes : (i) joint ventures where the Indian firm is an export house; (ii) franchising[2] (eg. Kentucky Fried Chicken, Nike); (iii) sourcing of supplies from small-scale sector; (iv) 'Cash and Carry' operations (Giant in Hyderabad, Metro in Bangalore)[3] (v) non-store formats–direct marketing (Amway). Large international retailers of home furnishing and apparels such as Pottery Barn, The Gap and Ralph Lauren have made India one of their major sourcing hubs. Up to 100 per cent FDI is allowed in 'Cash and Carry' operations. The Great Wholesaling Club Ltd is one such example.[4] In February 2002, the world's largest retailer, Wal-Mart, opened a global sourcing office in Bangalore. In November 2006, it announced its entry under a joint venture with the Indian corporation Bharti. For the time being, Bharti is to own the chain of front-end retail stores, while the two firms will have an equal share in a firm that will engage in wholesale, logistics, supply chain and sourcing activities.[5] This is seen as a preliminary step by Wal-Mart pending the removal of all restrictions on FDI in retail trade.

DISTINCT CHARACTER OF INDIAN RETAIL TRADE

The Indian trading sector, as it has developed over centuries, is very different from that of the developed countries. In the developed countries, products and services normally reach consumers from the manufacturers/producers through two different channels: (a) via independent retailers ('vertical separation') and (b) directly from the producer ('vertical integration'). In the latter case, the producers establish their own chains of retail outlets, or develop franchises.

In India, however, the above two modes of operation are not very common : For in India, today, less than three percent of the retail transactions are done in the organised sector; and this is projected to increase to 15-20 per cent by 2010.[6] To date, the organised sector is restricted to metropolises. The second mode is found in a few national firms and some subsidiaries of global firms. Indian wholesale trade too is not organised. The few government initiatives (such as the formation of Boards for tea, coffee, and spices, and the State Trading

Corporations) have largely become defunct by now, and private initiatives have mostly remained localised[7]. Small and medium enterprises dominate the Indian retail scene. The trading sector is highly fragmented, with a large number of intermediaries. So also, wholesale trade in India is marked by the presence of thousands of small commission agents, stockists and distributors who operate at a strictly local level. Apart from these, in many cases small producers such as artisans and farmers sell their goods directly to end consumers (often one family member is a producer and another sells the products). The existence of thousands of such individual producer-cum-sellers is an example of 'vertical integration' as it is found in the Indian retail sector. There is no 'barrier to entry', given the structure and scale of these operations.

'Customer relationship management' (to use the marketing jargon) is handled in India by numerous small vendors locating themselves close to their customers - either by opening a tiny outlet in a residential area or by hawking goods at the consumer's doorstep. In this process, a personal relationship develops, often extending beyond immediate business interests.

The retail sector acts as an important shock absorber for the present social system. Thus when a factory shuts down rendering workers jobless; or peasants find themselves idle during part of the year or get evicted from their land; or the stagnant manufacturing sector fails to absorb the fresh entrants into the job market, the retail sector absorbs them all. A skilled labourer turns into a street hawker, a farmer turns to delivering milk packets door to door, an educated unemployed youth hawks newspapers and a better off unemployed person starts a telephone booth and retails telecom cards as an 'add on' service. When (in exceptional cases) the factory reopens, or harvesting time arrives, some of these new entrants leave the retail trade and return to their respective employments.

Thus, after agriculture, the incidence of underemployment is probably highest in the Indian retail sector. There are nearly 12 million retail outlets. Small retailers operating in the unorganised sector dominate the trade. Those displaced as a result of FDI in retail may not show up as an increase in visible unemployment. Only the extent of under-employment in the retail sector might increase.

THE SOURCE OF THE PRESSURE FOR ALLOWING FDI IN RETAIL

Why is the government so keen in inviting FDI in the retail sector? Here are some arguments made by the proponents of FDI :

(i) "Only a few global firms possess proprietary expertise in retail trade. They would not transfer their expertise to local firms unless they were allowed to operate in the domestic market."

Reality: In the literature on retail, one could not trace the existence of any cutting edge proprietary expertise –either technical or managerial.

(ii) "The government needs FDI to meet its foreign exchange requirements."

Reality : Because of large capital inflows, the Government of India is today burdened with huge and growing foreign exchange reserves. By April 13, 2007, the foreign exchange reserves had swollen to $203 billion. The argument for FDI in retail to attract foreign exchange is not tenable.

(iii) “Only global retailers can satisfy the rising and varied demands of Indian consumers.”

Reality: It has yet to be shown which product or service is being offered by foreign retail firms is unavailable at present to Indian consumers, or cannot be provided without FDI. Moreover, the alleged benefits of ‘consumer choice’ are being inflated. Indeed, the availability of excessively wide choice makes it so complex and time-consuming for the consumer to decide that it leads to stronger loyalty to particular brands! Research reveals that an average grocery store in USA, offers 35,000 to 40,000 stock keeping units versus 12,000 to 15,000 thirty years ago. The suppliers offer about 20,000 new items each year; of which 1,000 are new efforts and the rest are line extensions. However, the top 5,000 items still account for about 90 percent of sales, as they did thirty years ago[8].

Rather than internal ‘pull’, the reason that the Government is interested in pushing FDI in retail trade is external pressure. Foreign firms are interested in the growing Indian market of the better-off; India is an emerging procurement site for global retailers, especially for handicraft products (including textiles) and semi-processed local food items; the profitability of major retail firms in the developed countries is declining, and capital is looking for better pastures; and new rules in international trade encourage movement of FDI across nations to maximize return on investment.

Thus major retail chains like Wal Mart and Tesco have already opened their procurement centres in India. For large-scale procurement operations, they will have to make substantial investments in infrastructure and develop an efficient supply chain. By opening retail chains in the host country they would like to exert monopsony[9] power, eliminating other major buyers from the market. In this context one must remember that India is fortunate to be part of two major centres of biodiversity out of the few remaining such centres in the world. The wide food variety and rich heritage of textile and other handicrafts makes India a very attractive source of supplies for retail giants. Wal Mart procured goods worth $1.5 billion from India in 2004, which is expected to touch $2 billion this year. From India, Wal-Mart mainly sources home furnishings, T-shirts, night-suits etc.[10] It has also been reported that Wal Mart has already proposed to the West Bengal government to take over the fresh food markets of, in and around Kolkata. Though the government has not accepted the proposal as yet, it has not rejected it either[11].

Analysis of FDI flows in trade indicates that, over the 1990s, developed countries faced market saturation and became relatively less attractive to foreign investors. Instead, developing countries and Central and East European countries became increasingly attractive to foreign investors[12].

Trade liberalisation and improvement in communication systems have increased opportunities for retailers to buy their products from producers worldwide. Some of the factors that have contributed to this trend are the reduction in tariff, incentives provided to foreign investment, cheaper real time communications, and cheaper transport.

These are some of the reasons that transnational retail giants are interested in entering India. Thus it is principally external pressure that is compelling the

Indian government to liberalise FDI in retail. Possible impact on marginal producers and work force—the experiences of other countries

Proponents of FDI in retail trade claim that it will improve the incomes of small and marginal producers by doing away with middlemen whose margins constitute such a large percentage of the final product. Is this true? In fact, an important issue missing in the whole debate is the relation between FDI retail firms and numerous small and marginal producers, especially in the agrarian and handicraft/handloom sectors. Some previous research findings on this issue may be illuminating.

(i) In April 1999, the Director General of Fair Trading (DGFT) asked the Competition Commission, UK, to investigate the supply of groceries from multiple stores in Great Britain. The Competition Commission identified 24 multiple grocery retailers who supplied groceries from supermarkets with 600 sq. meters or more of grocery sales area, where the space devoted to the retail sale of food and non-alcoholic drinks exceeded 300 sq meters and which were controlled by a person who controlled ten or more such stores. The Commission received many allegations from suppliers about the behaviour of the main parties in the course of their trading relationships. Most suppliers were unwilling to be named, or to name the main party that was the subject of the allegation. As e Commission could anticipate a climate of apprehension among many suppliers in their relationship with the main parties, the Commission had put a list of 52 alleged practices to the main parties and asked them to tell which of them they had engaged in during the last five years. It was found that a majority of these practices were carried out by many of the main parties. They included requiring or requesting from some of their suppliers various non-cost-related payments or discounts, sometimes retrospectively; imposing charges and making changes to contractual arrangements without adequate notice; and unreasonably transferring risks from the main party to the supplier. A request from a main party amounted to the same thing as a requirement. Ultimately, such practices would exert downward pressure on the incomes of farmers and workers involved in the supply of goods to such retail chains.

(ii) How large is the share of Third World producers in the developed country retail price of their goods? A 1981 study by the UN provided some data[13]. It showed that the Philippines suppliers of bananas to TNCs in 1974 received only 17 percent of their retail price in the Japanese market. And Thai suppliers of fresh pineapples in 1978 earned only 35 percent of the final consumer value of pineapples canned and marketed by US transnational corporation Dole. Of this 35 percent, only 10 percent was the share of the agriculturists, and the remaining 25 percent was accounted for by processing, packaging, etc., which were predominantly carried out by subsidiaries of transnational.

(iii) Similarly, the World Bank's Global Economic Prospects and the Developing Countries 1994 noted: "The high cost of processing, packaging, advertising, marketing, and distribution means that the cost of the primary product as a share of the final product price is usually small : for raw cotton the growers' price represents about 4-8 per cent of the final product price; for tobacco this share is closer to 6 percent. For bananas, producer countries obtain about 14 percent of the retail price; for jute goods it is 11-24 percent; for coffee, between 12 and 25 percent; and for tea the growers' price is 47 per cent of the UK retail price for packeted tea but only 15 percent of the US retail price of tea bags."[14] These figures seem too high. Michel Chossudovsky estimated around the same period that producer prices of coffee were only 4 percent of the final retail price in North American markets.[15]

(iv) A recent research project by Oxfam[16] shows that during the period since the UN study referred to above, the condition of the poor suppliers of fresh fruits has deteriorated further. Oxfam interviewed hundreds of women workers and many farm and factory managers, supply chain agents, retail and brand company staff, unions and government officials..In all, the research included interviews and surveys spread over 12 countries with 1,310 workers, 95 garment factory owners and managers, 33 farm and plantation owners and managers, 48 government officials, 98 representatives of unions and nongovernment organisations (NGOs), 52 importers, exporters, and other supply chain agents, and 17 representatives of brand and retail companies. The research documented the experiences not only of women workers, but also of their employers, the managers and owners of farms and factories. Below are a few important findings of the report :

Globalisation has hugely strengthened the negotiating hand of retailers and brand companies, whose global supply chains stretch from the world's major shopping centres to the farms and garment factories of the third world. New technologies, trade liberalisation, and capital mobility have dramatically opened up the number of countries and producers from which they can source their products, creating a growing number of producers vying for a place in their supply chains. These companies have tremendous power in their negotiations with producers and they use that power to push the costs and risks of business down the supply chain. Their business model, focused on maximising returns for shareholders, demands increasing flexibility through 'just-in-time' delivery, tighter control over inputs and standards, and ever-lower prices.

Under such pressures, factory and farm managers typically pass on the costs and risks to the weakest links in the chain: the workers they employ. For many producers, their labour strategy is simple : make it flexible and make it cheap. Faced with fluctuating orders and falling prices, they hire workers on short-term contracts, set excessive targets, and subcontract to sub-standard unseen producers. Pressured to meet tight turnaround times, they demand that workers put in long hours to meet shipping deadlines. And to minimise resistance, they hire workers who are less likely to join trade unions (young women, often migrants and immigrants), and they intimidate or sack those who do stand up for their rights.

The demands for 'just-in-time' delivery have typically cut production times in a few sectors by 30 per cent in five years. Coupled with smaller, less predictable orders and high airfreight costs for missed deadlines, the small producers are pushed to the walls. Moroccan factories producing for Spain's major department store. El Corte Ingles must turn orders round in less than seven days. "The shops always need to be full of new designs, we pull out all the stops to meet the deadline ... our image is on the line" said one production planning manager. But the image they hide is of young women working up to 16 hours a day to meet those deadlines, underpaid by 40 per cent for their long overtime working.

Global supply chains have created new opportunities for labour-intensive exports from low-cost locations. The result is a dramatic growth in the number of producers, heightening competition among the world's factories and farms for a place at the bottom of the chain. At the top end, however, market share has tended to consolidate among a few leading retailers and brand names. Such an imbalance between intensely competing producers and relatively few buyers in the global market puts the small suppliers at the receiving end. The owner of a Brazilian shoe factory, facing intense international competition to sell to leading footwear retailers in Europe commented: “We don’t sell, we get bought”.

Over the past twenty years, fresh produce and food service industries have headed towards global consolidation. In the food service industry, US-based Yum Brands has 33,000 restaurants—including Taco Bell, Pizza Hut, and KFC—in over 100 countries, and is especially focusing on expansion in China, Mexico, and South Korea. Supermarkets–grocery retailers with multiple stores–dominate food sales in rich countries and are rapidly expanding their global presence.

In the USA, by 1997, supermarkets and even bigger ‘super-centres’ owned by companies like Wal Mart and Kroger controlled 92 per cent of fresh-produce retailing. In the UK, by 2003, just five supermarket chains controlled 70 per cent of the market.

Since supermarkets increasingly control food retailing, the world’s farmers are competing for a place in their supply chains. It can be good business, especially for farmers selling top-quality and out-of-season produce. But fresh produce is a risky business. And the extreme imbalance in negotiating power between a handful of supermarkets and the world’s farmers means that most of the gains from trade are captured at the top. Supermarkets are pushing price and payment risks onto farmers and growers, controlling packaging and delivery requirements, squeezing producers’ margins, and focusing on technical, not ethical standards. The figure below captures the real picture. While the African producers as a whole get only 9 percent of the retail price of an exported apple, the overseas retailers in UK comer a 42 percent share.

Share of different parties in the final price of apples exported from South Africa to UK supermarkets

(Each actor in the supply chain adds to the retail price for apples to cover costs and margins)

Sector	% share of income				
Farm labour	5	Farm income	4	Supermarket	42
Importer’s commission and duty	7	UK handling	7	Shipping	12
Transport and customs	6	Farm inputs and packaging			17

Source: Oxfam (2004)

(v) In another recent report,[17] which corroborates the above observation, it was estimated that in case of bananas sold in European market by US multinationals, the farmer might get around 10 percent of the retail price, with workers getting anything from 9 percent in the case of Fairtrade bananas to as little as 1.5 percent on traditional farms. Whereas trading companies such as Del Monte, Chiquita, Dole and Fyffe's could be getting up to a third of the price, retailers took around 40 percent.

(vi) This pattern does not hold only for agricultural goods. The break-up is similar in the case of the typical manufactured exports of the developing countries. In the case of garments, Chossudovsky gathered data for Bangladesh garment factories which showed that the share of Bangladeshi workers' wages in the final retail price of a shirt in North American markets was 1.7 percent; the profit of the Bangladeshi employer was another 1 per cent. 'Gross commercial profit, rent and other income of distributors' accounted for 71.8 percent.[18]

Small suppliers, unorganised workers and consumers are the major losers as global retailers and brand owners consolidate their power through free movement of global capital. Changes in labour laws are brought about in line with the requirements of supply chain flexibility: easier hiring and firing, more short-term contracts, fewer benefits, and longer periods of overtime. The Indian Government is trying to bring about such changes, both directly and indirectly.

PRESSURE TO ENSURE IRREVERSIBILITY OF OPENING UP TO FDI IN RETAIL

It may be imagined that, if the entry of transnationals in retail trade leads to harmful consequences, the government can restrict and regulate their activities, or even remove them altogether. However, TNCs in services are striving to bring in changes in the General Agreement on Trade in Services (GATS) to ensure that their entry is irreversible and ever-expanding. For example, major associations of global retailers like the FTA (Foreign Trade Association) and European Services Forum (ESF), of which global retail firms such as Metro, Ahold and Marks & Spencer are members, have taken renewed initiatives to introduce a separate agreement under the World Trade Organisation (WTO) on trade and investment to safeguard their overseas investments. In a position paper on trade and investment in April 2003, the European Services Forum demanded a comprehensive WTO agreement on rules for investment. According to that document (ESF, 2003), a WTO agreement on investment should be legally binding and based on the fundamental legal principles of most favoured nation and of national treatment (i.e. non-discrimination). It should contain the following :

— A stand-still against the introduction of new barriers on investment;
— Post-investment protection;
— Protection of all material and intellectual property of the company;
— Effective protection against direct expropriation as well as against indirect expropriation through discriminatory treatment;
— A mechanism for compensation in the case of expropriation;
— Independent and binding disputes settlement mechanisms;
— The right of the company to determine its own ownership structure and provisions on legal, regulatory and administrative transparency;
— Scheduling of concrete and specific commitments by WTO members to further open their markets to foreign direct investment.

Earlier, in 2001, the FTA demanded the abolition of any restriction—both product exclusion and sectoral limitation - on what is termed ‘mode 3’ (commercial presence) of trade in services. It also called for the strengthening of the investment rules (in GATS). Euro Commerce, the employers’ confederation, not only lobbies for liberalisation under the GATS agreement, but also pushes for the reduction of tariffs in Non-Agricultural Market Access (NAMA) and on agricultural goods, since the retail sector wishes to import its merchandise as cheaply as possible.

Before investing in the emerging economies, the global TNCs demand concrete and specific commitments on unlimited freedom of operation from the host countries. They expect all such commitments to be made under GATS framework so that once any commitment is made, the host government loses the option of retracting from it in future.

In this context, the experience of Thailand, which opened up its retail sector for FDI in the 1980s, is revealing. The Thai government liberalised its trading sector before the GATS negotiation process was started. The European retail giants Tesco, Royal Ahold, and Carrefour set up their operations in Thailand. As expected, many of the traditional retailers had to draw down their shutters, unable to compete with global firms in an unequal fight. Traditional traders controlled 74 per cent of the retail market in 1997, but by 2002, their share came down to 60 per cent. Faced with severe criticism from local retailers, the government announced that they would place controls on large retail establishments by imposing zoning policy regulations. In 2002, the ‘Retail Business Act’ was enacted to control the expansion of foreign retailers. However, the Thai government reversed its decision regarding zoning regulation, allegedly under pressure from the European Commission (EC), which had requested Thailand to open up their retail sector through GATS negotiations. As WTO lists zoning laws as ‘trade barriers’, it is feared that the Thai government would lose what tools remain to control the expansion of giant retail chains if they further open their retail sector through commitments under the GATS negotiation process.[19]

TECHNOLOGY THAT PAYS FOR ITSELF

Big gains could come from modern telecommunications and the growing flexibility of India’s labour force, as shown by workers like Selvi Partipan in Chennai.

Mrs Partipan, a 40-year-old who gave birth to the first of her five children when she was 13, used to work as a street vendor. She fried samosas and other fare for passers-by, earning just $2 a day.

But six years ago, after partial deregulation of the leather industry, Mrs. Partipan found a leather factory job. She sewed everything from handbags to jackets and earned $3 a day. She learned that she could earn as much as an additional $7 a day by doing extra sewing at home in the evening and on weekends, when other factories were desperate to finish orders.

The difficulty lay in figuring out when a leather factory manager somewhere else needed workers. So last summer, she gave $80 to her son, a security guard who works a morning shift, to buy a mobile phone. When work became available, factories sent text messages to her son and others in English - Mrs. Partipan speaks only a local dialect - and he quickly told her and she raced to the factory gate.

"I've already gathered some orders by phone," she said, wearing a maroon sari and sitting on a plastic stool as a daughter cooked samosas at the same location where Mrs Partipan used to cook. "It is paying for itself." □□□

[This piece is an abridged and slightly modified version of the paper titled "FDI in India's Retail Trade : A Few Missing Issues in the Current Debate'' which was uploaded in SSRN on January 9, 2006 as working paper. The full text is available at :
http://papers.ssrn.com/sol3papers.cfm?abstract_id=874707]

Notes :

1. M. Guruswamy, K. Sharma, J.P. Mohanty, and T. Korah, "FDI in India's Retail Sector–More Bad than Good", Economic and Political Weekly, 12/2/05, estimates future job losses as a result of FDI in the retail sector at between 4,32,000 and 6,20,000.
2. In a franchise, a product or service with an established brand name is manufactured or marketed or provided by a licensee, who pays an initial amount and royalty to the owner of the brand name. The brand owner generally supplies goods or know-how to the franchisee.
3. 'Cash and carry' operations are allowed only to make bulk sales to wholesale distributors. In practice, however, these stores have found ways of getting around these restrictions.
4. A. Mukherjee, Distribution Services: India and the GATS 2000.
5. Business Standard, Economic Times, 28/11/06.
6. Indian Retailing- Birth Pangs, 2003, www.fitchratings.com.
7. Two significant exceptions are the initiatives by ITC, a diversified cigarette company in which the global tobacco giant the British American Tobacco (BAT) has a substantial stake, and Hindustan Lever Ltd (HLL), the Indian subsidiary of the global consumer goods giant Unilever. Through its recently launched procurement network, 'e-choupal', ITC plans to procure agricultural products directly from farmers for its food division. HLL opened a separate food division a few years ago. Though this division has not contributed much in terms of revenue, HLL has put in huge resources to develop it. Recent developments indicate that in Unilever's new operational structure, HLL's food division may become the hub for Unilever's global food operations.
8. HBS Working Knowledge, Readers Respond: Is Less Becoming More? November 14, 2005.
9. Monopsony is the situation when there is only one buyer in the market and many producers.
10. Hindu Business Line, November 15, 2003; May 13,2005.
11. Hindu Business Line, October 29,2005.
12. UNCTAD, World Investment Report 2004 - The Shift towards Services.
13. United Nations Economic and Social Commission for Asia and the Pacific (ESCAP), Transnational Corporations and Primary Commodity Exports from Asia and the Pacific, 1981.
14. World Bank, Global Economic Prospects and the Developing Countries, 1994, p. 41.
15. Michel Chossudovsky, The Globalisation of Poverty: Impacts of IMF and World Bank Reforms, Indian edition, 1997.
16. Oxfam International, U.K., Trading away Our Rights: Women Working in Global Supply Chains, 2004.
17. Biz/ed, 'Oligopolies, Fair Trade, Bananas and Protectionism', 19 January 2004, http://www.bizLHl.co.uk/current/mind/2003 4/ 190104.htm
18. Chossudovsky, op cit, p. 91.
19. Christina Deckwirth, "Stop the EU 's corporate trade agenda

[Courtesy : RUPE, Mumbai]