

**Should India Open Foreign Direct Investment in Multi-brand
Retail: A case study using the Wal-Mart Effect**

By

Ashish Kumar Das

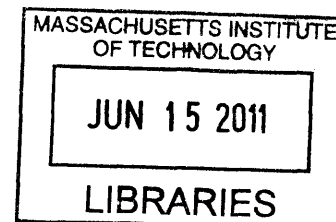
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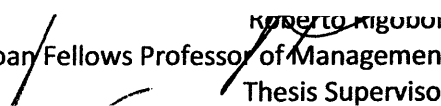
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Should India Open Foreign Direct Investment in Multi-brand Retail
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By

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ABSTRACT

As India grows, driven by its success in information technology and services, there is another revolution waiting to happen in the Retail sector dependent on whether the Government of India can unshackle the various inefficiencies that are keeping this industry constrained. Retail in India is estimated at nearly US\$ 400 billion and is growing at a CAGR of 9 percent (AT Kearney GRDI 2010). 96 percent of this sector remains un-organized and constitutes a workforce that have taken to self-employment for daily subsistence due to an overcrowded agriculture sector and lack of employment opportunities for lesser skilled workers in the manufacturing or services sectors. Food and groceries form nearly 60 percent of India's retailing followed by, among others, clothing and footwear at a distant 9 percent of retail. Despite the size of this market, retail and its food supply chain remains unorganized and inefficient. A lack of investment, technology and process control in the agriculture supply chain leads to tremendous waste accounting for nearly 25-30% of fruits and 10% of grains produced. Also, the related and supporting industries for food processing, cold chains and crafts remain nascent.

In a grim reflection on the situation, a politician in India recently remarked that Indian consumers buy shoes in air-conditioned stores but food on the streets. Despite this scathing but accurate comment, the debate on whether to organize retail remains unresolved. This debate is further complicated by intellectual and political debate on the impact of Foreign Direct Investment (FDI), by large international retailers like Wal-Mart, on the fate of small retailers. Interestingly, both these questions have been on the table of policy makers in India for more than 15 years and the Government has so far only allowed some FDI in 'single-brand' retailing and 'wholesale trading' of retail goods. While the incumbent Congress party led Government has voiced many reasons to organize retail and allow FDI in multi-brand retailing, public opinion in response to a discussion paper released by the Department of Industrial Policy and Promotion (DIPP) – Ministry of Commerce & Industry – has been negative.

In my quest to decipher whether India should organize and allow FDI in multi-brand retail, I have analyzed all the opinions received by the DIPP. I posit that the data is skewed and not sufficient to form the basis of a policy decision. I have also conducted an extensive literature review on the impact of Wal-Mart on small retailers to understand the potential impact it can have on India. Despite the concerns, I conclude that this change can be managed to India's advantage and that opening of the retail sector to FDI is an imperative, not an option.

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CHAPTER 1: Introduction

My thesis evaluates whether India should further liberalize its foreign direct investment (FDI) policy for the retail sector. My primary source of data is the set of suggestions received by the Government of India, in response to a Discussion Paper floated by the Department of Industrial Policy and Promotion (DIPP) asking for public opinion on whether India should open FDI in multi-brand retail. This question is of large significance for developing countries where retail is predominantly unorganized and managed through domestic players. Many developing countries including Mexico, Brazil, Argentina, Thailand and China have already taken steps towards organizing retail by allowing foreign retail to enter. The approach across countries is not consistent and tailored to their specific needs. Success also has not been consistent, either for the large retailers or for countries. It is for this reason that the data presented by the DIPP offers a unique opportunity to analyze and offer a hypothesis for India, who is currently in the midst of taking a decision on whether it will organize retail and if so, will it allow foreign retailers.

Currently, the Government allows foreign participation up to 51% through the approval mechanism for single brand retailing and up to 100% through the automatic approval route for foreign investments in establishing cash-and-carry (wholesale) trading. Foreign equity participation in retailing more than a single brand, i.e. multi-brand retailing, is banned. Therefore, while Tommy Hilfiger can establish its brand of clothing and sell to consumers in India, Wal-Mart cannot open its stores which carry more many brand and products, to sell to consumer directly. Wal-Mart and other multi-brand retailers can only sell to retailers, through the cash-and-carry, business-to-business format. These restrictions do not apply to domestic private companies who may open large format multi-brand stores to sell to consumers directly.

The size of the retail market in India is estimated at nearly US\$ 320 billion growing at a CAGR of 13%, where 96% of the market is unorganized and managed through mom-and-pop stores and small merchants. The private sector in India has not been able to organize and capture value from this market for various reasons, including the lack of infrastructure, i.e. roads, cold chains, small land-holdings and lack of scale from farmers, lack of financing etc. On the other hand companies like ITC Limited, PepsiCo and McDonalds have shown the way for Indian and foreign companies to partner directly with farmers to leverage efficiencies. Given this demonstrated success

and the slowing down of retail growth in the developed countries, India presents a unique and large market for large format, international retail stores like Wal-Mart, who are experts at managing complex supply chains and know how to most effectively invest in and manage the end-to-end process for maximum benefit.

The existence of such a large, growing, un-organized and under-developed retail market in India presents a unique wealth and value creation opportunity for private players, both domestic and international, the Government and the people of India. Debate on whether to liberalize this sector has continued since 1991 and remains unresolved. The two divergent views and issues in this discussion are:

- 1) **FOR:** India's economic growth is highly skewed towards growth from its technology and services sector, leaving behind a sluggish manufacturing industry and an over-crowded agriculture sector. Many believe that India's growth post liberalization has been achieved by addressing its self-imposed licensing regime which previously restricted both foreign and domestic industry. For growth to continue, proponents of further liberalization believe that India now needs to take a more detailed look at its various sectors, especially agriculture, and introduce the reforms necessary for growth and development to be more broad-based and sustainable. A majority of India's population is still employed in an over-crowded agriculture sector and the Ministry of Finance, acknowledges in their latest Economic Survey (2011), that the technological benefits gained from the first green revolution are waning. India's performance in global trade is still a small fraction despite having resources including the 2nd largest arable land point, and being the largest producer of wheat, rice, pulses and milk. Despite these resources, a significant quantity of agricultural produce is wasted either due to logistical inefficiencies or the lack of processing the agricultural produce.

- 2) **AGAINST:** Large format international retailers are known to capture the power in the market and drive out small mom-and-pop stores. This phenomenon has been observed in the United States with Wal-Mart and in other countries. The evidence for this phenomenon is well documented and perhaps beyond any doubt. Opposition in India against large format international stores lies predominantly in this argument. For the fear psychosis that this creates in the public, no political party is willing to "bell the cat" and risk the angst of the voting public. Whether the voting public will indeed be against this action is untested; but in today's age of coalition politics, this is not something a political party in power is willing to test at risk of losing confidence from its voters.

India is clearly at the juxtaposition of whether it should open its economy for further growth or whether it maintains its veil of autarky and keeps the foreigner's out. Interestingly, India is not alone in this asking this question. Many other developing countries are going through their own process of organizing retail and though there have been some initial hiccups, countries including Chile, Brazil, Thailand, Mexico have all adopted organized retail. To understand this issue from an Indian context, I have organized my thesis around the following three questions:

- 1) Should retail be organized in the first place? Why?
- 2) If it should be organized, should it allow foreign players like Wal-Mart? What is the risk?
- 3) What is the view of the people of India? What should India do?

Should Retail be organized in the first place? In a paper titled, "Retail – More Bad than Good" (Guruswamy, 2005) – the authors argue that India's pattern of high-skilled services led growth, combined with a sluggish manufacturing industry and an over-crowded agriculture sector has led to low employment opportunities for the masses. This has resulted in the creation of small mom-and-pop stores, not as a matter of choice but that of forced employment by way of unorganized, unlicensed small shops and road-side hawkers of fruits, vegetables and other small household items. Another paper on the Impact of Organized Retailing on the Unorganized Sector published by the Indian Council for Research on International Economic Relations (ICRIER) demonstrates that only 7% of mom-and-pop shop owners want their children to follow suit. Various publications, including the GOI discussion paper, argue that the existing form of agriculture procurement from farmers is monopsonistic in nature and highly exploitative of farmers at the upstream; and at the downstream, the traders wield a monopolistic power over small retailers including mom-and-pop stores whose only option is to purchase through the wholesale traders in cities and urban areas. Across the supply chain, there is no transparency of prices or control over the process. Power is obviously in the hands of these middle-men and traders and as long as the status quo is maintained, farmers and consumers will continue to be exploited. Organizing retail, combined with reforms in agriculture procurement, development of cold-chains and other infrastructure will benefit the producers and consumers overall. It will help develop the related and supporting small and medium scale industries in food processing, crafts, packaging, research and other manufacturing, creating many jobs which can absorb people displaced from unorganized retailing. Such development has the potential to provide more sustained productivity enhancements to the economy and provide the foundation for broad based economic development. To me, it remains ironical that a country trying to reduce poverty and improve the livelihoods of its people,

is also arguing to protect such forced employment, i.e. mom-and-pop stores. Irrespective of whether we allow foreign players in this market, any argument to not organize the retail sector sounds like an excuse to maintain the political power of middle-men and thereby allow the poor to remain poor. *In Chapter 2, I review these issues in more detail, i.e. the skewed economic development in India and the issues of human capital formation. I also highlight the retail industry landscape in India and outline the debate surrounding the issues of whether or not to organize retail in India. These arguments indicate there are benefits to organizing retail in India, irrespective of whether India allows foreign participation in this industry.*

Should foreign players be allowed in organized retail in India? On the question of whether to allow foreign players, we need to review three perspectives, *(i) Can we do this ourselves? (ii) What can we learn from the experience of other countries; and (iii) What can we learn from our history of managing foreign direct investment in the country?* *First*, if the domestic industry had been more proactive and the government had invested in infrastructure development, i.e. roads, financing, cold-chains etc and market based reforms in agriculture we, perhaps, would not have been asking this question. Unfortunately, infrastructure development has lagged and the domestic private sector has been found wanting in their willingness and ability to invest and organize this market. In the absence of local vigor in the industry, it becomes imperative to introduce foreign investment to introduce competition and development in the market. *Second*, in terms of learning from other countries, it is clear that large format retailers will cause market displacement, i.e. the mom-and-shop stores will be impacted. This effect is clearly documented in economic literature and Wal-Mart has for years been the chief corporate villain who has led this approach. It has been severely criticized in US domestic and international press as the harbinger of woes to local communities by keeping prices low and causing local retailers to close down, while suppressing profits of its suppliers by demanding lower and lower prices, thus squeezing out margins. Despite this criticism, it cannot be ignored that Wal-Mart has brought many benefits. Its innovations in supply chain are emulated by large format retailers around the world and its impact on keeping inflation low is either not understood or underestimated. Charles Fishman in his book “The Wal-Mart Effect” quotes a study by MIT Professor Jerry Hausman which finds that the Consumer Price Index calculated by the Bureau of Labor Statistics in the U.S., is too high by about 0.32 to 0.42 percentage points, which leads to an upward bias in estimated inflation by 15% (Hausman, 2004). The sheer size, sale and capacity of Wal-Mart to dictate prices through the supply chain give it an unmatched power in the market. In India, the introduction of such large format foreign retailers will also displace the middle-men, i.e. traders, who will find them-selves being crowded out

of their monopsony. The fact that 66% of domestic responses to the DIPP survey are from traders and that the majority of them strongly oppose opening to foreign retailers, is a clear indication that the trading community clearly understands this risk. As previously, the displacement of mom-and-pop stores is also certain, although the impact may be moderated by requiring Wal-Mart to comply with zoning restrictions, minimum retailing format and store sizes and provide a wholesale window for the mom-and-pop stores. FDI in this area can also develop the supporting small and medium enterprises for food processing, manufacturing and exports. This balance in liberalizing FDI and ensuring development of domestic business is absolutely essential and the Government of India, through its various institutions will need to proactively manage the deployment of such FDI in the country. The good news is that India has tremendous experience in managing foreign direct investment in a manner that does not compromise national interest. There is ample evidence through large success stories like Maruti Suzuki, Unilever and ITC/BAT (British American Tobacco). If the Government can bring together the will to take a decision, the government can also tap into the knowledge of its people and systems which have successfully managed such large transitions. India is clearly not without experience, yet it clearly is lacking in the will to take a decision. *In Chapter 3, I discuss the Wal-Mart effect and what it means for India. I also demonstrate through various examples a proven mechanism for managing foreign direct investment, adopted by India, in a manner that protects the national interest and which is also in concert with the private sector motives of revenue growth and profitability. I argue that this is not a zero-sum game, and that economic development and private sector growth through managed FDI, can indeed be a reality.*

What is the view of the people? To understand what the people of India and other commentators from outside India are saying, I have analyzed all the opinions that the Government of India has received in response to the Discussion Paper floated by the Department of Industrial Policy and Promotion (DIPP). In summary, the representation of various people is highly skewed to responses from traders from the State of Tamil Nadu, constituting 42 per cent of the total responses across India. Within this number, 85 percent have the same one page letter, on different letterheads, expressing shock at the Government's intention of opening FDI in multi-brand retail and extolling the negative impact on small retailers. Including traders from other States in India, the total representation of traders to all other people is 52 per cent of the responses received. I conclude that the responses received are not representative enough to make a policy decision which will impact the whole country. They do however offer a strong data point which demonstrates the worries and influence of this community. Any decision that the Government takes, will have to provide for a solution which will appease this community while also ensuring broad based reform which takes into account the various structural, political and cultural issues. *Chapter 4 presents and analyzes these*

pressures on the Government through various constituents. I follow this with an analysis of the structural, political and cultural issues using a three-lens model and provide a hypothesis on what India should do in Chapter 5. I argue that organizing its markets to enhance productivity and meet the growing needs of an increasing middle class, is an imperative and not an option anymore for India.

Finally, post building my hypothesis in Chapter 5, I respond to the questions posed by the DIPP on whether India should open FDI in multi-brand retail and if so, how it should go about doing so. I posit that despite the worries of market displacement of small retailers and traders, the Government and Industry has adequate time and experience to manage this change in an effective manner. I also discuss the potential international trade negotiation benefits that India could leverage on a bilateral basis with the United States and thereby strengthen its position in global trade, resulting in sustained productivity improvements and growth for India. Therefore, I recommend that India should definitely open FDI in multi-brand retail.

In summary, I offer that these decisions are difficult but an absolute necessity. India's strength is its population of young workers and it must provide the growth opportunities that its youth aspire to. India is not without experience, yet it must muster the political will to implement necessary economic reforms. Any political party will only ignore these decisions at their peril.

CHAPTER 2: Should Retail Be Organized In India

2.1. Understanding India's Growth Story

In this section, I review India's growth story and attempt to add, at the risk of being pessimistic, a hint of realism to the issues facing India. I posit that the most important factor in understanding the debate on FDI in multi-brand retail is to understand India's growth story and its many challenges in managing this growth to keep the dialogue in perspective.

2.1.1. Economic development

On the eve of the Industrial revolution (1770), India was the second largest economy in the world, contributing more than 20% of the total world output. By the 1970's, that share was 3%. Post-Independence, India's annual growth rate stagnated at 3.5% from 1950 to 1980's and growth in per capita income was only 1.3% (Yi, 2007). This abysmal growth led to the coining of the controversial term, the Hindu Growth Rate, coined by the famous Indian economist Raj Krishna (Tripathi, 2006)

As Arvind Subramanian from the Peterson Institute for International Economics and Center for Global Development, Washington D.C., puts it, "luckily for India, the Hindu growth rate was not eternal (Subramanian, 2008)." Arvind also argues that departure from this unremarkable growth happened in the 1980's and not in 1991 as is the conventional wisdom associated with opening of the Indian economy after the 1991 balance of payments (BOP) crisis¹. In terms of the approach to economic growth, India followed an unconventional model, either by chance or by design and is characterized by:

- **1960 & 1970's:** Inefficient import substitution system which erected barriers for foreign competition but also throttled domestic business by imposing taxes, industrial licenses and reservations for public and small scale sectors

¹ More about the balance of payments crisis may be read by accessing the following IMF report on imf.org: "What caused the 1991 Currency Crisis in India; IMF staff paper 49, Vol 3"

- **1980's:** The government took a pro-business approach, i.e. they eased the distortion by rectifying the licensing regime and allowing incumbents and existing business to benefit. Since 1980, India's economic growth rate has more than doubled, rising from 1.7 per cent (in per capita terms) in 1950-80 to 3.8 per cent in 1980-2000. Arvind calls this period, the true era of import substitution for India.
- **Post 1991:** Following the Balance of Payments (BOP) crisis, India opened its economy and adopted a pro-market stance by allowing foreign entrants and opening up competition.

A result of these developments has been that the Indian economy has grown at an impressive 6.6 per cent over the last two decades, spanning 1988/89 – 2008/09. In the six years before the global financial crisis of 2008, the economy was growing at 8.5 percent. While the financial crisis put back the GDP growth by 2-3 per cent, the latest Economic Survey issued by the Government of India, indicates that the Indian economy has recovered rapidly (Government of India, 2011). Growth in 2009-10 is estimated to have rebounded to 8.0 per cent as per the Quick estimates released on 31 January 2011 and 8.6 per cent as per the Advance estimate released by the Central Statistical Institute (CSO) on 7 February 2011.

These developments notwithstanding, there is a now, a new debate regarding the sustainability of this growth rate. The major issues facing the economy relate to the uneven distribution of this growth and what is now being called, a governance deficit which highlights the issues of managing a large economy in the face of a growing middle class, changing aspirations, a stronger oligarchy of domestic business and a corrupt polity and business environment.

2.1.2. Disparities by Sector and Region

At a macro level, there are two key issues that must be understood. First, while the economy is growing at 8 percent or more for the last decade, the majority of this growth is led by tremendous contributions from the services sector, led by IT and IT enabled services. Second, the growth is highly disparate within the country and is concentrated in richer states, leaving the poorer states far behind.

DISPARITY IN GROWTH BY SECTOR - SERVICE LED GROWTH

India's economic growth has been predominantly driven by the expansion in services, over other parts of the economy. It is argued that India may skip the intermediate steps of manufacturing led growth in the economic productivity ladder and transform its economy in a sustainable manner through the service led growth. Table 1, adopted from article in Business Standard 2010 (Singh, 2010) below shows the trend in growth by sector.

Table 1: Sectoral Percentage Shares of GDP

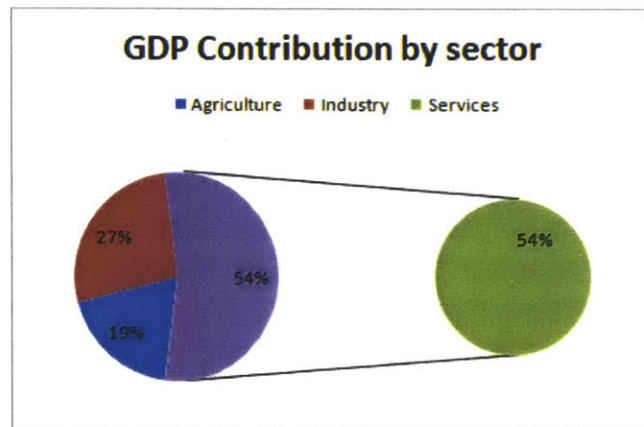
Year	Agriculture and allied activities	Industry	Services
1950-51	55.28	10.65	34.07
1955-56	53.36	11.8	34.84
1960-61	50.81	13.18	36.01
1965-66	43.16	16.01	40.83
1970-71	44.31	15.46	40.23
1975-76	42.37	16.05	41.57
1980-81	37.92	17.45	44.63
1985-86	34.96	18.53	46.52
1990-91	31.37	19.8	48.83
1995-96	27.34	21.24	51.43
2000-01	23.89	19.99	56.12
2005-06	19.54	19.36	61.1
2006-07	18.51	19.53	61.96
2007-08	17.8	19.24	62.96
2008-09	16.95	18.5	64.55

Source: Nirvirkar Singh, Understanding India's Service Led Growth

Nearly 65 per cent of the GDP now comes from Services. Interestingly between 1980-81 and 2008-09, the combined contribution of agriculture and services to the GDP has remained nearly constant, i.e. 81 percent in 1980-81 and 82 per cent in 2008-09. Industry has remained nearly flat, i.e. growing to 18.5 per cent from 17.5 per cent previously. Agriculture's contribution to GDP has fallen from 38 per cent in 1980 to 24 per cent in 2000, a drop of 20%, while the employment in agriculture dropped from 68 per cent to 59 per cent, a drop of 9

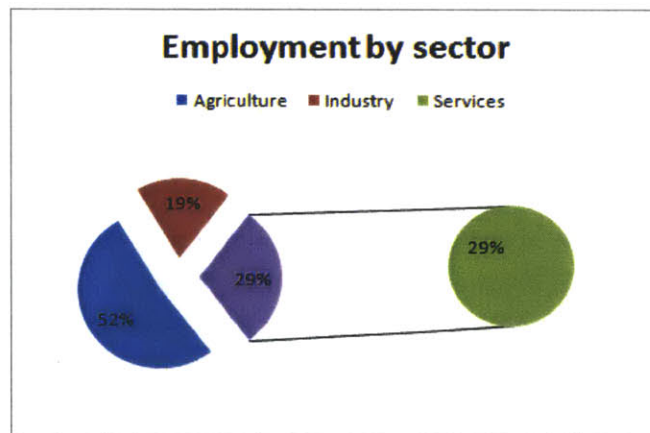
per cent, which implies more uneven growth in the rural areas. At the same time, the 20 per cent drop in agricultures contribution has been taken up by Services, which grew from 45 per cent in 1980 to 56 per cent 2000, whereas employment grew from 18 percent in services in 1980 to 22 per cent in 2000. It is obvious that the high skilled jobs in Services create higher margins and contribution to the GDP but with lesser employment. It is also clear that many of the rural youth today do not have the skills needed to enter the highly skilled job market that the Services sector provides. Figures 1 and 2 below provide a visual description of the enormity of the situation.

Figure 1: Service Sector GDP contribution



Data source: ICRIER - Impact of Organized retailing on unorganized sector, 2008

Figure 2: Employment in Service Sector



Data source: ICRIER - Impact of Organized retailing on unorganized sector, 2008

DISPARITY IN GROWTH BY REGION - FORWARD AND BACKWARD STATES

Despite India's strong growth performance, the other growing concern is that the benefits of growth have been concentrated in India's richer states, leaving the poorer states lagging further and further behind (Purfield, 2006). These concerns become more serious when one considers the projections suggesting that 60 per cent of the 620 million increase in India's population, by 2051, will occur in three of its poorest States: Bihar, Madhya Pradesh and Uttar Pradesh (Visaria, 2003).

In a paper titled *Regional Disparities in India*, NJ Kurian argues that the seriousness of emerging regional imbalances have not yet received the public attention it deserves. Fifteen² major states account for 95.5 per cent of the population, while the rest of India account for the remaining 4.5 per cent of the population. Kurian breaks these fifteen states into two groups, Forward group and Backward group. Geographically, these forward States, namely Andhra Pradesh, Gujarat, Haryana, Karnataka, Kerala, Maharashtra, Punjab and Tamil Nadu fall in the western and southern parts of the country. The backward group comprises of Assam, Bihar, Madhya Pradesh, Orissa, Rajasthan, Uttar Pradesh and West Bengal, and these States fall in the northern and eastern part of the country and they are geographically contiguous (Kurian, 2005).

In addition to demographics, the differences between the forward and backward groups extend to literacy, income, investment and central assistance. Against India's literacy rate of 65.4 percent, as per the 2001 Census in India, Kurian highlights that all States in the forward group, except Andhra Pradesh³, have literacy rates above the national average and vary from 90.9 per cent in Kerala to 67.0 per cent in Karnataka. In the backward group, all except West Bengal have literacy rates below national average. They vary from 64.3 per cent in Assam to as low as 47.5 in Bihar. The level of literacy in West Bengal is 69.2 per cent. And while poverty has declined, as shown in Table 2, the share of incomes varies greatly between the forward and backward group States as shown in Table 3. Poverty in the backward group now contributes to 70 per

² With the recent reorganization of the States, there are a total of 28 States, besides 7 Union Territories in the Indian Union now. In the absence of the relevant data, for the purpose of the present study, we consider the undivided States of Bihar, Madhya Pradesh and Uttar Pradesh.

³ Literacy level of Andhra Pradesh as per the 2001 Census was 61.1 per cent

cent of the poor in India as shown in Table 4. It is also interesting to note that post the economic reforms in 1991, all the forward group States have improved their income, except for Haryana and Punjab; while the entire backward group States, except Rajasthan, have further deteriorated.

Table 2: Decline of poverty in India

Year	1977-78	1983	1987-88	1993-94	1999-2000
Percentage of poor	51.3	44.5	38.9	36.0	26.10

Source: N.J. Kurian: Regional Disparities in India (Kurian, 2005)

Table 3: Per capita Gross State Domestic Product as a percentage of GDP

States	1981-82	1985-86	1990-91	1997-98
Forward group				
Andhra Pradesh	87.4	82.4	92.5	92.9
Gujarat	125.3	124.4	118.8	137.4
Haryana	146.5	139.9	146.6	139.4
Karnataka	92.8	93.7	95.4	107.2
Kerala	90.5	90.9	87.8	116.4
Maharashtra	143.0	134.7	144.7	167.5
Punjab	168.6	165.0	169.7	146.5
Tamil Nadu	92.8	97.0	100.0	119.5
Backward group				
Assam	83.6	92.1	83.1	62.2
Bihar	58.8	60.6	53.5	44.2
Madhya Pradesh	80.8	74.8	78.1	73.5
Orissa	75.0	74.7	66.9	61.8
Rajasthan	76.6	74.0	79.3	81.1
Uttar Pradesh	75.8	71.9	70.6	64.4
West Bengal	103.3	102.9	91.7	85.1
All India	100	100	100	100

Source: Soumitra Chaudhuri : Table 2 in Economic Growth in the States – Four Decades – 1; Money and Finance, Vol.2, Number 4, Oct-Dec., 2000; (Kurian, 2005)

Table 4: Percentage share of poor within the forward & backward groups

States	1983-84	1987-88	1993-94	1999-2000
Forward Group				
Andhra Pradesh	5.10	5.22	4.81	4.57
Gujarat	3.65	3.98	3.28	2.61
Haryana	0.92	0.83	1.37	0.67
Karnataka	4.64	5.17	4.88	4.01
Kerala	3.31	2.88	2.39	1.58
Maharashtra	9.01	9.65	9.53	8.76
Punjab	0.89	0.82	0.78	0.56
Tamil Nadu	8.05	7.53	6.31	5.01
Total for forward States	35.57	36.08	33.35	27.77
Backward Group				
Assam	2.41	2.47	3.01	3.63
Bihar	14.31	13.71	15.40	16.36
Madhya Pradesh	8.61	8.61	9.32	11.47
Orissa	5.62	5.40	5.01	6.50
Rajasthan	3.93	4.65	4.01	3.14
Uttar Pradesh	17.24	17.47	18.87	20.36
West Bengal	9.87	9.24	7.95	8.20
Total for Backward States	61.99	61.55	63.57	69.66
All India	100.00	100.00	100.00	100.00

Source: Planning Commission Data (Kurian, 2005)

2.1.3. India's oligarch's

As India's businesses grow, power is concentrating in the hands of a few. James Lamont and James Fontanella-Khan, in an article in the *Financial Times* highlight that the ability of big business to influence policy now is greater than it was prior to the 1991 reforms (Fontanella-Khan, 2011). An Asian Development Bank report cited in the same article suggests that the 50 billionaires in the country account for 20 per cent of India's GDP and 80 per cent of stock market capitalization. In the article, they compare India to Russia and draw a comparison to Joseph Stiglitz's *Globalization and its Discontents* which focuses on how Russia mismanaged its transition from communism to free markets.

In reviewing India's history of economic liberalization from Arvind Subramanian's lens', it is easy to understand where this concentration of power comes from. Circa the 1980s when the Indian government started lifting the self-imposed restrictions on industry, only a few domestic players were able and ready to capitalize on the opportunity. The major family held businesses, including the Tata's, Birla's, Bajaj families along with Reliance, Mahindra's, Godrej and newcomers including Anil Agarwal of Vedanta, Sunil Mittal of Bharti Airtel and Munjal's of Hero Honda, have continued to strengthen their businesses. The poster child among this has been the entrepreneurial growth story of the IT and IT Enabled sector, along with strong growth in telecommunications.

It is the same large family businesses who are now opening large retail stores in India, with the exception of a new runaway success with the Future Group, who own the Pantaloon brand and began as a solo men's-wear, single store. Pantaloon has pioneered the hypermarket format in India and attracted other large players, including Tata, Reliance, and Goenka's. Not all are successful. Bharti Airtel has tied up with Wal-Mart, and other large domestic players are either beginning to partner with international retailers or wait, while simultaneously lobbying with the Government of India to open the retail sector to foreign direct investments. The lack of infrastructure, i.e. roads, ports and absence of effective cold-storage and warehousing across the country make retailing, especially in the food sector, very capital intensive and while the efficacy of the Government's current procurement and distribution system can be debated, it is not something that the large domestic businesses have felt inclined to invest in, without express support from the government. In support of this argument, one needs to only look at the fact that though FDI in cold chain

is permitted up to 100 per cent, the FDI inflow have been negligent and the domestic players have not stepped up either (DIPP, 2010).

2.1.4. Employment, Middle Class and changing Politics

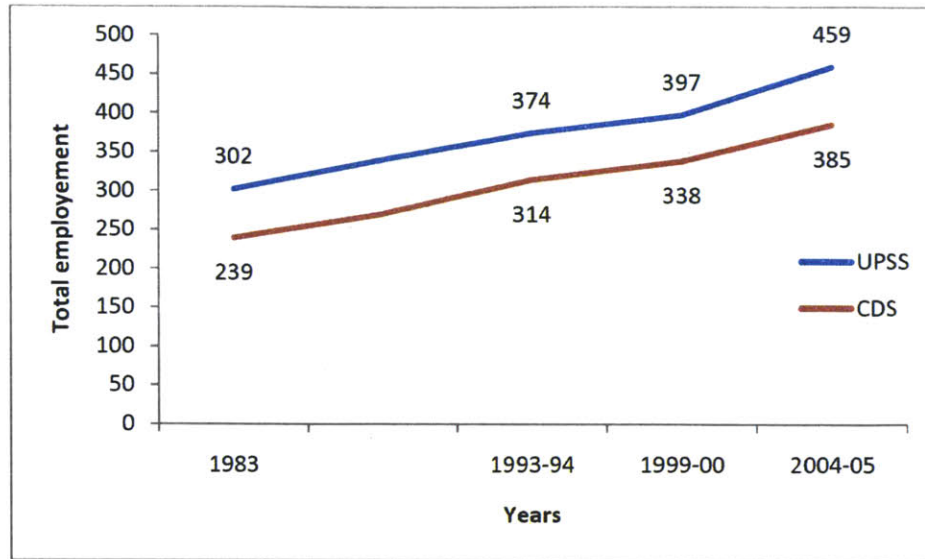
EMPLOYMENT

In 2006, a year of 9.6% GDP growth – India produced 1 million fewer jobs than in 1993, when the economy was just starting to grow (Khilnani, *The paradox of India's new prosperity*, 2010). In the Government of India's first annual report on employment, titled 'Report to the People' released in July 2010, the employment statistics show that employment growth in the period 1993-94 to 2004-05 grew at 1.87% per annum against 2.06% in the preceding period of 1983 to 1993-94. Employment estimates using of two different approaches⁴ to calculating employment are shown in Figure 3 from the period 1983 through 2004-05 (*Employment*, 2010). Another report, on Skills Formation and Employment Assurance in the Unorganized Sector, by the Government of India, prepared by the National Commission for Enterprises in the Unorganised Sector (NCEUS) states that informal or unorganized workers constituted an overwhelming 86 per cent of total workers in 2004-05 and that between 1999-2000 and 2004-05, what increased in India was the informal employment, both in the organized as well as the unorganized sectors. The report also highlights that three-fifth of this workforce is self employed (NCEUS, 2009). The Commission highlights that with rapid growth in the economy, India is seeing broad based shortage of skilled manpower to meet the workforce needs and refers to an estimate by an October 2004, CII-McKinsey⁵ report stating that India needs 20 million increase in skilled manpower by 2015, requiring an incremental skilling of 1.5 million people (from 2005) every year. The lack of skills and education result in denial of access to regular employment resulting in a situation where only 4 percent of the illiterate workforce has access to regular employment. Forty per cent of the remaining illiterate workforce is employed as casual labor and the remaining are self-employed.

⁴ The Indian labor market is characterized by complex situations which arise due to full-time and part-time workers, variations in availability of work during different seasons of a year, workers engaging in multiple jobs, workers ready to work at low wages and other social and cultural factors (*Employment*, 2010)

⁵ 'Made in India: the next big manufacturing export story', a joint report by Confederation of Indian Industries and McKinsey (CII-McKinsey) in October 2004

Figure 3: Employment (in millions) by UPSS⁶ and CDS method⁷



Source: Ministry of Labor, 2008 and Planning Commission 2008 (Employment, 2010)

The lack of regular employment is also linked with the backwardness of States. In general, poorer states such as Bihar, Chhattisgarh, Jharkhand, Orissa and Uttar Pradesh have a high proportion of workers engaged in casual work and very low proportion of regular employment. In contrast, developed states like Maharashtra, Tamil Nadu, Punjab and Delhi have a high proportion of regular employment (Table 5). This report (Employment, 2010) further supports the issue of the growing disparities of growth in India, as highlighted in Section 2.1.2 earlier in this paper.

⁶ UPSS – Usual Principal and Subsidiary Status relates to the activity status of a person during the reference period of last 365 days preceding the date of survey. The activity status on which a person spent relatively longer time (major time criterion) is considered the Usual Principal Status

⁷ CDS – Current Daily Status of a person is determined on the basis of his/her activity status on each day of the reference week using a priority-cum-major time criterion (day to day labor time disposition). Broadly, a person is considered working (employed) for the full day if he/she worked for 4 hours or more during the day

Table 5: Classification of States according to % of Regular Employment

Percentage of Regular Employment to Total Employment			
Very low, less than 10%	Low, 10 to 15%	Medium, 15% to 20%	High, 20% and above
Bihar, Chhattisgarh, Jharkhand, Orissa, Uttar Pradesh	Rajasthan, Madhya Pradesh, Assam, Andhra Pradesh, Karnataka, Uttaranchal, Himachal Pradesh, West Bengal	Jammu and Kashmir, Gujarat, Kerala, Haryana	Maharashtra, Tamil Nadu, Punjab, Delhi

Source: NSSO Survey, 2004-05

MIDDLE CLASS AND CHANGING POLITICS

With forecasts for India's real GDP growth over the next two decades ranging between 6 and 9 per cent, McKinsey Global Institute predicts that India's incomes levels will triple, if this growth is sustained for a period of 20 years (McKinsey, The 'Bird of Gold': The Rise of India's Consumer Market, 2007). In their report titled, "The Bird of Gold: The Rise of India's Consumer Market", McKinsey projects that by 2025, rising incomes will lift 291 million out of poverty and create a 583 million, strong middle class.

The impact of the emergence of a strong middle class and its impact on the politics in India can be best understood by first examining the dependence of the poor and backward states on its political leaders. Raghuram Rajan⁸, in his speech to the Bombay Chamber of Commerce, on September 10th, 2008, argued that the people on backward states 'tolerate' the corrupt politician simply because he is the crutch that helps the poor navigate a bureaucratic system that gives them little or no access (Rajan, 2008). As the India's middle-class grows, there is hope that the politics will change as people will demand more transparency and will have lesser tolerance or need for a local politician to help them navigate and therefore extract rents from the common man.

While a solution in the rise of the middle class to India's many problems in managing its growth, politics and corruption may seem simplistic, the current waves of outburst and action against a Minister of State and the summoning of

⁸ Raghuram Rajan is Professor of Finance, Booth School of Business, University of Chicago

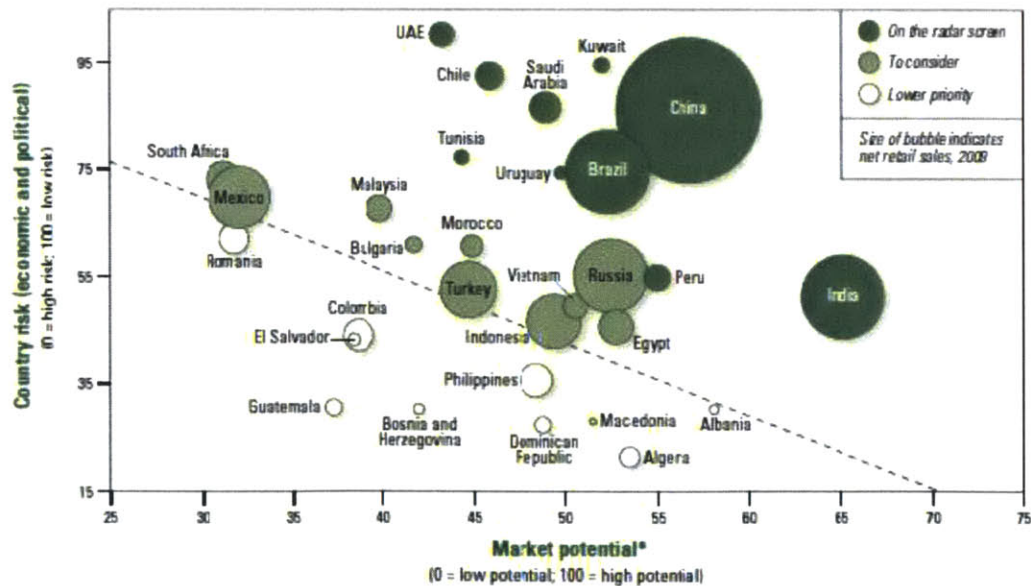
India's billionaires, in the recent telecom scandal, itself mark a sea of change in India's society and politics (Reuters, 2011).

2.2. The Retail Debate

MARKET SIZE AND STRUCTURE

AT Kearney's Global Retail Development Index (GRDI) 2010, in a survey of 60 global retail executives, representing all sectors, sizes and geographies, shows that Brazil, Russia, India and China remain the top priority for retail expansion. Nearly 80 per cent of the executives named one of these countries as part of their firm's plans for short-term international growth (ATKearney, 2010). India has been on leading the GRDI index from 2005 to 2007 and then again in 2009. In 2010, India slipped to number 3 on the GRDI list. Despite this dip, India remains a very attractive market for retail (Figure 4) in AT Kearney's analysis.

Figure 4: AT Kearney 2010 GRDI Country Attractiveness



Source: AT Kearney 2010 GRDI Report

As per the projections of the Indian Council for Research in International Economic Relations (ICRIER), the retail business is expected to grow at 13 per cent annually from US\$ 322 billion in 2006-07 to US\$ 590 billion in 2011-12 (ICRIER, Multibrand Retail, 2008). The AT Kearney GRDI report of 2010 estimates the market at US\$ 410 billion and on track to grow rapidly to US\$ 535 billion by 2013. While these numbers are a bit lower than ICRIER's projections made in 2008 before the global financial crisis, it seems that India has recovered fast and well from the shock to end up close to the earlier projections. This in itself is impressive. The retail market is divided into the unorganized and organized sectors, where the organized sector contributed only 4 per cent in 2006-07 and was expected to grow at a CAGR of 45-50 per cent to reach 16 per cent by 2011 - 12 (Figure 5). As of the AT Kearney 2010 GRDI report, organized retail was still at 5 per cent and had not achieved the growth rates anticipated.

Figure 5: Projected growth of Organized Retail



Source: (ICRIER, Multibrand Retail, 2008)

Compared internationally, the Indian retail market remains the least developed among the emerging Asian and economies and its BRIC counterparts (Table 6). Retail trade in India continues to be labor intensive and employs more than 18 million people which translates to nearly 8 per cent of the workforce of 459 million people (refer Figure 3), across 10.69 million enterprise of which 49 per cent were in the rural areas.

Table 6: Share of organized and unorganized sectors (BRIC and Asian countries)

Countries	Organized (%)	Unorganized (%)
India	4	96
China	20	80
South Korea	15	85
Indonesia	30	75
Philippines	35	65
Thailand	40	60
Malaysia	55	50
Brazil	36	64
Russia	33	67

Source: Planet Retail and Technopak Advisers Pvt Ltd (ICRIER, Multibrand Retail, 2008)

REGULATION AND THE DEBATE ON FDI IN MULTI-BRAND RETAIL

The current policy⁹ of the Government of India places the following restrictions on foreign equity participation in the retail sector¹⁰:

- FDI in multi-brand retailing is prohibited
- FDI in single-brand retailing was permitted in 2006, to the extent of 51%, by approval route. As of May 2010, the Government had received 94 proposals of which 57 have been approved¹¹, attracting an inflow of US\$ 194.69 million between April, 2006 and March, 2010. Under this policy, products to be sold must be of a single brand and must be sold under the same brand internationally. Approvals must be sought from the Foreign Investment Promotion Board (FIPB) and Department of Industrial Policy & Promotion (DIPP). Additions to product categories to be sold under 'single brand' require fresh government approval.
- FDI in cash and carry wholesale trading was allowed in 1997, to the extent of 100% under the approval route. In 2006, it was brought under the automatic route. Between April, 2000 and March, 2010, FDI inflows of US\$ 1.779 billion

⁹ Source: DIPP released discussion paper on FDI in multi-brand retail (DIPP, 2010)

¹⁰ FDI is governed by the Foreign Direct Investment Policy of the Government of India and the Foreign Exchange Management Act, 1999. Foreign investment is permitted in virtually all activities without government approval, except for a few strategic sectors. FDI policy is framed by the Department of Industrial Policy & Promotion (DIPP), the Ministry of Commerce & Industry and the Government of India.

¹¹ Proposals received and approved relate to retail trading of sportswear, luxury goods, apparel, fashion clothing, jewelry, hand-bags, life-style products etc.

were received in this sector, amounting to 1.54 per cent of total FDI inflows during the same period.

- In addition, the Government allows 100% foreign investment in the cold-chain infrastructure but this sector has not seen significant FDI inflows.

Post the financial crisis of 2008, this debate has caught the attention of global media and politics. The debate on this issue however, goes back to the 1991 period when the government started opening the economy in an effort to salvage the balance of payments crisis of 1991 (refer section 2.1 – Economic Development). In 1993, the government opened foreign participation in retail, but no foreign players were approved. Three years later, the restriction was reemployed. The heart of the opposition has been the economic reforms and improvements in the retail supply chain versus small shopkeepers and unions who fear being crushed by the international retailers (Fels, 2007). Proponents of improved productivity and efficiency of the retail sector through FDI (ICRIER, Conference page, 2005) argue:

- Better realizations for producers through integration of supply chain and sourcing capabilities with retailers
- Improved products, price, quality and service for consumers
- Link local suppliers, farmers, manufacturers to global markets
- Improved tax income for the Government which can be ploughed back

Opponents to FDI argue that the displacement of jobs due to organized retail will be disastrous, as the economy despite growing at an average of 6.6 per cent has not added enough jobs in the past decade, calling it the period of ‘jobless growth’ (refer section 2.4 on employment). Their arguments highlight:

- The high degree of unorganized retail is a derivative of the lack of adequate employment in the rural and urban sector. This is also a direct offshoot of the lack of vocational training and skills in the youth of India, which can be readily employed (refer section 2.4 on employment)
- In addition, the manufacturing sector has not picked up growth and yet does not offer opportunities for employing lesser skilled people. As a result, the agriculture sector is overcrowded, and the high-end services, technology and manufacturing sectors face a shortage of skills
- The difference between the growth of modern retail in developed and developing nations is marked by the ‘extreme speed of transformation’ (ICRIER, Multibrand Retail, 2008).

- Opponents fear that the rate of displacement of people from retail will far outweigh the pace at which jobs can be provided to these people (Guruswamy, 2005).

In summary, a question that many of the opponents are asking echoes a comment by Guruswamy, Sharma, Mohanty and Korah in their report “FDI in India’s Retail Sector – More Bad than Good” where they ask why FDI is needed when India has a vibrant domestic sector. They base their views on the fact the Food retail is a very large sector of the retail market, accounting for 63 per cent of retail sales. This sector alone has the opportunity to generate employment and cascading enhancements and economic activity in the rural sector. Unfortunately while this argument plays very well to the autarky sentiment in the Indian public, the domestic sector has not invested in improving the infrastructure or supply chain in India. Many domestic retail chains like Subhiksha and Magnet have actually folded up or exited the market during the economic downturn while others have focused on optimizing their operations (ATKearney, 2010).

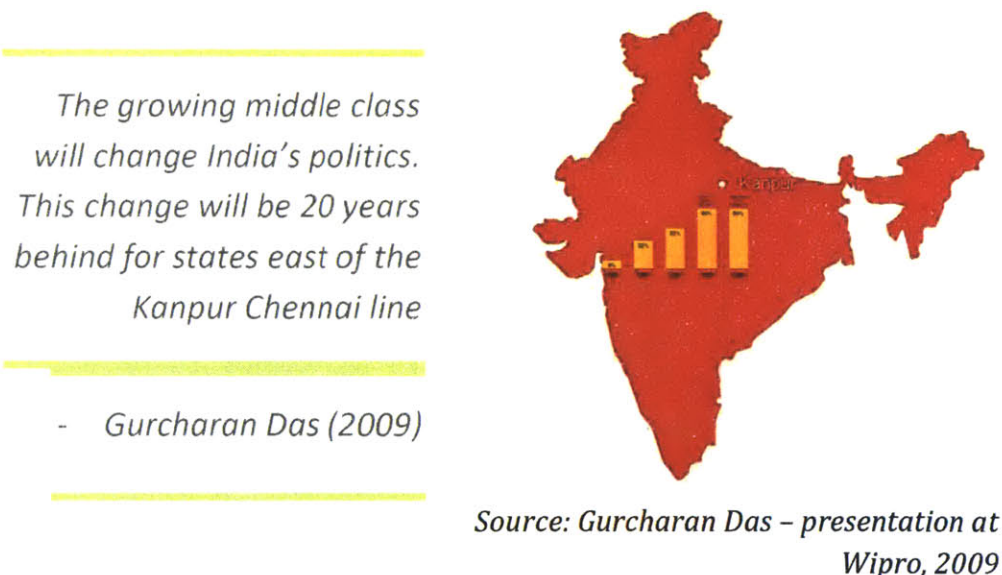
2.3. Section review

This section highlights the following key messages:

- India’s pattern of development is unconventional. It has chosen democracy before growth, unlike the experience in East Asia, and its growth is being driven by skilled labor, in services, high technology and manufacturing which bypasses the traditional method of development from agrarian to textiles and other low-skilled manufacturing to more complex manufacturing and then services and high technology, pharmaceuticals and aerospace etc.
- India is a gradualist. Dr. Montek Singh Ahluwalia, the Deputy Chairman of the Planning Commission, in his speech at MIT acknowledged that implementation of development policies take time in India and that India could be more efficient. He however eluded that by mandating continuous consultation and participation, India creates a firm foundation for inclusive growth and social peace (Ahluwalia, 2009).

- India has many reasons to feel confident about its future. But Raghuram Rajan warns that such confidence should not lead to hubris and complacency. There are real issues that need to be addressed and the resolution starts with getting the Indian domestic corporations and public officials to become more transparent and efficient.
- Gurcharan Das¹² in his address at WIPRO¹³ summarizes the potential of India's growth, changing politics and the development divide in a simple picture (Figure 6). The middle-class is growing, and with it, the consumption patterns, education and the markets of India are changing. While regional disparities in growth exist, the country is unified in its aspiration for equanimity of opportunity and growth.

Figure 6: Changing India



- Organizing the Retail Industry provides a huge opportunity for India, its people and also for the private sector to grow. India can choose to keep it protected and underdeveloped, or organize through domestic and foreign private players.

¹² Gurcharan Das is former CEO of Procter & Gamble India and later MD, P&G Worldwide (Strategic Planning)

¹³ Wipro is an Indian Information Technology company. See www.wipro.com

- Opposition to Organizing Retail seems to center around keeping foreign players out. Opponents do not object to domestic firms setting up organized retail chains. Only a few respondents to the DIPP discussion paper make reference to a Joint Parliamentary Committee report which recommends that multi-brand retail should also be banned for domestic players.

The rationale for opposition has been fear of the negative impact to unorganized small retailers. Ironically the outcome to the mum-and-pop stores would potentially be the same, whether the organizing of the market is done through FDI or domestic players. In summary, it seems that the debate on multi-brand retail is no more about whether retail should be organized or not, but rather about whether foreign players should be allowed access. Or at least, the debate has now moved to this context.

X

CHAPTER 3 – Should Foreign Players Be Allowed in India’s Retail Market

Despite the rhetoric of opposition to opening of FDI in multi-brand retail, it is illuminating to note that the opposition is perhaps not so much about the impact to mom-and-pop stores, but more about ensuring that India does not concede economic control in this process. This fear is clearly seen in the comments received by the Government of India, in response to its attempt to seek public opinion (DIPP, 2010). This section attempts to understand what India should expect from FDI by large format multi-brand retailers. I illustrate this by using Wal-Mart as an example and posit that such large retailers will cause market displacement and India’s fears are not unfounded. On the other hand, I also highlight what such multinational companies fear when they invest in India. India and Indian companies are not without power. I conclude this chapter by illustrating successful examples of multinationals working with the private sector in India and aligning their profit motive to the national interest of the country.

3.1. Understanding Wal-Mart & the Wal-Mart Effect for India

There is a world of literature available on Wal-Mart, its supply chain, sustainability strategies and impact on communities. As much as there is information on Wal-Mart, there is also debate and opposition to Wal-Mart and the negative impacts of Wal-Mart.

Wal-Mart, is the world’s largest retailer with revenues of US\$405 billion for fiscal 2010¹⁴, free cash flows of US\$14billion, operating more than 8,400 stores including 4,304 stores in the United States and another 4,112 across 15 countries. In 2007, it earned more than the economies of 144 countries (Riper, 2007). It operates in a very low margin, high turnover business (Table 8) and is by far the most efficient at managing its inventory and costs. Wal-Mart (for effect) earns revenue of more than US1 billion a day, is Fortune 1 on the Fortune 500, employs more than 2 million associates¹⁵, serve over 200 million customers each week and its revenues compared to the GDP of countries would place Wal-Mart as the 26th largest economy in the world (Council, 2010).

¹⁴ Wal-Mart Annual Report 2010

¹⁵ Wal-Mart employees are called associates

The very scale and size of Wal-Mart is jaw-dropping and depending on how it impacts a person, it can be awe inspiring or very scary. When Wal-Mart enters a country, it invites promise for improving the incomes for many while also instilling a fear of displacement of jobs and an adverse impact to the communities. I am writing this chapter to highlight the nature of Wal-Mart's business, as also being prescriptive of what other large retailers (domestic or international) attempt to emulate, either successfully or not, and to understand what this means for us. I understand that this may be oversimplification and not representative of some retailers. I posit that the exceptions are few.

NATURE OF RETAILING

One of the first things to understand is that retailing is a tough, low margin, high turn business. Success depends on how profitable a company can be in its operations. Table 7 provides a glimpse of the comparative net margins across companies and industries¹⁶. It is evident that even within the low margin business of large retail Wal-Mart is able to extract twice the net profit margin compared to other large retailers. And, it is manages to do this year after year, consistently.

What is the secret of Wal-Mart's success? Edna Bonacich and Jake Wilson in their paper in titled "Global Production and Distribution: Wal-Mart's Global Logistics Empire" highlight that their success is linked to the corporate philosophy of Every Day Low Prices (EDLP). EDLP targets to minimize margins and maximize profits by three categories, internal processes, relational process and external processes. The description of internal and external processes focus on dynamics of abstemious management practices, keeping wages low and a fierce anti-unionism, coupled with the use of Wal-Mart's considerable power to pressure governments for various favorable policies and advantages. An example of Wal-Mart's influence is the construction of a Wal-Mart store, despite protests, in Mexico by leasing property on Perimeter C of the Teotihuacán archaeological site, popularly known as the Temple of the Sun, and which has been granted the prestigious UNESCO recognition as a World Heritage Site (Margath A. Walker, 2006).

¹⁶ US based businesses. Data compiled from ValueLine.com

Table 7: Net margin comparables

Industry	Company	2009	2008	2007	2006	2005
Retail (large)	Wal-Mart	3.5%	3.4%	3.4%	3.5%	3.5%
	Kroeger	1.5%	1.6%	1.7%	1.7%	1.6%
	CostCo	1.6%	1.8%	1.9%	1.8%	1.9%
Retail (mid)	Macy's	2.5%	2.2%	3.7%	4.3%	5.0%
	GAP	7.8%	6.7%	5.5%	4.9%	6.9%
	Starbucks	6.1%	5.1%	7.1%	7.5%	7.8%
Retail (online)	Amazon	3.7%	3.1%	3.2%	1.8%	4.0%
	Ebay	15.3%	20.8%	21.3%	18.9%	23.8%
Consumer Products	P&G	14.3%	14.5%	13.5%	12.7%	12.2%
	Coca Cola	22.4%	22.1%	20.7%	23.1%	22.5%
Pharma	Pfizer	17.2%	16.6%	31.5%	31.0%	29.2%
Bio-tech	Amgen	33.7%	28.0%	25.5%	29.3%	29.8%
Healthcare	United Health	4.4%	4.5%	6.2%	5.8%	7.3%
Manufacturing	Dow Chemicals	1.4%	2.9%	6.8%	8.4%	9.2%
Oil & Gas	Exxon	8.9%	7.0%	10.6%	11.3%	11.7%
Technology	Intel	12.4%	14.1%	18.2%	14.3%	22.3%
Internet	Google	27.6%	24.3%	25.3%	27.7%	24.7%

Source: data compiled from analysts reports on valueline.com; access through MIT student account

While Wal-Mart gets a lot of flack in the world for their internal and external processes, they are seen as clear leaders and innovators in the relational process of managing its end-to-end supply chain. Boncich and Wilson further argue in their article that although Wal-Mart has been one of the leaders of the revolution in logistics¹⁷, the forces that have led this shift in managing end-to-end supply chains are greater than one company alone. Wal-Mart is both, a product of these changes and a creator of them.

¹⁷ Logistics is defined as 'management of the entire supply chain, from purchase of raw materials through sale of the final product, and back again for replenishment of goods as they are sold (Wilson, 2006)

CORE COMPETENCE

Wal-Mart's innovation has two core competencies. The first core competence is that their logistics system stands on a set of "distribution centers", and not warehouses. This is the heart of Wal-Mart's competence. In 1945, after getting out service, Sam Walton¹⁸ moved to Newport, Arkansas and bought a small, underperforming store which was part of the Butler Brothers franchise¹⁹. Through his experience, Sam Walton learnt that Butler Brothers purchased goods from more than 7,500 different manufacturers and as much as 25 per cent remained in stock from one to three years. Walton determined to keep his goods in motion and in 1970's he financed a series of distribution centers which were designed not to store, but to quickly repackage and consolidate them into truckloads which would move immediately to the nearest store. These distribution centers set the pattern of growth for Wal-Mart. Till 1978, all new Wal-Mart stores were built or acquired within a single day's round-trip truck drive from Bentonville²⁰, and the average distance from Bentonville to the stores was 273 miles (Lichtenstein, 2009).

Figure 7 shows the concentration of Wal-Mart stores across the United States. Another unique pattern of store development is the very high correlation to population. The relation between population and Wal-Mart locations is brought out by a technique called 'buffering' (Graham, 2006). Buffering is a GIS techniques where a circle is drawn around a point to create a catchment area. Figures 8 and 9 show the results of buffering by a 20 and 60 mile radius respectively. Zook and Graham's analysis shows that 60 per cent of the entire US population lives within 5 miles of a Wal-Mart location and 96 per cent are within 20 miles.

The second core competence that Wal-Mart has is their Point of Sale (POS) system. Between 1985 and 1987, Wal-Mart invested to build the world's largest private, integrated satellite communications network, which beamed data, voice, and video communications to and from corporate headquarters and more than fifteen hundred stores. By the 1980s, Wal-Mart's low income consumers had started using credit cards but the lines at the checkout counters were long. The development of the POS technology was a response to fight against this

¹⁸ Founder of Wal-Mart

¹⁹ Butler Brothers got into franchise in 1920. By 1947, there were more than twelve hundred franchise stores under the Ben Franklin name. Store owners were obligated to purchase 80 per cent of their merchandise from Butler Brothers at a mark-up of 25 per cent for the wholesaler (Lichtenstein, 2009).

²⁰ Headquarters and the place where Wal-Mart built the first 150,000 square foot distribution center

inefficiency (Lichtenstein, 2009). The technology system is Wal-Mart's second core competence and is its nerve center.

Figure 7: Wal-Mart stores in the US, by retail division

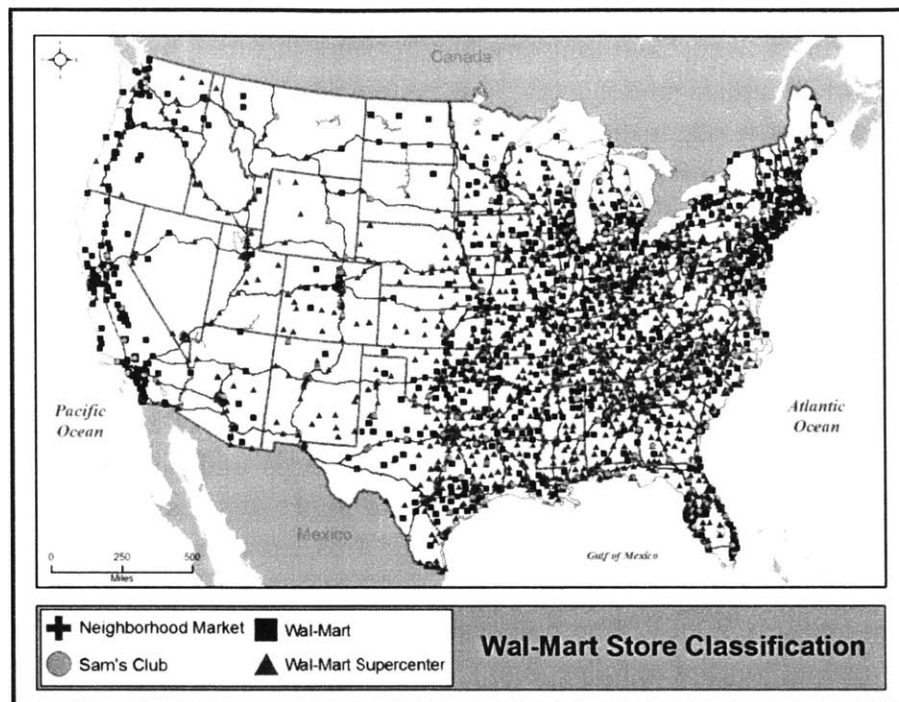
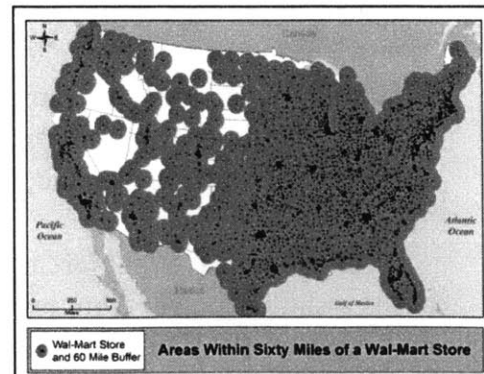
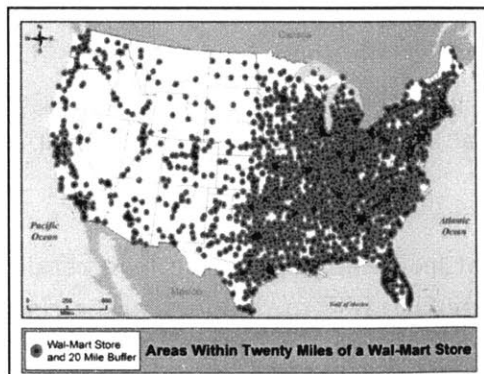


Figure 8: Areas within 20 miles

Figure 9: Areas within 60 miles



Source of Figures 12, 13, 14: Zook and Graham <http://www.zook.info/Wal-Mart/>

In addition to the logistics capabilities through distribution center and its POS technology, Wal-Mart developed a strategic capability in its relationship with Procter & Gamble. By 1987, Wal-Mart was P&G's third largest domestic customer, and P&G was Wal-Mart's single biggest vendor. Both companies realized their synergistic potential and integrated their retail systems to benefit from a symbiotic relationship best described as a "push" system in logistics. In the push system, production is dominated by large consumer goods manufacturers who have long production runs in order to gain efficiencies of scale and minimize unit costs. The system leads to production of inventory surpluses which are pushed out to retailers. The manufacturers offer deals and promotions to motivate retailers to purchase large quantities in advance of delivery.

LEAN RETAILING

As usage of the POS system, "Retail-Link" grew, Wal-Mart could access more and more data about consumer preferences and behavior. With more information, Wal-Mart was in a position to improve sales by getting a clearer command of what it was actually selling. This led to a revolution in logistics, where the industry moved from the "push" system described above to the "pull" system (Wilson, 2006). The pull system characterizes the Just-in-Time (JIT) or lean retailing concept as following:

- shorter lead times, making it difficult to do mass production
- reduced inventory for all actors
- integrate processes along the entire supply chain, rather than within organizations
- move from functional excellence to integrated solutions along the whole chain
- Retailers, suppliers, transportation providers ideally form strategic partnerships, sharing information so that all participants are able to rapidly respond to shifts in demand.

In summary, Wal-Mart is a master at lean retailing, where lean retailing causes a shift in power from producers/manufacturers to retailers, and a rise in retailer power (Wilson, 2006). Some people call this the Wal-Mart Effect.

THE WAL-MART EFFECT

Literature review associated the Wal-Mart effect primarily highlights the negative impacts on labor and displacement of small retailers resulting in a negative impact on communities. Discussed below are some key themes that may constitute the effect of Wal-Mart.

1. Impact on Rural communities:

A 10 year study on the impact of Wal-Mart on rural communities with population 30,000 – 50,000, in the state of Iowa, points out that towns which attracted a Wal-Mart had greater than average sales and a geographically broader customer base, however these same towns saw sales decline to levels lower than before Wal-Mart, after the first fears of Wal-Mart's entry (Stone, 1997). Stone shows that while the Wal-Mart towns attracted a sizable increase in sales initially, the biggest losers were small towns in close proximity, which had significant sales loss (up to 47 per cent) when a Wal-Mart opened within 20 miles. Stone concludes with an assessment that state level shopping habits of consumers, changes from purchasing goods from multiple retailers to buying the majority of goods from mass merchandisers, over time after the opening of a large mass merchandiser such as Wal-Mart.

2. Changes in consumer behavior:

The same effect (as above) is cited by Holly R. Barcus, in a paper titled Wal-Mart-scapes in Rural and Small Town America. Barcus points out that Wal-Mart provides, even in rural areas, an important pastime through the experience of "shopping". For the rural consumer, Wal-Mart provides an experience similar to shopping in an urban shopping mall, where rural youth and college students "hang-out". While this consumerism conflicts with the stereotypical rural idyllic, Barcus argues that Wal-Mart changes consumer behavior and the divisive tension between the idealized rural versus the consumption-oriented lifestyle provides an important backdrop to understanding the opposition to Wal-Mart when it comes to small towns.

3. Market destabilization and impact on competition:

With the Wal-Mart focus on cost control, volumes and Every Day Low Prices (EDLP), it seems that consumers may, over time and after the initial newness of Wal-Mart rubs off, choose convenience, range and quality over the

affordable products that Wal-Mart sells. Certainly this is one of the arguments that proponents of allowing FDI in multi-brand retail are offering, i.e. the Indian consumer will prefer to shop from the local mom-and-pop store and therefore the small and large retail business can co-exist.

Burt and Sparks, in their paper titled Wal-Mart's World suggest that Wal-Mart has appeared unconcerned about the state of the market. In their view, Wal-Mart takes the position that its offer is so good, that over time, consumers will re-evaluate their choices and elect to not go anywhere else but Wal-Mart. Evidence from market tracking studies in America and Canada suggest after the initial lack of concern by consumers over price, time changes the pattern quite quickly in favor of Wal-Mart. Price steadily becomes more important in consumer's eyes and Wal-Mart's market share, volume, and awareness climbs steeply (Sparks, 2006). Competition feels the Wal-Mart effect in two waves, short-term and long-term. In the short term, the low price effect does not immediately impact competition and who, in turn, react with competitive price cuts. In the long term, it is the sustained application of EDLP pressure over a number of years through price reductions, volume and store growth and reinvestment in margin reduction that destabilizes the market. This destabilization forces consolidation, whether directly (agreed mergers in China), indirectly by fear (Promodes/Carrefour protective merger in France), or competitively (copying of the business model and consolidation in the US, (Wrigley N. , 2002).

Burt and Sparks further suggest that this destabilization does not occur everywhere, and nor does it happen without reactions from existing retailers such as Tesco in the United Kingdom, Metros in Germany, various supermarkets in California, labor and government in Germany, suppliers in Argentina, Brazil, Germany and Korea, regulator authorities in the UK. In the United States itself, the expansion of Wal-Mart has been immense and discussion on range from specific issues with communities, labor etc, to the very nature of Wal-Mart. At the international level, the resistance is at two levels. The first is similar to debate on the very nature of Wal-Mart and whether such development is desirable in countries. The second level of resistance arises from the battleground with existing retailers and other international retailers. The local businesses are forced to react and under pressure, in some instances, governments and regulatory authorities intervene to make Wal-Mart's development less rapid.

4. Internationalization of Wal-Mart

In international markets, Wal-Mart faces stiff competition from other retailers, like Tesco, Carrefour and Ahold. It has not been a major success, though

the international revenues now form a substantial 25 per cent²¹ of their global revenues. In its constant search for lower costs, Wal-Mart has run into troubles where its internal and external practices have been questioned. Their incessant pressure on suppliers and need to control the entire supply chain to achieve maximum margins has created resistance and seen Wal-Mart exit from international markets, i.e. Germany. However, Wal-Mart is learning and adapting to local needs in international markets. Supercenters across the world have different merchandise mixes and balances, operational practices from one country are transferred to another and ideas and formats are being placed where they can enhance the business and meet market demands (Wrigley A. C., 2004).

IMPLICATIONS FOR INDIA

Implications of the Wal-Mart effect on India may be summarized as below:

- Supply side:
 - Wal-Mart (and other domestic and international retailers) will cause a shift in power from the middle-men in Mandi's²² in India's APMC markets and the trading community into the hands of large retailers
 - The character of production will change. Wal-Mart demands flexible production and small inventories and while SME's and other suppliers can benefit from larger orders, they will need financial and technical assistance to upgrade their capabilities and capacities. Currently Wal-Mart India states that they source 90 per cent of goods and services locally²³ but if volumes grow and the domestic manufacturing is not able to keep pace, we will see Wal-Mart procure from China and other low-cost destinations
 - The character of distribution of freight will be forced to change. India's internal logistics are primarily road and air based. There will be pressures on the government to develop infrastructure to enable an efficient logistics network. Wal-Mart's growth, as with domestic retailers, may be localized to areas within States with better infrastructure.

²¹ Wal-Mart Annual Report 2010

²² Mandi's are wholesale markets for agriculture produce. Farmers bring their produce to Mandi's and sell to government appointed middle-men.

²³ India factsheet on Wal-Mart Facts, <http://walmartstores.com/pressroom/factsheets/>

- Demand side:
 - The increase in economic growth, fueled by a rise in the younger educated class will contribute to the success of malls in small towns (Mayo, 2010)
 - There is growing literature which suggests that as modern retailing expands its reach, consumer preferences change from being restricted to products and services to includes a whole range of activities which define the purchase experience. The attractiveness of stores is intended to draw consumers and the ambience of organized retail provides a place to relax as well as shop. Demand side pull for organized retail will force such formats to diffuse fast throughout society (Mayo, 2010).

- Impact on small retail – destabilization of the market
 - Competitive reaction and consolidation will happen. FDI inflows may go towards M&A activity for consolidating traders, SMEs and perhaps even some small retailers.
 - The ability of small retailers, suppliers and middle-men to survive will depend on institutional opportunities to access finance to grow their own capabilities and capacities.
 - Consolidation in agriculture land will remain an issue due to the various land-rights issues within India. This can prove to be a challenge for large retailers who need volume procurement. Experiments with farmers by PepsiCo and Wal-Mart India so far are productive.

In summary, Wal-Mart's entry and growth may be slowed by intervention and the lack of infrastructure in India. However, the need from farmers and consumers will pull the large retailers to improve the choices and opportunities from a demand side. Whether India can manage this growth will depend on the strength of its institutions, domestic market and the choices it makes.

3.2. Foreign Direct Investment in India

Foreign Direct Investment (FDI) is, in essence, the creation or expansion of firms that operate across national boundaries (Krugman, 1993). In principle, Krugman and Graham argue that in thinking about FDI, the first part of economic theory that should be consulted is not the theory of international trade or capital movements, but the theory of the firm per se. A simple definition of FDI is offered by Rachael McCullough as being “the acquisition by a firm in one country of *control* over business activity in a second country” (McCullough, 1993). In examining why firms go across national boundaries, many hypotheses may be offered, including the need for growth in production and sales, competitive signaling, de-risking business from exchange rate fluctuations, diversification of capabilities by learning from international markets and reducing the cost of capital.

From the lens of FDI, Dunning synthesizes key elements of why firms choose to invest in international locations in his paper “The Determinants of International Production” (Dunning, 1973). The paper describes the following determinants for internationalization, i.e. incurring the cost of expansion through direct investment:

1. Ownership Advantage (O): Firms will invest only when they possess a competitive advantage such as superior technology, managerial know-how, established brands, or efficient channels for product distribution, and can sufficiently exploit that advantage over local firms to offset the cost of international coordination
2. Location Advantage (L): A firm will invest in a country if the foreign production locations offer attractive factors including natural resources, growing market and demand conditions, incentives and cost advantages.
3. Internalization (I): In addition to O and L, a company needs to understand if it must internalize to capture the value generated by O and L, i.e. appropriate the advantages it generates. Typically, given the basis that a Multinational Corporation (MNC) will invest directly knowing it can generate sufficient advantages over the domestic firms, an MNC worries about its ability to sustainably exploit and appropriate the advantages.

Given the above basis for understanding FDI, it should be understood that international retailers like Wal-Mart will enter India only because the necessary market and demand conditions exist where they can exploit and appropriate the inefficiencies of the indigenous firms and markets.

Retail in India fares well among many factors that invite FDI, including market size and growth, macroeconomic stability etc, however among the many attempts by domestic firms to exploit organized retailing formats, some stores and initiatives have already closed down, i.e. Subhiksha have closed down (ATKearney, 2010). As previously in this paper, even though the Government has allowed 100 per cent investment in cold chains²⁴, India has not seen any investment of consequence either by domestic or international players.

ISSUES FOR (MULTINATIONALS) FDI IN INDIA

Building from the question on why India has not seen FDI or domestic investment in the cold-chain leads us to the often asked comparable, i.e. why China has attracted more FDI than India? Many blame the Government policies as being too restrictive and anti-foreign investments, citing a culture of autarky in India. Another argument relates to the difference in the differences in the Diaspora of China and India (Balasubramanyam, 2004). Balasubramanyam suggests that perhaps the Indian Diaspora, primarily located in the US and employed as professionals, has chosen to invest in portfolios of investments, primarily bank deposits against the Chinese Diaspora who, based out of East Asia, have channeled FDI into China to take advantage of the low cost labor and land.

While there are other arguments, I propose that the lack of attracting FDI in India has more to do with the lack of faith by MNCs of their ability to effectively internalize/capture the value of their investments in India. I use portions of an article by Witold Henisz, titled "The Institutional Environment for Multinational Investment" (Henisz, 2000) and various portions of the book "Multinationals in India" (Nayak, 2008) to illustrate my proposal in the following paragraphs. I discuss Nayak's model for FDI to complement with a developing country's national objectives.

²⁴ Warehousing and Refrigeration capabilities in the supply chain for perishable food items

In keeping with thoughts expressed earlier with reference to the OLI framework for FDI, Henisz suggests that when multinationals enter new markets, they are exposed to risks of expropriation from their joint-venture partners and as political hazards increase, they are faced with an increasing risk of opportunistic expropriation by the government. These transaction costs arise due to two reasons:

1. Independent contractual hazards:

Henisz proposes three categories of contractual hazards, namely (i) asset specificity – where a multinational may lose control over their investments (sunk costs) in property, plant and equipment in the host country; (ii) leakage of their technology and know-how, and (iii) free-riding on their brand-name reputation by the joint-venture partner. As the potential gain from expropriation of assets or of revenue streams increases, the joint venture partner will use all means, including manipulation of the political system to seize that return.

Example: Indian Equity in ITC Limited²⁵

By 1907, the British American Tobacco company had invested in the manufacturing, and selling of cigarettes and local trading of tobacco leaf through its various subsidiaries in India. Until 1953, BAT wholly owned these companies, when it was asked to dilute its equity by a proposal of the Government of India. BAT adapted to this request due to their prior experience in other 55 countries that they operated in and had faced similar political pressure for national control. The dilution of BAT's equity began in 1954 and was 75 per cent in 1969, 60 per cent in 1974 and 40 per cent in 1976. Table 8 shows the change in equity holding.

In 1994, J.N. Sapru, former chairman of ITC, stated that ITC does not need BAT. In 1995 there were several counter allegations between K.L.Chugh, the then chairman of ITC and BAT. This public drama on ownership followed a spate of raids by the Enforcement Directorate²⁶ on grounds of ITC violating the Foreign Exchange Regulations Act, 1973. The enquiries led to the arrest of several top executives of ITC, including Chugh. By June 1997 BAT and ITC resolved their differences as BAT licensed ITC to manufacture and sell some of

²⁵ Case study of British American Tobacco (BAT) in India, from the book *Multinationals in India* (Nayak, 2008)

²⁶ Monitoring body for Foreign Exchange regulations

its global brands, including 555, State Express and Benson & Hedges. Author Amar Nayak notes that this episode is an aberration in a hundred year history of BAT in India. However, this does typify the concern that some MNE's may have regarding independent contractual hazards as discussed by Henisz.

Table 8: ITC equity holding, 1953 - 2004

Year	BAT & other foreign companies (%)	Institutional ²⁷ (%)	Indian private investors (%)	FII ²⁸ (%)	GDR ²⁹ (%)	NRI ³⁰ (%)
Until 1953	100	-	-	-	-	-
1954-64	94	-	6	-	-	-
1964-69	94	1	5	-	-	-
1969-74	75	10	15	-	-	-
1974-76	60	18	22	-	-	-
1976-84	40	30	30	-	-	-
1984-85	38	32	30	-	-	-
1985-86	31	32	36	-	-	-
2002-03	32.5	38.38	14.9	9.62	3.09	0.7
2004-05	32.40	38.38	12.73	17.49	2.98	0.60

Source: Multinationals in India, pg 101

2. Independent Political Hazards:

Henisz proposes that the second category of hazards that a multinational corporation faces is from the State itself which – given its monopoly power on legal coercion and its implicit presence in the background of every economic transaction – poses a threat to the multinational corporations either through policy shifts in taxation or regulation, or through outright expropriation.

The expropriation may benefit the government directly by transferring revenue to government budgets or bank accounts of government officials.

²⁷ Institutional: Indian Institutions

²⁸ FII: Foreign Institutional Investors

²⁹ Global Depository Receipts

³⁰ Non-Resident Indians

Also, the government may receive political benefits and mileage by transferring assets or property rights to domestic ownership. However, governments may also incur costs in terms of future loss or revenue from multinational corporations and costs due to impact on domestic partners and actual and potential employees of such multinational corporations.

Example: Maruti Udyog Limited & Suzuki Motor Corporation³¹

In a classic example of how India shut out foreign competition and domestic industry, the Government of India (GOI), in 1953, passed a legislation that all foreign car makers who assembled cars in India will need to manufacture cars in India within 3 years. As a result, General Motors and Ford Motor ceased their operations in India, in the same year. For the next 30 years, the passenger car industry was under-developed and left to the two companies, Hindustan Motors and Premier Automobiles, who made one model of a car each and sold approximately 50,000 cars per annum in total.

In 1969, Sanjay Gandhi, son of then Prime Minister Indira Gandhi started a small passenger car company by the name Maruti Ltd. The company had little success and was liquidated in 1977, when by an act of Parliament, the car company was acquired by the GOI and became a public sector company, renamed as Maruti Udyog Limited (MUL). The GOI then sought international bids and on October 2, 1982, signed a joint venture with Suzuki Motor Corporation (SMC).

Through the partnership, SMC invested to develop and strengthen a cluster around itself in an otherwise under-developed car components market. A list of car component vendors promoted by SMC is shown in Table 9. Within 25 years, SMC had set up several group companies in India, with stakes in car component manufacturing companies to car financing and insurance companies, three wholly owned subsidiaries in insurance and distribution services and two joint ventures with car component manufacturers.

³¹ Case study of Suzuki Motor Corporation and Maruti Udyog Limited, from the book *Multinationals in India* (Nayak, 2008)

Table 9: List of car component vendors promoted by SMC/MUL

S. No	Component Manufacturer	Components manufactures
1.	Bharat Seats Ltd	Car seats
2.	Caparo Maruti Ltd	Sheet metal sub-assemblies
3.	Climate Systems India Ltd.	Aluminum radiators
4.	Denso India Ltd.	Parts and components
5.	J.J. Impex (Delhi) Private Ltd.	Service & repair
6.	Jay Bharat Maruti Ltd.	Sheet metal components
7.	Krishna Maruti Ltd.	Car seats
8.	Machino Plastics Ltd.	Injection plastic parts
9.	Mark Auto Industries Ltd.	Automotive assemblies & components
10.	Mark Exhaust Systems Ltd.	Exhaust systems & door sashes
11.	Nippon Thermostat (India) Ltd.	Automotive components
12.	Sona Koyo Steering Systems Ltd.	Steering gear systems
13.	Suzuki Metal India Ltd.	Aluminum die casting, cylinder block etc
14.	Subros Ltd.	Air conditioning, coolers, refrigerators
15.	Asahi India Glass Ltd.	Tempered glass for cars

Source: Multinationals in India, pg 142

In 1983, the GOI held 74 per cent stake in MUL and SMC held 26 per cent. Over years, SMC increased its stake from 26 per cent in 1983 to 40 per cent in 1989 and 50 per cent in 1992. In 2004, SMC held 54.2 per cent and a majority control in MUL.

In keeping with Henisz's hypothesis of independent political hazards, SMC experienced difficult times with the GOI in 1997, when the government appointed their nominee, R.S.S.L.N Bhaskarudu as the Managing Director of the company. SMC expressed its concern over this appointment and faced resistance from the government. This problem continued till August 1999, when Bhaskarudu resigned. Issues still persisted due to what SMC viewed as an act of expropriation by the government and therefore reduced its investment in MUL between the period of disagreement, 1997 – 2001. In 2000, SMC bargained hard with the government and (in keeping with Heinsz's observations where the government and supporting industry stands to lose

revenues) were successful in buying a part of the GOI equity to increase its stakes and gain a controlling ownership.

Relevance to the Retail FDI scenario:

Ownership is a major motivator for foreign companies to invest in new markets and many companies, including Wal-Mart and other foreign companies will be averse to invest in the development of infrastructure and supporting industries if the GOI sticks to its current approach of not allowing the foreign retailers a greater ownership and access to markets, where they can internalize the gains.

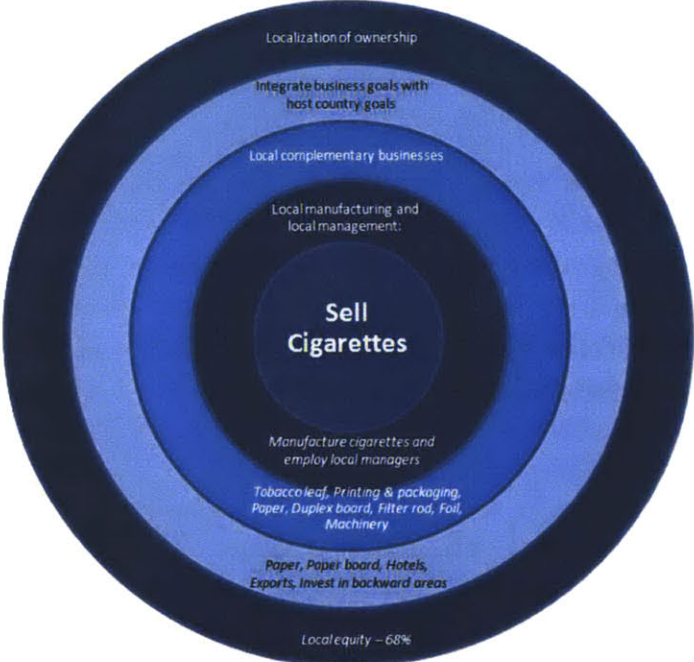
A SUCCESSFUL FDI FRAMEWORK – ALIGNING PROFIT AND NATIONAL INTEREST

Within the same examples of BAT and MUL, author Amar Nayak proposes that the Government of India and these foreign companies were able to complement and integrate the business goals with the (host) country's goals, i.e. India. Barring a few issues as highlighted above, these companies have done phenomenally well for themselves and for the economy as a whole.

The policies have included protectionist adaptations for India, including import substitution by complying with the government's requirement to source locally and develop local vendors, investment in the social sector and localization of management and ownership over time. Figures 10 and 11 respectively show the development approach taken by BAT/ITC and MUL/SMC in India.

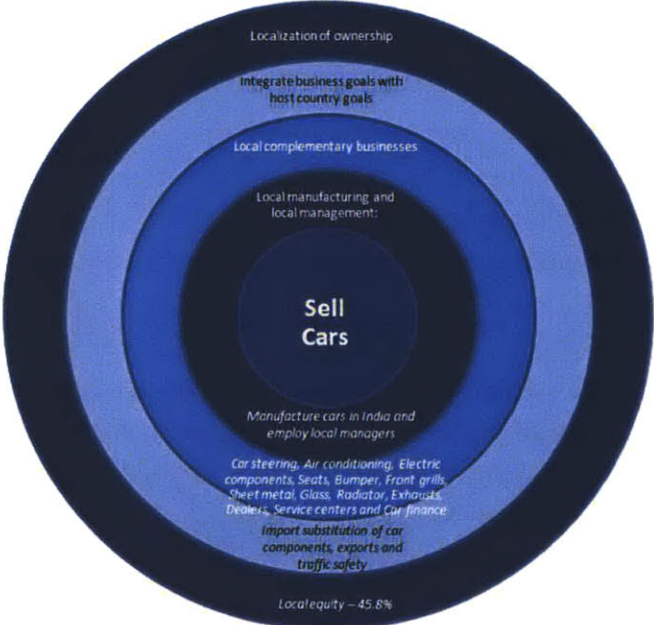
A review of the partnership approach demonstrates that with a good understanding and appreciation of mutual goals, a multinational corporation can effectively integrate business and country goals to become true transnational companies.

Figure 10: Holistic FDI pattern of BAT / ITC , 1906 - 2004



Source: British American Tobacco, 1906-2004, Multinationals in India, pg 105

Figure 11: Holistic FDI pattern of MUL & SMC, 1982 - 2004



Source: Suzuki Motor Corporation, 1982-2004, Multinationals in India, pg 157

IMPLICATIONS FOR INDIA

The literature in economics is not very clear on whether Infrastructure development follows FDI or if FDI follows infrastructure. The government of India is clearly hoping, or at least marketing, that FDI in organized, multi-brand retail will remove supply side bottlenecks, invest and improve infrastructure in the food supply chain, ease inflation and boost India's agriculture exports. In inviting such FDI, the questions of whether FDI will displace domestic industry or whether governments and local joint venture partners will expropriate the competitive advantage and investments of foreign multinationals are real issues and need to be considered very carefully.

Nilesh Kampani, India's answer to Warren Buffet, suggests that India needs Infrastructure and clear policies before it invites FDI. His interview on a website³² is titled "India does not need FDI" and he is quoted as suggesting that the investment coming in from FII's are more than adequate for the financing needs that India has (Kampani, 2006). While the title of the interview and spin on the conversation appeals to the pro-Indian, protectionist populism, I think what he is referring to is that India needs long term, infrastructure improving and committed FDI. In the absence of such material commitment, the only difference between FII flows and FDI remains the percentage of investment in organizations, while still keeping the nature of capital, volatile and hot. In my view, Mr. Kampani is suggesting that India needs to mature and put in place a mechanism that is devoid of constant political interference, before we invite long-term FDI. The risk of large, committed monies leaving India (like when Coca Cola left India in 1977 after the government asked it to hand-over the secret recipe) are more damaging for investor confidence in the long run than the flows of hot money.

Notwithstanding, India is compared to China and its inability to attract FDI is cause for many a case study on what not to do. In analyzing the growth approaches that India and China have taken, Martin Wolf describes the differences as being a factor of political and social philosophies. Quote: "China has accepted both growth and social transformation. India welcomes growth but tries to minimize social dislocation... Chinese politics are developmental, while India's politics remain predominantly clientelist" (Wolf, 2005).

³² <http://www.rediff.com/money/2006/apr/03minter.htm>

The questions facing India, with regard to FDI in multi-brand retail are not new. The government has been discussing this in various forms since 1993. We also have examples where India has successfully managed long term FDI and developed many industries in India, on the back of great partnerships. These successes are a cause for many an international company to want to invest in India, despite the political wrangling that continues. However, the implications of such stagnation in decision making are clear – they come at the cost of development and force many in India to continue to live lives in poverty.

3.3. Section Review

The purpose of this chapter was to address the question of whether India should invite foreign direct investment in organizing retail. Wal-Mart has long held its infamous crown of being the chief corporate villain which displaces markets and causes small mom-and-pop stores to close down. As argued in this chapter, this fear is not unfounded. However the immediacy of the impact is perhaps exaggerated. A McKinsey report projects that India is still in Stage 1 of organized retail (Figure 12) and suggests that based on the adoption patterns of organized retail in developing countries, it will take organized retail in India anywhere from 5 to 15 years to gain a scale of any relevance (McKinsey, The Great Indian Bazaar, 2008).

Figure 12: Adoption of organized retail



Source: McKinsey – The Great Indian Bazaar, 2008

While the McKinsey study should allay fear of immediate displacement of small retailers and traders, it is perhaps too pessimistic on the speed at which this change may occur. Other reports suggest that developing economies are adapting to organized retail much faster, driven primarily by their demand side characteristics (ICRIER, Multibrand Retail, 2008). Notwithstanding, this provides the Government with an opportunity to develop and introduce adequate competition policies to protect the industry from being taken over by multinational companies. Also, Wal-Mart will face competition from other international large format players and the entry of many players will help to create a more efficient market for agriculture products.

As demonstrated in the various examples of industries that have been incubated and developed by the Government of India, Retail presents another unique and large opportunity for the Government to work with the international private players to revive this industry. However, it must be understood that in the absence of clear policies and regulations to support the small retailers and middle-men, they will be squeezed out. Therefore, the Government needs to be proactive and ensure adequate industry status, clear policies, access to finance, promotion of related and supporting small and medium industries, education and vocational skills training, to ensure small mom-and-pop stores with the ambition to grow can expand their operations; and the ones that get displaced, are absorbed in related and supporting small and medium scale industries.

CHAPTER 4 – Summary & Analysis of Responses to DIPP Discussion Paper

As part of its decision making process, the Government of India released a discussion paper on whether the country should allow foreign participation in multi-brand retail. The discussion paper released acknowledged various issues facing the retail sector, and in particular the inefficiencies of the agriculture sector. The report outlined the experience of various countries in their attempts to organize retail and the positive and negative impacts thereof. Also, the discussion paper quoted various research publications including those sponsored by the government and independent research conducted. The discussion paper has sought responses to twelve (12) specific questions from the people of India and interested parties internationally. This chapter reviews the feedback received and attempts to map the interests of stakeholders in this decision.

4.1. GOI discussion paper & Analysis of feedback received

In general, the private sector and international respondents have applauded the DIPP for a well researched and thoughtful discussion paper. Opponents have voiced their concerns suggesting that the paper projects a pro-FDI stance by arguing that the government administered procurement and supply chain has become inefficient, causing lack of transparency in prices and impacting inflation. Following is a summary of observations:

Support for Discussion Paper:

- The discussion paper is timely.
- It highlights the issues facing wastage in public distribution system
- Provides relevant international experience as reference
- ICRIER report, base for the discussion paper, has been appreciated

Opposition for Discussion Paper:

- Overemphasis on ICRIER report
- The discussion paper has been released in English only and many have demanded that the Government release the discussion paper in Hindi for broader participation

- Overemphasis on benefits to consumers and farmers has been seen as being simplistic and ignoring the power relationships in supply chains
- Lack of alternate or supporting recommendations, i.e. industry status for retail, increasing access to credit and long term financing for small retailers, improvements in skills training, acknowledgment and plan for dealing with displaced jobs. This leads the respondents to suggest that the paper is essentially narrow in focus, i.e. to force discussion on FDI as the solution to many problems, including inflation

Other issues which impact the acceptance of the discussion paper:

- Some respondents argue that retail between food and non-food items need to be differentiated as the responses will change depending on focus
- Many highlight inherent contradictions in the discussion paper, asking for job reservations for rural youth, yet also suggesting that multi-brand retail be restricted to urban cities
- Most respondents have not attempted to respond to questions relating to international trade negotiations, i.e. TRIMS; and have also generally avoided answering questions on whether the penalties should civil or criminal or both.

Key insights:

- Respondents have asked for Retail to be recognized as a formal industry, with a centralized Regulatory Authority to establish guidelines and reduce bureaucracy
- The need for long-term financing is highlighted through many comments
- Inability of domestic industry to establish effective retail and lack of FDI in cold-chains, even though allowed 100% through direct route, is a vote from multinationals against India's FDI attractiveness (examined further in Section 3.4).

SUMMARY DATA ANALYSIS

In response to the discussion paper, the DIPP received and posted all responses received on their website³³. After removing responses which were submitted by the same person twice and others which were scanned in more than once, the total unique responses received amount to 163. Of these, 94 per cent (154 responses are from the domestic respondents) while 6 per cent (9

³³ <http://dipp.nic.in/>

responses are from foreign respondents). Foreign respondents include multi-national retail companies, like Wal-Mart, Carrefour and Metro who have presence in India and consulting firms like Deloitte and the Nielsen Company. Foreign respondents also include the US and UK chambers of commerce.

In summary, 100 per cent of foreign respondents replied in favor of opening multi-brand retail in India, while only 31 per cent of domestic respondents voted in favor. In the large chunk of responses, i.e. domestic respondent, an overwhelming 71 per cent of respondents voted against opening of multi-brand retail (Figure 13). Two domestic respondents suggested very specifically and crafted their entire response for non-food multi-brand retail and have been shown in the Conditional category.

Figure 13: Summary response to DIPP survey

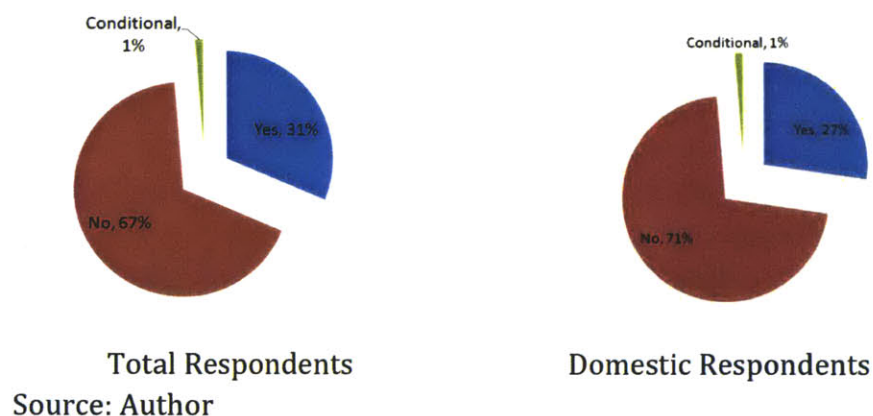
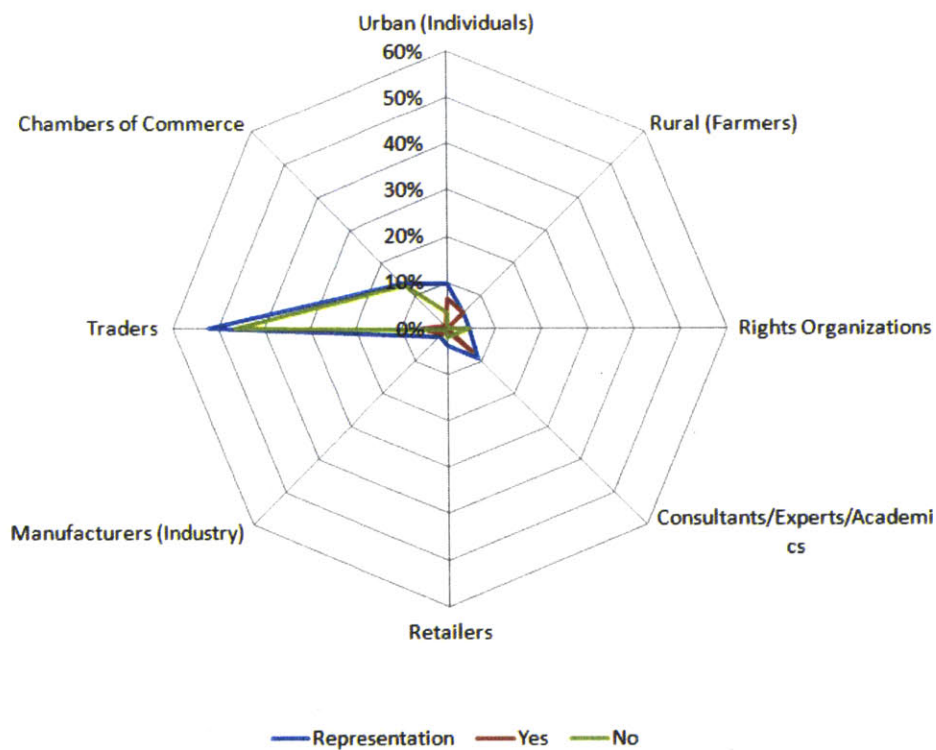


Figure 14, shows all domestic respondents (154 in total) by various categories and their responses. In an attempt to understand the origin of various views, I have classified them as described below. It can be seen that the maximum responses are from traders and merchants associations.

- Urban Individual (15 responses) – professionals, government officials replying in their personal capacity and students
- Rural Individual (7 responses) – farmers
- Rights organizations (7 responses) – includes consumer rights committees, industry opinion polling organizations and the activist groups
- Consultants/Experts/Academics (14 responses) – includes responses from consulting firms, experts in policy and retail industry and professors at management universities in India

- Retailers (6 responses) – responses from retail companies like Spice retail and the Future group plus other small retailers
- Manufacturers & Industry (4 responses) – primarily DCM Shriram and small enterprises
- Traders and associations (80 responses) – various traders and merchants associations
- Chambers of Commerce (21 responses) – includes district level chambers

Figure 14: Domestic respondent views by detailed categories



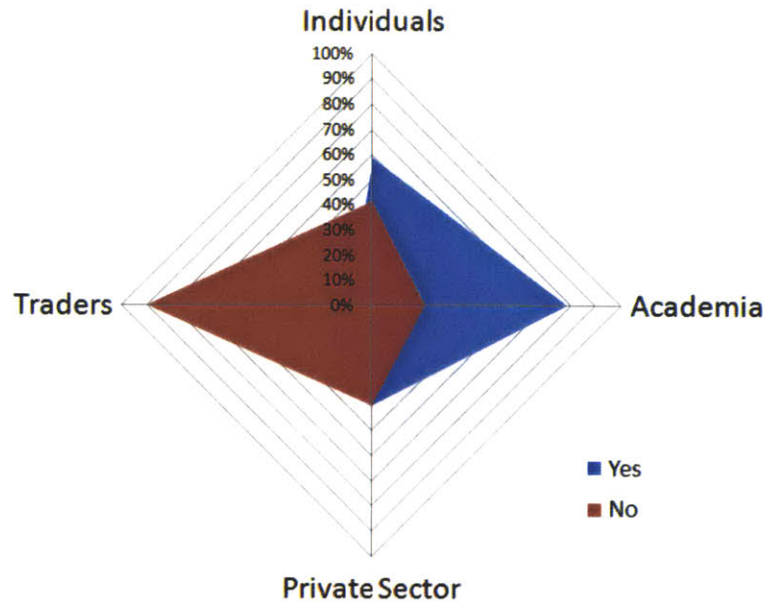
Source: Author

OPPOSITION BY TRADERS

The distinction between trader associations and chambers of commerce at the district level at best blurry and for a better understanding of how the overall traders and merchants associations view this issue, against the individual (rural and urban respondents) and other, I have clubbed traders, traders

associations and chambers of commerce into the same category as traders. Individuals include rights organizations and the Private Sector includes manufacturers and retailers. Figure 15 shows that 59 per cent of Individuals, 79 per cent of Academia and experts and 40 per cent of the Private Sector are in favor of opening FDI in multi-brand retail; against 90 per cent of the trading community who have voted against the proposal.

Figure 15: Divergence of trader’s views with rest of respondents (domestic)

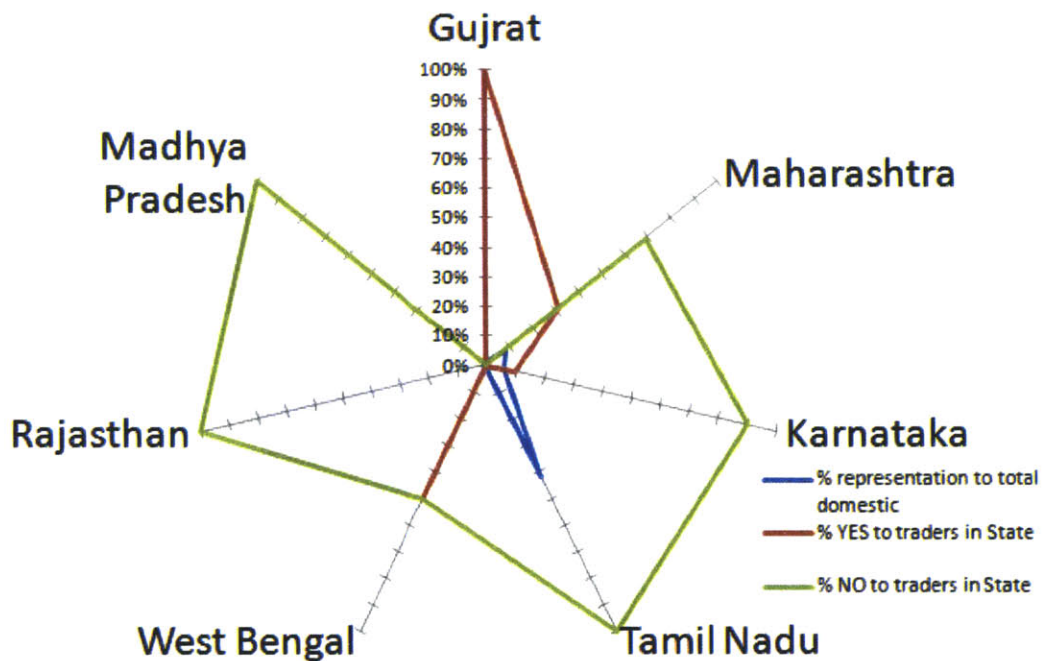


Source: Author

With 101 out of 154 domestic responses, the trader’s community represents 66 percent of domestic responses and 62 per cent of all responses. This skews the data highly in proportion of the domestic traders. Further, of the 101 traders, 64 come from the State of Tamil Nadu, thereby causing the traders from the State of Tamil Nadu to represent 42 per cent of the overall responses received (Figure 16). With 100 per cent of traders in Tamil Nadu having voted against FDI in multi-brand retail, the voice of 5 farmers (the only rural representatives in the entire population) from Punjab (see Appendix 1) who have all voted positively to allow foreign direct investment are completely drowned. This assumes that the comments from any sector of the society are only weighted by the number of responses received. This analysis is therefore biased towards respondents who had access to a computer, internet and understood

English. This bias is consistent with the inherent bias of the Discussion paper and opposition received by the Government for not having released this paper in Hindi and through other channels.

Figure 16: Traders responses by State



Source: Author

The difference in responses from various States is consistent with the theory of backward and forward States. The shaded portion between the States of Madhya Pradesh, Rajasthan and West Bengal represent the three backward States whose traders have responded. Together they account for 6 per cent of trader's responses while the forward and southern States of Tamil Nadu and Karnataka represent 73 per cent of responses.

Interestingly, 85% of responses by traders from Tamil Nadu are exactly the same. Therefore, if one letter in Tamil Nadu were to change, the number of respondents in favor of opening FDI in multi-brand retail would increase from the current 31percent to 64 per cent. This swing would cast the ballot in favor of opening FDI in multi-brand retail.

FEEDBACK FROM THE REST OF INDIA

While the previous analysis focuses on the voting of yes and no, Table 10 outlines feedback on additional questions by using data from respondents who have voted 'yes' for FDI in multi-brand retail. As the number of people who have answered any specific question is small and inconsistent, it is presented in a tabular form as a summary of responses. I do not attempt to present any analysis of this data as it is small and inconsistent. However, the comments provide interesting insights to potential solutions that the Government could choose to implement. The table includes comments by Wal-Mart India³⁴, received by the DIPP for each of the questions asked.

Table 10: Comments by each question

Question	Yes	No	Depends	Blanks ³⁵	Comments
1. Should there be a Cap on FDI? If so, how much?	11	18		134	8 – suggested 49%; 8 – suggested 51% Wal-Mart has suggested they preferred no caps but were willing to accept caps for political reasons
2. Should FDI be leveraged for backend infrastructure development and what percentage should be stipulated	17	15		131	All 15 “No’s” – suggest that FDI investment will happen automatically and therefore there is no need to mandate. Wal-Mart subscribes to this view A unique suggestion was to instill a minimum capitalization like n place for NBFC ³⁶ , in addition to Zoning to ensure such facilities are outside the cities and closer to farmers

³⁴ Available on the DIPP public website <http://dipp.nic.in/>

³⁵ Includes 101 respondents who said NO to FDI, therefore all their other responses have been disregarded and considered as blank. This also includes 2 responses who said YES to FDI, conditional to being for non-food items. Their responses to all other questions have been included as stated in their letters.

³⁶ Non Banking Financial Companies

Question	Yes	No	Depends	Blanks ³⁵	Comments
3. Should a minimum threshold investment be mandated to establish “genuineness”? If so, how much should it be?	8	19	1	135	<p>Questions raised on the definition of “backend” infrastructure. Also, suggestions highlight that mandating a certain amount will distort and put undue pressure to “show” certain investment, leading to inefficient allocation of capital</p> <p>People who approved have suggested various figures ranging from 25 million to 100 million, or up to 50% in the first 5 years. Wal-Mart suggests 100 million to be invested over 5 years in the food category; while recommending no stipulation in the non-food category</p>
4. Should job reservations be mandated for rural youth?	6	23	1	133	<p>Interestingly, not many people are in favor of reservations. The options suggested include: Retailers to spend 2.5% of annual revenue to develop rural infrastructure like classrooms, parks, sewage treatment, public dispensaries, broadband connectivity etc</p> <p>Provide skills training to rural youth. Wal-Mart subscribes to this opinion and has stated success in Brazil in using this approach</p>

Question	Yes	No	Depends	Blanks ³⁵	Comments
					<p>Opponents highlight that the reservation question contradicts question 7 of the DIPP questionnaire suggesting that the stores will open in urban areas. Also, some fear that reservations will cause flight of manpower into cities and further exacerbate the issue of urban poverty in India.</p> <p>Opponents inquire if domestic large retailers will be subject to the same conditions</p>
5. Should we stipulate a minimum percentage of procurement from the SME ³⁷ sector?	13	16	1	133	<p>The general feedback received states that the SME sector is already involved and will continue to be a part of the supply chain. Some feedback worries that mandating a certain percentage of procurement will lead to undue pressures on SME's – primarily because the large retailer need large volumes at short or just-in-time deliveries which the SMEs will not be able to meet.</p> <p>Wal-Mart has suggested a commitment for 50% local procurement.</p> <p>Suggestions for reservation suggest varying minimum procurement numbers from 10 to 50 per cent.</p>

³⁷ Small and Medium Enterprises

Question	Yes	No	Depends	Blanks ³⁵	Comments
					Suggestions include recommendations to start small and develop with retailers to ensure smooth functioning and growth of the sector. Access to financing was brought up in the suggestions.
6. Can small retailers benefit from the logistics infrastructure developed? And should a minimum percentage of sales be mandated to small retailers?	22	4		137	<p>Many think that the Cash-and-carry format already takes care of this need. Suggestions recommend a commitment to serve local retailers in varying ranges from 25 to 50%.</p> <p>Opponents suggest that the 'power' will shift from government and market forces, however inefficient, to the large retailers</p> <p>Wal-Mart has suggested that large retailers should develop an additional 1/3 square foot in cash-n-carry stores for every square foot of multi-brand retail. It also asks for parity in enforcing such requirement on domestic large retailers.</p>
7. Should stores be allowed only in cities with a population > 1,000,000? Should a 10km area outside the municipal/urban agglomerations be included in the	3	21	1	138	<p>Opponents state that cities already have shopping malls and do not see the benefit. Responses in favor suggest that these outlets should be opened in poor and rural areas as the need is greatest there. Others argue that this there should be no restrictions.</p>

Question	Yes	No	Depends	Blanks ³⁵	Comments
definition of the city for setting up such ventures?					Wal-Mart has suggested that limiting to this size will severely impact the efficiency of logistics making them sub-optimal. It has recommended the limits to 200 cities with population of 200,000. Wal-Mart recommends including a 10km perimeter in view of the real estate prices and availability.
8. Are the conditions being proposed in compliance with TRIMs? Can they be harmonized across foreign and domestic retailers and will such conditions be in compliance with Article 301 of the Indian Constitution?	5	2		156	By far, this is one question that people have been hesitant to answer. Most responses suggest that the Government either knows best or they should hire expert counsel on this matter A few individuals have suggested that such conditions will be out of compliance with TRIMs. Wal-Mart and a few others suggest that should the Government require conditions on indigenous procurement, it should apply to the domestic retailers as well
9. Should there be an exclusive regulatory framework? Should there be a Shopping Malls Regulation Act? And should	6	15	1	141	Comments suggest that the current regulatory environment and bureaucracy is inefficient. Suggestions also state that the current APMC ³⁸ do not help small holder farmers

³⁸ APMC – Agriculture Produce Market Committees constituted by State governments and Union Territories to manage the buying and selling of agricultural commodities. The APMC Act in each State requires that all agricultural products be sold only in government regulated markets.

Question	Yes	No	Depends	Blanks ³⁵	Comments
intervention be at the Center or State levels?					<p>Recommendations highlight the need for recognizing Retail as an industry, a Regulatory framework for promotion and monitoring of retail, single window clearance and enhanced financing and credit facilities for retailers to be made available</p> <p>Comments also highlight the role for the new Competition commission in protecting the market from monopolistic environments</p> <p>Wal-Mart's comments are against the establishment of a Shopping Mall Regulation act, which seems to be in consonance with the general feedback. Wal-Mart suggests that the Government could outline a policy which restricts multi-brand retailers to open stores with a minimum of 2,000 square feet</p>
10. Should the Government retain first right to procure? Or should the government put a mechanism to collect levies if buffer food stocks fall below a	18	3		142	<p>The feedback in general has been that the Government PDS³⁹ system is inefficient and ignores market prices. The suggestions state that distribution will benefit with the infrastructure investments due to opening of retail. A few respondents have suggested that the Government should</p>

³⁹ Public Distribution System to collect, store and distribute food

Question	Yes	No	Depends	Blanks ³⁵	Comments
minimum threshold?					retain the right to procure first stressing that it should be at market prices. Some respondents suggest that it is not the amount of food but the lack of warehousing and storage that needs to be solved. Wal-Mart's comments are consistent with the feedback received.
11. Should permissions be granted by a centralized authority and should this also monitor Cash-n-Carry outlets?	12	11		140	Response here has been similar to question 9. Respondents stress the need for single window clearance and improving the regulatory mechanism. Wal-Mart highlights the ICRIER report which has a list of 40 existing licenses required to open retail stores
12. Should penalties be civil, criminal or both? What additional penalties should be imposed?	-	-	-	-	This is the only question where everyone, by mostly not responding or by making a brief suggestion about the Indian legal system, have agreed that the existing Civil procedures, along with FEMA ⁴⁰ and other provisions including criminal proceedings when applicable, are adequate.

Source: Author

⁴⁰ Foreign Exchange Management Act

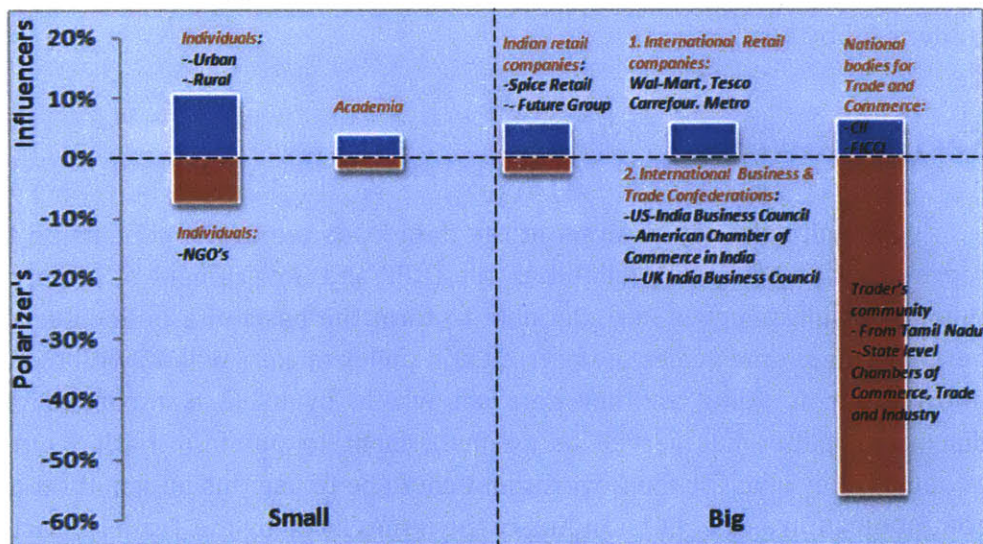
The comments in Table 10 provide useful feedback and sense of how the people's sentiment and Wal-Mart's view (overly generalized as being representative of the international retailers view) can help form policy. However, as highlighted previously, the number of people who have answered in affirmative to opening of FDI in multi-brand retail is overshadowed by the number of people who have objected.

In particular, there are only five farmers in the entire population, and they are in support of opening FDI in multi-brand retail. Their response is written in Hindi and is a one page letter stating that they don't get the right price, right weighing of produce nor do they get full money. They say that they have been selling to the company over the last 2-3 years and that they want to sell maximum produce to the company⁴¹.

4.2. Mapping the Stakeholders

All respondents to the Discussion Paper floated by the DIPP, Government of India, may be seen as either influencing the decision (Influencer's) to open FDI in multi-brand retail or as opposing by providing a polarizing view (Polarizer's), as shown in Figure 17.

Figure 17: Influence of various stakeholders



Source: Author

⁴¹ Mohd Haneef – response pack number 30 in the DIPP website

In terms of the diversity of views across the spectrum, we have seen a broad cross-section of the society to be in favor of opening FDI in multi-brand retail. However, as presented in Section 4.1, the number of responses has been dwarfed by the sheer volume of polarizing views from Traders in the country, mainly comprised of responses from the traders in Tamil Nadu.

The Influencers argue for opening the sector by citing a multiplier effect on growth and productivity to the nation, while at the same time acknowledging the challenges of introducing modern, organized retail, in a predominantly unorganized sector. The Polarizer's have predominantly attacked international organized retail, while not focusing on similar impact by domestic organized retail as much. Their appeal is based on demonstrating strength in numbers.

Given the immense influence this lobby has on the government in the State of Tamil Nadu and also the knock-on effect they have on trader lobbies in the States of Karnataka and Andhra Pradesh, both adjoining southern States in India, any solution to the government's proposal to open FDI in multi-brand retail will have to resolve or confront their opposition. In today's environment of coalition politics, confronting this lobby may prove to be detrimental perspective of this lobby and design programs and policies that can effectively address their concerns. The perspective of the Tamil Nadu trader's lobby is presented below as a result of how they perceive the issue on hand, the impact on their interests, institutions involved in promoting this agenda and the information that the traders' lobby has.

4.3. Section Review

In summary, my analysis of the data leads me to the conclusion that the representation of views available to the DIPP and Government of India, through this discussion paper is not adequate to form the basis of a policy decision. At best, it brings some voices to the front and policy makers will do well to view this information as being another data set which, by itself, is inconclusive. The discussion paper has served as an instrument to put information out to the people. Other uses for the Government could be to use this information to target communication and understanding of the issues faced by the Traders, particularly in Tamil Nadu and attempt to educate and design a solution that is economically sound and implemented to limit avoidable losses.

CHAPTER 5 – A Three Lens Analysis

The 3-Lens analysis is based on “Managing for the Future: Organizational Behavior and Processes”, by Deborah Ancona, Tom Kochan, John Van Maanen and Eleanor Westney. The analysis is built further based on research by Eleanor Westney, using the same approach, on issues facing NGO’s. The three lenses, Structural, Political and Cultural, provide a multi-faceted perspective of looking at problems and ensuring we see the “whole” issue and not only that which resonates with our individual ways of thinking and responding to events around us. The divergent views and inability of a large body of people to agree on the benefits and challenges of organizing and introducing foreign players in multi-brand retail in India, is an example of how various stakeholders are seeing only that which resonates with them and ignoring the “whole” picture.

In my analysis, I stretch this model, which has been used to look at organizational issues, to apply the framework for a country, as an organization.

5.1. The Three-Lens Analysis

In order to solve a problem, it is helpful to have a rich understanding of organization, issues, sources of issues, range of approaches that can be taken etc. When asked, different people summarize the problem and solutions from their perspective. If they had a better, even wider understanding of the larger organization, they might see different perspectives and realize the problem may be somewhere else. Essentially, who we are and what we do is often shaped by the environment and constraints around us, and that which shape us. The authors of “Managing the future” cite an often-told parable about three-blind men to bring out the singularity of individual viewpoints:

Three blind men were asked to describe what an elephant is like. One blind man felt the elephant’s tail and observed, “An elephant is very much like a piece of rope.” The second blind man felt the elephants’ side and observed, “An elephant is very much like a wall.” The third blind man felt the elephant’s trunk and observed, “An elephant is very much like a pipe.” Each was right. And each was incomplete and partly misguided.

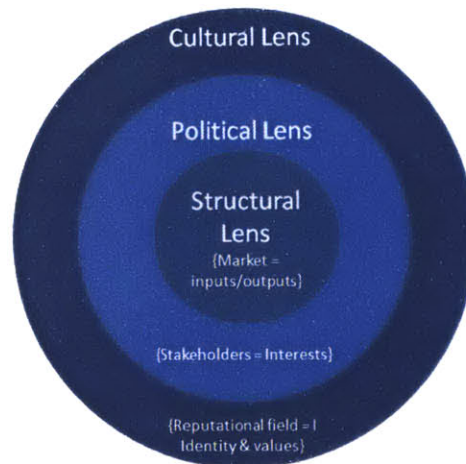
Ancona et.al, suggest that in an organizational context, our individual ways of thinking and responding to events around us (our personal schema⁴²), are transcribed into organizational ways of thinking as organizational schemas. The organizing of work in a particular manner, perspectives, values etc represents what defines an organization. Such schema helps individuals find recurring patterns in everyday complex situations, in the absence of which, each task would be a monumental new project. It is however, the nature of schemas itself, which also leads us astray. Schemas tend to become “outdated”, are “resistant to change”, have the tendency to become “universal rules” and as such have the same problem as the interpretation of an elephant by the three blind men, they are “incomplete” and silo’ed not allowing new thoughts and perspectives to influence a different tomorrow. To observe these schemas and understand what is really going on Ancona et.al, based on years of research, propose three lenses. The lenses are:

1. The Structural Design Lens: A resource space, viewed as a flow of inputs & outputs, flow of tasks and information, sorted by roles and structures and defined rational optimization to achieve organizational goals.
2. The Political Lens: A relationship between how power and influence are distributed and wielded, how different stakeholders express their perspectives and get involved in (or get excluded from) decisions.
3. The Cultural Lens: A view of how history has shaped assumptions and meanings of different people, and how practices and artifacts take on specific meaning to translate into stories and rituals which shape a culture.

Applying the 3 lens approach to the decision making process of the Government of India first requires us to understand the various factors influencing the retail market in India and define what factors constitute the various lenses, before we look at their interplay and influence in decision making. Figure 18 shows the construct of the issue:

⁴² A schema, as defined by social psychologists, is a cognitive structure that represent organized knowledge about a given concept or type f stimulus, A schema contains both the attributes of the concept and the relationship among the attributes – (Fiske and Taylor, 1984)

Figure 18: Three Lenses



Source: Adapted from Eleanor Westney

At the core, the market may be understood as a resource space, which is defined by various inputs and outputs. A simple Porterian 5-forces analysis at the company and industry level, and a review of Porter's diamond of national advantage at a country level would reveal the various structural factors at play within the retail market. The second layer defines the various interests of stakeholders and social actors who have a stake in the decision and influence the politics of the situation. The outer layer represents the reputational field which describes the norms developed within stakeholders and social participants which guide what image they want to project to others and how they see their own organizations. This third layer defines the cultural construct.

This section reviews the issues regarding FDI in multi-brand retail from three different lenses, structural, political and cultural.

A VIEW FROM THE STRUCTURAL LENS

From an FDI lens, Michael Porter's diamond model for competitiveness of nations may be seen as satisfying the Location advantages (L) that constitute the eclectic OLI framework discussed in Section 3.4. In continuation of the argument that multinationals, when looking to engage in FDI, look for various factors including the nation's factors of production, skilled labor or

infrastructure, demand conditions, the existence and maturity of related and supporting industries, and the nature of firm strategy, governance and domestic rivalry that exists, Porter states that national prosperity is created, and not inherited (Porter, 2008). Below is an analysis of the retail landscape in India, using Porter's Diamond of National Competitiveness:

1. Factor conditions:

For factor conditions to be of competitive advantage, they must involve sustained investment to develop and create important factors of production, such as skilled human resources or a scientific base. The mere existence of a large pool of labor or local raw materials do not constitute an advantage, or at least they do not translate into any meaningful advantage, unless they are developed, specialized and matured to become an advantage that is unique to the country by virtue of not being easily replicable (Porter, 2008).

a. Agriculture:

Food and groceries form an important and large part of any major Retailer's basket of products. In the United States, groceries account for 51% of sales for Wal-Mart (Downing, 2011). In India, spend on food, beverage and tobacco constitute 42% of spend is expected to remain the biggest category by 2025 (McKinsey, The 'Bird of Gold': The Rise of India's Consumer Market, 2007). Also, agriculture contributes to nearly 18% of the GDP in India and employs more than 60 per cent of the population. India has the second largest arable land after the United States and 97 per cent of domestic needs are supplied by domestic production (USITC, 2009).

Despite the staggering size and improvement in India's agriculture from food shortage and subsistence farming to self-sufficiency and technology led-cultivation, the issues that plague productivity improvements are a preponderance of small and marginal holdings for about 82 per cent of total farm holdings, imperfect market conditions and the lack of backward and forward linkages in the supply chain (Ramaswamy, 2008).

b. Employment and skills development

The Government of India's annual Report to the People acknowledges that the quality of employment in India is characterized by a predominance of unorganized employment, which lowers earnings and lower job security. The report estimates that 96 per cent of employment in India is in this informal sector. In urban areas, the percentage of unorganized sector workers is close to 65-70% and while not all are poor, the report estimates that close to half of this number is in dire need of occupational up-scaling. Also, the working environment is not conducive; working hours are long and most of the conditions of decent employment (i.e. paid leave, pension, bonus, medical support and health insurance, maternity leave benefits, compensation against accidents, etc) are non-existent (Employment, 2010).

A World Bank report, prepared at the request of the Government of India, highlights that continuing to raise labor productivity while at the same time generating enough jobs for a growing labor force is proving to be a major challenge for India. This issue has come into sharp focus over the last decade where the economic growth has increased but employment growth has fallen to less than half that of the 1980s (also discussed in Section 2.4 of this paper). The report suggests that the government's efforts in developing vocational skills are not effective. The report highlights that the supply of workers with vocational/technical skills has declined since 1980s and that their relative wages have also come down since 1990s. The causality proposed is not that there is little demand for skilled workers, but that the workers with technical/vocational qualifications do not have the necessary skills that meet the labor market needs (WorldBank, 2007).

The overall factor conditions for Retail may thus be summarized as being vastly under-developed and challenging. While the government continues to develop and provide education and skills in the informal sector, the fact that the private skills training and education in the informal sector is weak, continues to be a challenge for improving the quality of the workforce.

From the perspective of large retailers, they will face the challenge of training employees from the informal sector and providing the skills necessary to the functioning of their outlets and operations.

Bharti Wal-Mart has already invested in two skills training centers in the State of Punjab, where 5,550 candidates have enrolled and 1,050 have been placed across the industry, including Wal-Mart's operations in India. In March, 2011, Wal-Mart has announced a Memorandum of Understanding (MoU) with the Karnataka government to open similar training centers (Bharti Walmart, Karnataka Government launch Skill Centre, 2011).

2. Demand Conditions:

The composition and character of the home market usually has a disproportionate effect on how companies perceive, interpret, and respond to buyer needs. The size of home demand proves far less significant than the character of home demand (Porter, 2008)

With the growth in India's middle-class (covered in Section 2.4 of this paper), McKinsey predicts that India will become the world's fifth largest consumer market in the world (McKinsey, The 'Bird of Gold': The Rise of India's Consumer Market, 2007). In the same report, McKinsey suggests that consumption will quadruple, though on a per capita basis real spending will remain modest at \$1.065, which is still triple of today's levels. Most of this increase is expected to be a result of change in income and not so much due to savings or population changes. The geographic pattern of India's income and consumption growth is expected to shift from being predominantly rural (57 percent of consumption – due to the absolute size of population – is in rural households) to becoming more urban. While the initial income growth will be faster in the urban areas, the income and consumption of rural households will reach today's urban levels by 2018.

Economic growth and urbanization of small towns and cities will emerge as attractive markets and provide an opportunity for large retailers to address the growing formal sector of the economy. By 2025, the Indian consumer market is expected to become largely an urban affair, with 62 percent of consumption in urban areas (McKinsey, The 'Bird of Gold': The Rise of India's Consumer Market, 2007).

3. Related and Supporting Industries:

The third component of national advantage is the presence of related and supporting industries that are internationally competitive. Far more significant than mere access to components and machinery, is the advantage that home-based industries provide in innovation and upgrading. This advantage results on the foundation of close working relationships between suppliers and end-users located near each other and who can leverage the advantages of short lines of communication, quick and constant flow of information and on-going exchange of ideas and innovations (Porter, 2008).

In the discussion paper on whether India should allow FDI in multi-brand retail, the Government of India has clearly acknowledged that even though India is the second largest producer of fruits and vegetables, it has very limited integrated cold-chain infrastructure and the supply chain is highly fragmented and unable to distant markets without large loss of produce (DIPP, 2010). The USITC report on Impact of Indian Tariff and Non-tariff Measures on US Exports highlights that the marketing and distribution inefficiencies result from high levels of government intervention, poor quality and limited availability of storage and transportation infrastructure, a lack of alternative sales outlets for farmers, several layers of middle-men, inadequate grades and standards, and few tools for risk management (USITC, 2009). The report also suggests that these inefficiencies discourage the entry of U.S. firms into the Indian market and increase the cost for firms already in the market.

A report by the Indian School of Business (ISB) highlights that India has the potential for becoming the food basket for the world as it has all the necessary factor conditions and a functioning agriculture system that meets the large needs of the Indian population and is a net exporter. The paper acknowledges that the overall efficiency and productivity of the food processing sector can be vastly improved and thereby result in India becoming a major supplier. The clusters around the food processing industry need large investment and present opportunities for the private sector. Internationally, retailers like Wal-Mart and Tesco have become the channel masters and control this supply chain, while in India, there are no superstores and the farm holding is small, leading to no economies of scale and lack of investment in this sector so far (Vishwanadham, 2005). The various clusters that exist, but in an informal manner and there is scope for

various clusters to grow (Figure 19). As an example of the potential for development, even though India is the second largest producer of fruits and vegetables, only 2 percent of this produce is processed, compared to 65% in the U.S; also, only 26% of Marine products, 6% of poultry and 20% of Meat are processed in India compared to 60-70% in developed countries. Milk is another product that India is the second largest producer of in the world and only 35% of this produce is processed compared to 60-75% in the developed countries.

Figure 19: Food supply chain cluster



Source: ISB, Can India be the Food Basket for the World (Vishwanadham, 2005)

4. Firm strategy, structure and rivalry:

National circumstances and context create strong tendencies in how companies are created, organized, and managed, as well as what the nature of domestic rivalry will be. No one managerial system is universally appropriate and competitiveness in a specific industry results from the convergence of management practices and organizational modes favored in the country and the sources of competitive advantage for the industry (Porter, 2008).

The firm strategy, structure and rivalry have to be understood for both the agriculture markets and the retail sector which is, by definition, not granted an industry status with the country. In agriculture, most of the farmers are small holders. Agriculture, in India, is general is constrained from both the inputs and outputs sides. In a case study (The ITC eChoupal Initiative, 2004) on soy-bean farmers in the State of Madhya Pradesh in India, farmers were understood to lack inputs and technology for seeds, fertilizers, herbicides and lose 60-70% of the productivity of their crop. Farmers are required to sell only through the government appointed mandi's (wholesale markets) which are further regulated under the APMC scheme (Agriculture Produce Market Committees are constituted by State governments and Union Territories to manage the buying and selling of agricultural commodities. The APMC Act in each State requires that all agricultural products be sold only in government regulated markets scheme). Price discovery for the farmers happens after they tow their produce for miles to the government wholesale market, where Government appointed Collection Agents auction and agree on the price. Farmers face unfair practices in the way their produce is weighed, the amount of time taken (which, in the absence of cold storage and modern warehousing, affects the quality of produce and is subject to pilferage) and also how they are paid. Often, the farmers are paid a portion of what is owed with unofficial guarantees to pay the remainder amount at a later date. The ITC e-Choupal initiative has taken permission from the Government, established an alternative wholesale market for soy beans, with the caveat that farmers would not be forced to sell at the ITC e-Choupal markets. ITC established computers in villages with internet connectivity which gives price information at the wholesale market and also global commodity prices, so that the farmers can choose where they want to sell. At the wholesale market, ITC provides a resting place for the farmers, automated and fair weighing of produce and ensure all farmers are paid their total dues on the spot.

While the ITC e-Choupal initiative is very successful, this has not been replicated by other private players at the same scale or with similar success. Most of agriculture procurement and management of the supply chain is still in the hands of the middle-men. The discussion paper on FDI in multi-brand retail clearly highlights that "intermediaries dominate the value chain...they flout mandi norms and their pricing lacks transparency. Wholesale regulated markets, governed by State APMC Acts, have developed a monopolistic and non-transparent character." (DIPP, 2010). The intermediaries include collection agents and "traders" who further sell to the small retailers through APMC markets in cities.

Small retailers in the cities and small towns procure from these traders and have no other alternative. The small retailers predominantly are self-employed due to many factors, including the lack of relevant and employable skills. In a survey conducted by the ICRIER on the Impact of Organized Retailing on the Unorganized Sector (ICRIER, Multibrand Retail, 2008), it found that access to bank credit was very low among the surveyed unorganized retailers and only 12 per cent had availed themselves of in the year preceding the survey, i.e. 2007. It is no wonder that in the same survey, only 7 percent of unorganized retailer said they would like their children to continue with the same business.

In summary, a view from the structural lens suggests that the state of farmers (upstream) and that of the small retailers and consumers (downstream) is controlled by the intermediaries. Demand is clearly positioned to grow and the supporting and related industries, including organized retail, are currently held captive to old and now inefficient public distribution system through government appointed wholesale markets and agents.

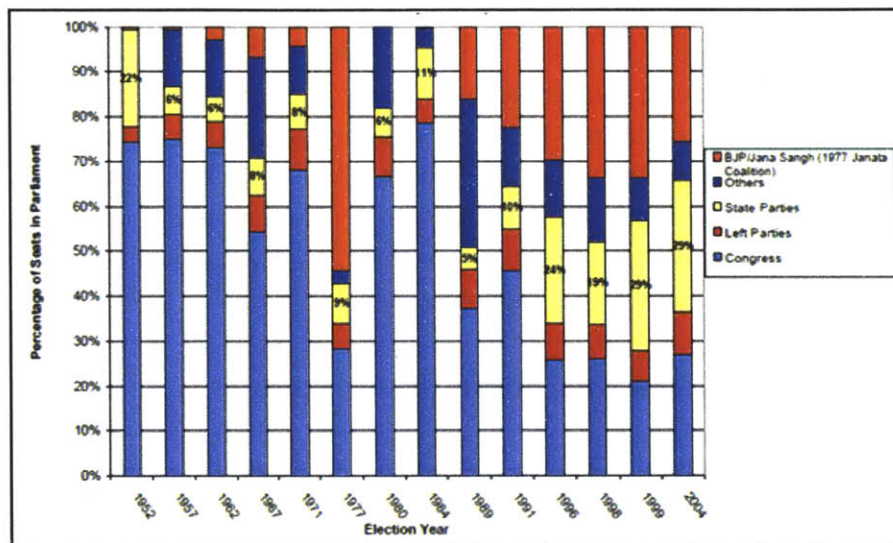
A VIEW FROM THE POLITICAL LENS

To understand the relationship of various stakeholders and social actors who have a say in the decision on whether to allow FDI in multi-brand retail, we need to first define who the stakeholders are. For the purpose of my analysis, I view the stakeholders as being the major constituents who have responded to the Government of India's discussion paper on this issue. Based on the sheer volume of responses received and analysis presented in Section 3.2, it is obvious that the majority stakeholder is the "trader's community" in the State of Tamil Nadu. Farmers, small retailers, consumers, urban and rural unemployed, professionals and academia are at best minority stakeholders in this discussion.

The political system, post Independence in 1947, has primarily been a single party led, stable and dominant system under the leadership of the Indian National Congress. The Congress party system started between the periods of 1967 - 77. The party saw increasing internal rifts and in 1977 and the emergence of a new party, the Janata Party which was created in an effort to forge a centrist alternative to the Congress Party. However, the initial formation of the Janata Party and a subsequent two attempts, failed. The second attempt was in 1989-91 with the emergence of the Janata Dal and the third in 1996-98, with the emergence of the United Front which was a loose

alliance of 14 regional parties. Due to factionalism, personality clashes, and ideological divisions, none of these alliances was able to survive for a full five-year term (Hardgrave, 2007). This has led to the emergence of a new coalition form of government, where even the Congress Party now is dependent on the support of regional alliance partners to remain in power (Figure 20). The current coalition led by the Congress, includes their alliance with the DMK Party of the State of Tamil Nadu.

Figure 20: Coalition governments: The changing face of Indian politics



Source: Steven I. Wilkinson, *The Politics of Infrastructural Spending in India* (World Bank Report, July 31, 2006) pg 17

Robert Hardgrave, in his book, “India: Government and Politics in a Developing nation”, suggests that as demands and aspirations of the India people have increased and as new groups have entered the political system, the capacity of the government to respond effectively has not kept pace. He quotes another author, Gunnar Myrdal⁴³, as saying that under pressure from sectors of society with a vested interest in preserving the inequalities of the status quo, the Indian leadership has been undermined by the paradoxical position in which it finds itself:

⁴³ Gunnar Myrdal, *Asian Drama: An inquiry into the Poverty of Nations*, 3 vols (New York: Pantheon, 1968), pp, 1-117.

On a general and noncommittal level they freely and almost passionately proclaim the need for radical social and economic change, whereas in planning their policies they tread most warily in order not to disrupt the traditional social order. And when they do legislate radical institutional reforms – for instance in taxation or in regard to property rights in the villages – they permit the laws to contain loopholes of all sort and even let them remain unenforced.⁴⁴

The dynamics of coalition governments makes politics extremely competitive within India. The Coalition governments are formed and held together by the judicious spreading around of loans, grants and subsidies (Wilkinson, 2006). These funds are derived through a variety of sources: membership dues, contributions, public meetings, business houses, traders, contracts, nonresident Indians, cooperatives, industrial groups and the underworld (Hardgrave, 2007). Rifts between coalitions can arise over many issues and the ability of the Government (the incumbent Congress Party in this case) to take action depends on their ability to garner support from the coalition they have with regional parties.

Tamil Nadu and the Indian Government:

The incumbent Indian Government, led by the Congress Party has a 7 year coalition with the current Government of Tamil Nadu, led by the DMK Party. The Congress-DMK alliance is a major part of the current coalition form within the incumbent national Congress party system. Over the past few months, there have been a series of issues which could potentially rock the Congress-DMK alliance (NDTV, 2011), including the internationally infamous 2-G telecom scam, where the Minister of Telecom for the Government of India, a nominee from the DMK government was arrested on corruption charges.

Incidentally, the State of Tamil Nadu is currently (March-April 2011) going through its once-in-five-years, Assembly elections which will decide the fate of the incumbent DMK government in Tamil Nadu. Off-late there have been many corruption allegations against the DMK government, including reports that the DMK government is giving bribes to poor people to vote for the Party in the elections. Funds for these elections, like for other parties, come from various traders lobbies. In Tamil Nadu, the previous ruling party AIADMK (All India Anna DMK) got most of its funds from liquor and transport lobbies in Tamil

⁴⁴ Ibid

Nadu (Hardgrave, 2007), and with the current DMK government's ambitious plans to give laptops to students in colleges who vote for them, the need for funds is going to be high (Vasundara, 2011).

Given that Tamil Nadu is among the most urbanized States in India and has a strong trader's lobby, neither the incumbent DMK government, nor the Congress Party will be keen to take on the might of the traders who have vociferously objected to the opening of FDI in multi-brand retail. This clientalist approach towards the stronger sections of society is not new. Farmers have previously complained against exploitation by traders lobbies in Tamil Nadu, but there is no evidence that much has been done to correct the situation (Ragunathan, 2004). The small landowners do not identify with the needs and aspirations of the landless, giving rise to a new quasi-caste system, based on social class/income. The situation is worse in Tamil Nadu which, along with its neighboring States of Kerala and Andhra Pradesh, has a high proportion of landless rural households⁴⁵. Fundamentally, Hardgrave quotes Baldev Raj Nayar to sum up the political power of the class system:

“the levers of political and state power have rested in the hands of what may be termed the “middle sectors” of economic and social life in both urban and rural areas – the educated and professional groups, town merchants and small businessmen in urban areas; and the middle peasantry or kulaks⁴⁶ in villages”⁴⁷

A VIEW FROM THE CULTURAL LENS

Describing a Culture is perhaps the most difficult aspect of the three-lens analysis. When trying to do so for a country as large and diverse as India, one begins to wonder where to start from. In context of the issue on FDI in multi-brand retail, I think three norms which have developed in India, i.e. divisive politics on the basis of religion and caste, a tolerance for corruption and the sentiment of autarky, are perhaps relevant to discuss.

⁴⁵ Tamil Nadu, Kerala and Andhra have 34-37% landless against 12-23% Northern States of U.P, Madhya Pradesh, Rajasthan, Punjab (Hardgrave, 2007)

⁴⁶ Landowners in villages – they own between 2.5 to 15 acres of land each, and control 51% of the land, constituting 35 percent of rural households and 25 percent of total population of India (Hardgrave, 2007)

⁴⁷ Ibid Baldev Raj Nayar, “Political Mobilization in a Market Polity: Goals, Capabilities and Performance in India,” in Robert I. Crane, ed., *Aspects of Political Mobilization in South Asia* (Syracuse: Maxwell School, Syracuse University, 1976), pp. 148-49

The first issue is the approach of divisive politics. India contains all of the world's major religions; it is subdivided into a myriad of castes; and it has 15 major languages, as well as 24 other languages, each spoken by 1 million or more people, plus a large number of minor languages and dialects. India is the world's largest democracy and sixty years of freedom have seen major changes in politics and the society, where the country has gone from a single party nationalist approach to divisive Hindu nationalism and is now experimenting with consensus politics. India's diversity is at the same time, its strength and weakness. The diversity by social class perhaps is the toughest challenge that India has for economic growth and social justice. Political parties have used such differences to garner votes by playing to the sentiment of poor people and promising an improvement in their situation. Such divisive politics took an ugly turn when the BJP and other parties came to power in 1998 on the basis of a strong anti-Muslim propaganda. In 2004, the BJP lost to the Congress, and gave the reigns to Dr. Manmohan Singh, who is seen as chief architect of India's economic reforms. The good news for India is that the people voted for Dr. Manmohan Singh again in 2009, and chose economic reforms over divisive politics based on religion or caste.

The second issue that has pervaded in India is a tolerance of corruption. While India's infrastructural needs are enormous and have been recognized by international institutional investors, Indian business organizations and politics remain the primary obstacle to India's economic growth (Wilkinson, 2006). Wilkinson identifies two problems in infrastructural growth in India. The first issue is the lack of resources, i.e. the large government deficit which is running in excess of 80 percent arising from subsidies for agricultural inputs, train travel and oil. The Thirteen Finance Commission (FC-XIII) has recommended a calibrated exit from such fiscal expansionary measures and set a target of 68 percent by 2014-15, combined for Center and State governments (EconomicSurvey, 2010). The second issue that Wilkinson identifies is that the money that is being spent seems to be going waste, with spending spread across too many small projects, no return on state investment in infrastructure and poor quality of construction and maintenance. The state level audit reports confirm that money is diverted to people and places that appear not to fit the criteria of the programs. This corruption however is tolerated. Wilkinson proposes the following reasons for which corruption is tolerated:

- Capital infrastructure projects create kick-backs to political parties through which incumbents raise money and pay off party supporters. Contractors and landowners are overpaid, paid early, given extra

payments etc. This guarantees that the political parties have some influence over the “middle sectors” of society

- Infrastructure spending is distributed in a clientilistic way to ensure political support and votes. Wilkinson cites a study in Andhra where “the voters are told and convinced that choosing a candidate who does not have access to the minister is useless since he cannot get any benefits for the village”.
- Politicians frequently begin projects, which are unnecessary duplications, in order to provide assurance to the people and also to maximize political payoffs. The impact on infrastructural provision or the ability to complete projects is not seen as being of consequence.

A solution to corruption is not easily found. There are many institutional reforms that need to take place in India, starting with the Judiciary and including the Education of India’s people. In the interim, as the middle class grows in India, many believe that this trend will change and people will demand more transparency. The role of free press in India is crucial and is playing an important role in bringing news and information across the country. As more and more villages get electricity, cable television and communications facilities, the politicians are finding it difficult to remain corrupt.

The third norm that has shaped India’s culture is the sentiment of autarky. Post independence, the Indian people have sheltered themselves under the umbrella of being self-reliant and not opening its doors to foreigners. This sentiment is amply represented in the feedback received by the Government of India, in response to the DIPP’s discussion paper on FDI in multi-brand retail. Many letters have said “after opening to the East India Company, we allowed the British to rule us for 200 years. Why does this government want to repeat the same mistake?”

As India’s democracy grows older and India transforms to become a more urban country, the strength of this argument is fading. The youth today are influenced by western clothes and lifestyles. They aspire for life’s they see depicted through Indian and International cinema and as incomes grow, there is ample evidence that India’s consumption patterns are changing. Sunil Khilnani⁴⁸ suggests there is a new self-belief among the youth in India and that

⁴⁸ Star Foundation Professor and Director, John Hopkins University, *The Paradox of India’s New Prosperity* (India 2010, Business Standard, 2010), pp. 171-185

their social values are appreciably more liberal than their elders. While there is a tension between the old values of autarky and Indian nationalism, the rising demand for economic growth and equality of opportunities across the nation is changing the dynamics of politics and the social fabric in India. As the country develops, more of its population can see evidence of new prosperity all around them and have new expectations and lesser tolerance for inequality. Sunil Khilnani asks the question, “what if these expectations are not met?” He quotes Albert Hirshman:

With two lanes of cars in a tunnel, both at a standstill; when one lane begins to Move, those in the immobile lane will initially begin to feel optimistic, believing their turn will come soon. After a certain point, if their turn does not come, they will get Impatient, and then agitated – and someone will break the line and disrupt traffic. That moment when impatience and anger sets in cannot be determined in advance, but it will come.

In summary, the culture is changing and people are hopeful of a more prosperous future. It remains to be seen if the new hopes will be met and if Political parties firmly adopt a reform oriented, clean political image and functioning.

5.2. Implications for India

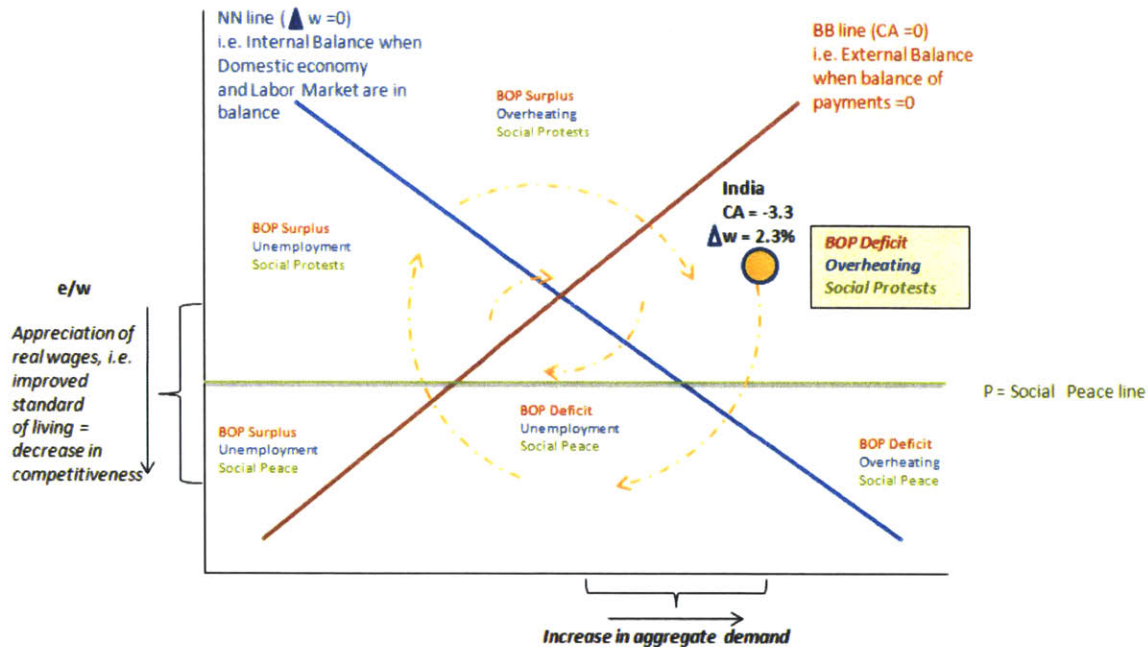
While reforms in reducing self-imposed barriers through taxes, licensing, reservations and restrictions on investments have led to spectacular economic performance for the country, primarily led by a buoyant services sector, India still continues to struggle with its ability to provide improve the productivity of its agriculture sector and boost its manufacturing. The 2010-2011 Economic Survey of India acknowledges that the technological breakthroughs achieved in agriculture through the Green Revolution are gradually waning and India needs another Green Revolution to bolster productivity (EconomicSurvey, 2010). While this may seem desperate, I posit that the Government can manage growth in a sustainable manner by organizing and reviving the retail sector.

ORGANIZE RETAIL TO INCREASE PRODUCTIVITY AND MANAGE INFLATION, CURRENT ACCOUNT DEFICIT AND INCREASING WAGES - BBNN (SALTER SWAN MODEL)

A frequent issue that India battles with is the fluctuations in its Inflation rates. Inflation in India is most commonly reported in terms of the Wholesale Price Index (WPI), which is a basket of manufactured products (weighted 64 percent), primary articles comprising mainly of food items (weighted 22 percent) and fuel and energy (remaining 14 percent). The WPI in 2010-11 started with a double digit 11.0 percent in April 2010, came down to 8.8 percent in August 2010 and went up to 13.6 percent in December 2010. The spurt in December 2010 is explained by the Finance Ministry in the Economic Survey 2010-11 as being caused due to supply bottlenecks in vegetables, onions, tomatoes, fruits, milk, eggs and fish. The supply shock was due to poor monsoons (agriculture in India is predominantly rain-fed). When combined with growing consumption in India, including the rural areas and the growing commodity prices globally, inflation pressures have been accentuated by the demand side pulls combined with supply shortages. The Reserve Bank of India has been actively tightening interest rates and raising the cash reserve requirements for banks. Government spending though has not come down and the Congress is committed to spending more money on the National Rural Employment Guarantee Scheme (NREGS) which promises a hundred days of employment to the rural sector. Inflation targeting so far has kept the economy managed but the Government and the RBI is walking a tight rope between slowing down the economy due to severe tightening and risking hot money flushes due to the rising interest rates.

The slowing down of productivity and the increasing demand and inflation are creating worries of the Indian economy moving towards being overheated. Increasingly, the Government of India has been suggesting that organizing the retail sector and improving the supply chain will reduce the wastage of food (currently estimated at anywhere between 30-40 percent) and ease the pressure on inflation. This argument is not without merit. However, for this effort to work, the Government will need to invest in building infrastructure and introducing reforms in APMC system. The resulting development of food processing and other small and medium enterprises can help move workers from an overcrowded agriculture sector into better quality work, while improving the overall productivity of the economy. Such sustained development can help India manage its growth in a changing global economic climate and the resulting inflationary pressures better. The patterns of movement are shown in Figure 21 – using the BB-NN Model (Rigobon, 2004).

Figure 21: Need for increasing Productivity



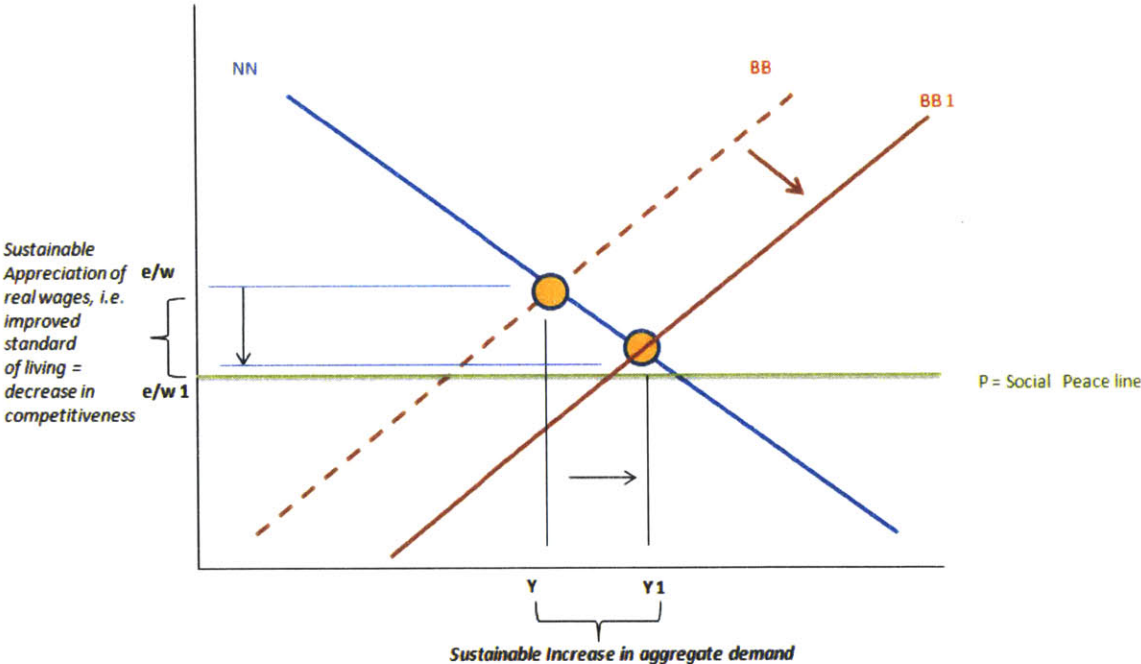
The increasing demand in the economy causes a strain on the Current Account (balance of payments) causing an increase in CA deficit. Also, as a result of increasing wages, the standard of living increases, while the economy becomes less competitive. Both these pressures will cause an increase in inflation especially if the demand cannot be matched by internal productivity improvements and supply is constrained due to shocks (weather, disease, sabotage) and inefficiencies (hoarding due to corruption, wastage). It can be seen that these factors will potentially negate (or quickly make redundant) any inflation targeting that the government will do, including measures to curtail lending, i.e. increase reserve ratios. The only options that the Government will be left with are capital controls and reducing government spending and/or increasing taxes. Both, capital controls and fiscal prudence are measures that are politically difficult – internationally and in the domestic vote bank.

The only alternative India has is to increase Productivity, as shown in Figure 22.⁴⁹ By improving productivity, internal demand can be met with indigenous production or the increase in exports can pay for the imports required. As inflation is controlled, real incomes will grow, causing an increase in domestic savings. This productivity improvement can be implemented by

⁴⁹ The BB-NN model and its functioning is shown heuristically in Appendix 2

Government led, or Government sponsored, or Market driven approaches. Also, the Market approaches can be domestic or through foreign participation. Given the fact that the Indian Government is running a high fiscal deficit, has not been able to invest in infrastructure development at the rate required, nor has the domestic private sector been able to develop the supply chain, it makes sense to invite foreign participation to revive the retail sector. As we have seen in previous examples of managing foreign investments, India has experience with such strategic partnerships which can provide a profit to the investors and yet align with its national interest.

Figure 22: Heuristic depiction of increasing productivity and managing growth



ORGANIZE RETAIL TO INCREASE TRADE

The philosophy and politics of autarky cause India to neglect potential opportunities in bilateral trade. This issue is especially pressing in view of the rise of China and the recent developments where the United States is entering into bilateral Free Trade Agreements with countries in Latin America. Arvind Subramanian, in his book *India's Turn*, suggests that in the context of GATT, to which India is a founding member, the critics in India continue to clamour for renegotiation of terms in India's favor, apparently unmindful of the possibility that India may have exhausted its substantive negotiating options due to

fragmentation of the South East Asia block. Another option that critics suggest is to accept only those provisions that are in favor of India. Arvind further argues that the WTO GATT comes as a package and India's options are to take it or leave it. This brings India to the issue of whether they become a part of a unified international trading system superseding GATT.

Given the current economic situation in world, and especially given the impact of the financial crisis on the economy of the United States, now is perhaps the best time to engage and enter into bilateral trade arrangements with the United States. Opening of retail to foreign participation, i.e. Wal-Mart was one of the discussion agenda's that President Obama included in his visit to India in 2010, will invite the much needed capital for infrastructure development, growing of the small and medium sector enterprises through developments in cold-chain providers, food-packaging, crafts etc. Yet, from fear of foreign domination, the traders in India were protesting and applying political pressures even before he arrived (Service, 2010). As such, the costs of keeping India's economy shackled are potentially explosive. India is straining at its seams to grow and every time we restrain this growth for the profit of a few, i.e. traders and politicians, or suggest that in accordance to our sentiment of self-sufficiency, we will go it alone, we ignore the economic costs of such inefficiencies and are at risk of bursting at the seams. If incomes do not grow and the economic balance is not maintained with smart trade choices, India runs the risk of seeing an increase in social protests, perhaps even an increase in violence and a coming back of 'religion-based' politics, which since the last few elections have focused more on economic growth than the divisive politics of religion. Any cynicism towards my suspected link between economic downturns and increase in politics based on race, religion and violence may be cast aside when one looks at the current issues being brought up against President Obama's citizenship and race. While there are various studies which explore causality between economic progress and social protests, I do not delve into empirical data to prove this point here. I merely draw a parallel to the demolition of the Babri Masjid (Mosque) in Ayodhya in 1992. The demolition by a large group of protestors was said to have been instigated and led by various political parties, in particular the Bharatiya Janata Party (BJP). While religion and caste based politics are common place in India, the timing of the demolition within a year of the India facing its severest economic crisis in 1991, is perhaps telling that economic downturns are directly linked to an increase in social unrest and divisive politics.

Not increasing trade and opting for appeasement of the traders' lobby may bring short-term respite to the incumbent Government. However, any Government which ignores economic reform will do so at its own peril.

5.3. Section Review

The analysis of data received from responses to the DIPP discussion paper were not adequate to arrive at a proposition for whether India should or should not open FDI in multi-brand retail. Therefore, I undertook a review of the various issues that impact this decision and conclude that despite the many economic reasons for opening of FDI in retail, this sector is currently shackled by India's own policies and the lack of political will to change status quo.

Using the BB-NN model to demonstrate transitions in economies, I heuristically conclude that India needs to improve its productivity if it has any hope of keeping its inflation in check and managing the growth that its people aspire to. Retail presents an opportunity that is very large and despite the complexities involved, opening of this sector with appropriate supporting policies and regulations is an imperative and not an option anymore.

CHAPTER 6 – Thematic Response to the DIPP Discussion Paper

In this section, I provide my perspective to the twelve questions that the GOI has put forth. I see the questions that the DIPP is asking in four broad themes, being whether India should open to FDI; and if it does, what will the fate of the unorganized sector, whether India can take a protectionist stance and how should the government obtain the right balance between regulation and governance.

Note 1: All answers are assuming that domestic and international organized retailers will be subject to the same guidelines.

Note 2: Under each theme, I have listed the questions as they appear in Chapter 7 of the DIPP Discussion Paper.

6.1. Should FDI in multi-brand retail be allowed?

7.1. Should FDI in multi-brand retail be allowed? If yes, should there be a cap on FDI? How much should it be?

7.2 Should % FDI investment be marked for growing back-end infrastructure?

7.3 Should a minimum threshold limit for back-end infrastructure development in dollar terms be specified?

Yes, India should open FDI in multi-brand retail for the simple reason that two wrongs do not make one right, i.e. while retail is unorganized and inefficient due to many reasons ranging from lack of employment opportunities, low access to capital to trading lobbies and politics of coalitions etc, a decision to keep things at status quo with the logic of protecting the small retailer makes no sense. Only 7 percent of the small retailers say they want their children to do this business; and their reasons for this answer could range from their inability to grow and scale this business to the new aspirations of youth. The only people who benefit from maintaining status quo are those with a vested interest in keeping control of the supply chain in a Janus faced manner where they have monopsony power over the producers and monopoly over the customers (i.e. the small retailers themselves).

Opening of the market should be a calibrated approach. To begin, India should mandate a cap of 49% foreign equity. While mandating a cap on FDI increases the perceived risk to the multinational of expropriation by Government

or Joint Venture partner, it will give time and leverage to the Government to put in place the required infrastructure and mechanism to monitor and develop this sector. As the industry matures and measures within the competition law are strengthened, the Government can evaluate increasing the allowed FDI percentage to afford foreign investors greater control.

Specifying minimum thresholds for back-end investment will be inefficient due to the fundamental issues of determining what the right number is, and then trying to adhere to the same. This will create inefficient allocation of capital and provide incentive for rent seeking behavior from various monitoring agencies. As is evident from the examples of Maruti Suzuki and ITC discussed in this thesis, investment in related and supporting industries will happen as a result of the business strategy and operational needs of large retailers.

6.2. Rural development and the fate of mom & pop stores

7.4 Should conditions be imposed? i.e. 50% of jobs be reserved for rural youth?

7.5 Should a specific % of procurement happen from SMEs?

7.6 Should special wholesale windows for small retailers be mandated, to allow the small retailers to leverage the supply chain of these large retailers?

7.7 Should this foreign investment be allowed only in cities with population of more than 1 million (2001 census)

Employment reservations for rural youth cannot be monitored. Also, this comes with various associated issues of reporting to the labor commissioner, managing selective employment etc. As pointed out by many respondents, this suggestion is clientelist and contradicts with the Government asking to restrict such retail outlets to urban areas. If the government's hope is that such conditions will ease the issue of urban poverty by offering jobs to rural youth who are in cities working as laborers, then I view this as a short-term measure, whereby this may end up attracting more rural youth to migrate to cities. Practically, reservations for employment provide an escape route to the government to avoid accountability for low skills development and employment opportunities for rural youth. This is not recommended.

As acknowledged by Wal-Mart, a minimum local procurement of 50% should be specified, to encourage the domestic SME business and development of supporting and related businesses. Currently Wal-Mart, in India, sources 90 percent of its goods and services locally. In view of the FDI approach

demonstrated by Maruti and ITC, it is possible for a multinational to integrate their business objectives with the developmental goals of the host country. This approach will allow the building of trust and sustainable development over a period of time. As suggested by Wal-Mart, for every square foot of multi-brand retail, the large retailers should develop 1/3 square foot of cash-and-carry stores. Also, the cash-and-carry stores should extend credit facilities to small retailers.

Restrictions on the basis on population of more than 1 million only will cause operational inefficiencies due to the geographic locations of the cities. Conditions on retailers should be defined on the basis of store location (zoning), minimum size, retailing format etc to ensure that the impact to small retailers can be minimized. Whether the number of small retailers will increase (as in China) or decrease (as with the rest of the world) is yet to be seen. However, when implementing these zoning and format restrictions, policy makers and traders must be prepared to see a shift in market power to the large retailers. The most impacted will potentially be the traders as they will lose their customers, i.e. small retailers to the Cash-and-Carry business of large retailers.

6.3. International negotiations & legal implications

7.8 Will the conditionality's be acceptable under the WTO guidelines / pressure? Should they be uniformly implemented to domestic retailers? Do conditionality's infringe on Article 301 of the Constitution of India?

The nature of government protection and support to various industries including pharmaceuticals, airlines and agriculture around the world is well documented and debated. The wrangling of such negotiations and the legal ramifications are difficult to comprehend in the context of this discussion paper. From the perspective of introducing conditions which provide for balanced growth in the economic and social interests of the country, India may not be constrained by TRIMs. However, ensuring all conditionality's are equally applicable to domestic and international retailer may be a safe position to take, while allowing for the Indian Government to ensure its national goals are being met. The opening of FDI in multi-brand retail may open doors for India to negotiate through multilateral and bilateral trade negotiations to increase its share of agriculture exports as is productivity increases. The opportunities afforded by this window cannot be underestimated.

Imposing certain conditions to ensure smooth functioning may not be inconsistent with the spirit of Article 301 of the Constitution, when read with other Articles within the Constitution, which allows restrictions and conditions on trade and commerce if they are for the reason of public good.

6.4. Balance between regulation and governance

7.9 Should a new Act – for Shopping malls be created? Should intervention be at the national or state levels?

7.10 Should the government retain first right to procure from farmers – for the public Distribution System – which acts as a safety net for the poor?

7.11 How will the requirements be enforced / monitored for compliance? Should a centralized agency be created?

7.12 What should the penalties for non-compliance be?

A regulatory framework which promotes the development of the retail sector, through clear policy guidelines should be developed. As highlighted through various comments received by the DIPP, the retail promotion and regulatory framework should be applicable for small retailers, traders – wholesale, organized, unorganized, cash-and-carry, and trading through franchise agreements. The retail sector should be granted industry status which will facilitate financial incentives, availability of organized financing and established insurance norms. Also, the enormous number of licenses (approximately 33 licenses are needed as per ICRIER report, annexure 3, pg 135) need to be streamlined to improve the business climate and reduce rent seeking behavior.

As the Government supports a very large safety net program for people below the poverty line, the government should retain the right of first procurement. However, such procurement should be at market prices.

The retail specific regulatory framework may work like the TRAI (Telecom Regulatory Authority of India⁵⁰) and serve as a speedier and more specialized grievance resolution mechanism. The Competition Act may be further strengthened to regulate for market failure by creation of monopolies. For multinationals, violations will be covered under stipulations of the Foreign Exchange Management Act. Other violations should be referred to the Indian judicial system as is, for civil or criminal proceedings.

_____X_____

⁵⁰ Regulatory body specific to the Telecom industry

CHAPTER 7 - Conclusion

The issue of opening FDI in retail was initially brought up in 1993 and now, 18 years and many academic publications and political debates later, we are still far from a resolution. I wrote this thesis with the primary objective of understanding some of the concerns which have prevented the Government from allowing FDI in retail; and also to provide a clear picture of what Wal-Mart (as a proxy for large format international retail) can mean to India. The emphasis of my thesis is to allow both parties to understand the benefits and concerns of each other better, so that they may arrive at a solution that is mutually beneficial. Through various examples, I have demonstrated that such a solution has been previously adopted by India and thus by leveraging its experience, the opening of FDI in retail can be replicated with a high probability of success.

Through my research, I have gained a new appreciation for the complexity of the development issues facing India. It has become abundantly clear to me that we have some very smart people in the Government, bureaucracy, academia and the private sector who understand the economic, social and political drivers for growth and its constraints. Also, given the politics of coalition, I understand the herculean challenges for the Government to reach consensus on any matter and the need for immense political courage. Unfortunately, due to the lack of political courage, Governments choose to follow the path of appeasement and, in trying to keep everyone happy, tough decisions are over-looked or postponed for another Minister or Official or Government to consider. It takes a crisis like the Balance of Payments crisis of 1991 to shock people into action and take the right decisions. While this is not unique to India, it is perhaps an opportunity for the government in India to demonstrate that a large and diverse democracy like India can be united in its economic progress. Raghuram Rajan's speech at the Bombay Chambers of Commerce on September 10th, 2008 summarizes the situation quite well:

“many of the reforms in the recent past involved taking off self-imposed shackles... what needs to be done in years to come requires better, cleverer, focused government, rather than less government. With the right policies and some luck, we will become a middle income constitutional democracy (in my life time); but inaction coupled with bad luck, could make us an unequal oligarchy or worse, perhaps far sooner than we think... India is far more resilient than we give it credit for...but it is important for the right minded

people to put their considerable weight behind policies that can set us on the right track”

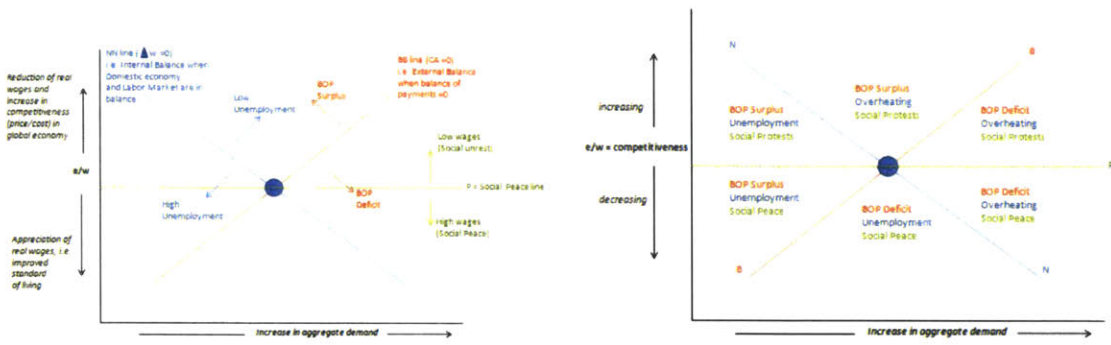
In summary, I suggest that arguments to maintain status-quo by preventing retail to be organized, either by domestic or foreign participation, are in fact a disguised attempt to keep the poor, poor! While there is no doubt that international large format retailers will displace the small unorganized retailers and traders, there is no guarantee that domestic large format retailers will not cause the same displacement. The difference perhaps will be the learning cost that the country will need to bear as the domestic large format retailers mature in their supply chain and retailing processes. A smarter way for the Government will be to realize the benefits that international large format retailers like Wal-Mart can bring to the country. India has the experience of managing FDI in a manner that is consistent with national priorities and I am confident that with smart regulation and controls, the same results can be achieved in retail by using FDI. The alternative is to not organize retail, either by domestic investment or foreign. And even though the Joint Parliamentary Committee (JPC) report has suggested this as the preferred action, thankfully this has not stuck well with the Government and they are not obliged to implement the recommendations of the JPC. If India does not upgrade and organize its retail sector to eliminate the inefficiencies and provide a better livelihood for its people, then the country is making a conscious choice to resign itself to the continued issues of poverty, farmer suicides, subsidies through large safety net programs etc.

Retail by itself is not a silver bullet, however it is one of the key decisions that the Government of India needs to implement for economic growth to be broad based. The first step is to remove the barriers to entry which must then be followed by a commitment to improve the business climate. Contrary to conventional wisdom, I posit that India can replicate the success it has had with companies like Unilever, Maruti, ITC etc. and that Wal-Mart can have a positive economic impact in India. The first step to achieving this result is to understand India and Wal-Mart and avoid the trap of mutual ignorance which over time leads to mutual arrogance. India does not need another crisis to wake-up and make economic reforms. It only needs to recognize the benefits of mutual collaboration. I hope my thesis has been able to bring this point home.

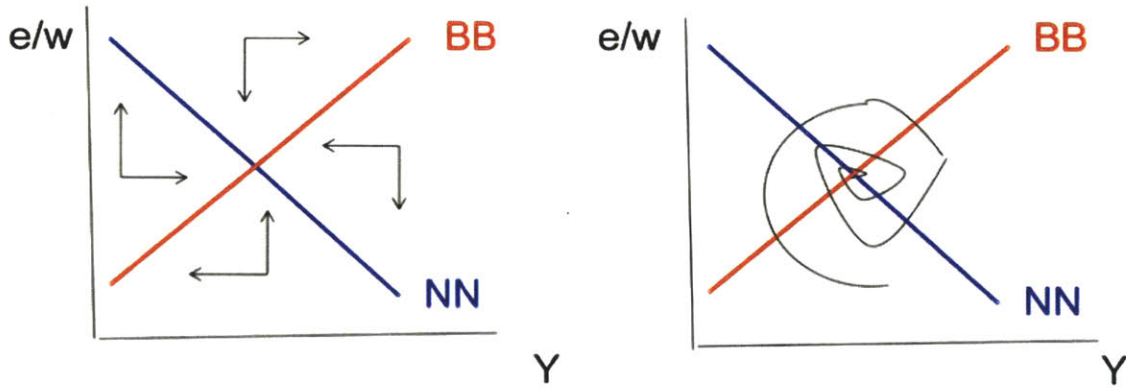
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Appendix 2: BB-NN Model

Key components of the BB-NN model



How economies move along the BB-NN model. Changes take years to manifest.



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