

**Implications of Government Intervention in Foreign Direct Investment:  
The E-commerce Sector in India**

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## **ABSTRACT**

The last few decades have seen significant changes in the international investment landscape and foreign direct investment (FDI) has remained an integral part of it. Since the turn of the century, with an increase in the importance and usage of internet by businesses, the digital platforms of e-commerce have transformed the way in which firms conduct business across international borders. The laws governing the functioning of this sector play a huge role in its future growth. India has demonstrated massive growth in the last few years and its e-commerce sector, in particular, has grown markedly. Today, the sector has reached a market value of approximately US\$20 billion and it is expected to reach US\$120 billion by 2020. Since the liberalisation of the Indian economy in 1991, the Indian government has encouraged foreign investment in various sectors of the economy from manufacturing, infrastructure, to IT and business services. India brought further reforms in 2016 when they relaxed screening processes for foreign investors to encourage them to participate in the e-commerce sector. This recent introduction of policy reforms in the e-commerce sector has raised fears among industry experts that the policy has the potential to have negative implications in the Indian market. The aim of this dissertation is to analyse the potential consequences of the recently introduced e-commerce policy on the Indian retail sector. The research question guiding this study is “How is the recent government permission of 100% FDI in the e-commerce sector in India expected to impact the Indian retail sector?”.

A qualitative analytical stance with interpretivism as the research paradigm has been adopted for this study. Within that, a thematic analysis of secondary sources of data was conducted to derive key themes and acquire a better understanding of the research topic.

The results of this research study suggest that the introduction of the recent e-commerce policy has significantly changed the market conditions in the e-commerce sector in India. The policy has shown signs of reducing predatory pricing, and it has raised hopes of achieving a level playing field in the retail market. However, the policy has also brought on negative implications like the reappearance of fraudulent transactions, negative impact of increased foreign competition on homegrown companies, less e-commerce, and a continuing violation of rules. This has raised fears that the new policy is too restrictive in its effect on controlling the market, and that it will bring negative implications for the retail sector, instead of positive, in the long run. Additionally, there is also evidence of fears that the policy has sparked a speculative bubble in the retail industry, which potentially brings grave consequences for the Indian economy if and when it bursts. Therefore, it is concluded that the government of India needs to play a stronger role in controlling foreign participation in its domestic e-commerce sector and that it needs to come up with a better policy framework to control market conditions and restore equilibrium to ensure sustainable growth of the e-commerce and retail sector in India.

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## **ATTESTATION OF AUTHORSHIP**

I hereby declare that this submission is my own work and that, to the best of my knowledge and belief, it contains no material previously published or written by another person (except where explicitly defined in the acknowledgements), nor material which to a substantial extent has been submitted for the award of any other degree or diploma of a university or other institution of higher learning.

A handwritten signature in blue ink, appearing to read 'Kush', enclosed within a light blue circular stamp.

Kush Shah

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## **CHAPTER 1: INTRODUCTION**

Treading through international arenas to carry out business activities and foreign investments is a tricky and a risky business. If a company is not careful enough with its direction and fails to execute its plans efficiently, then it can face massive consequences. Similarly, if a country is not prudent enough with its policies with respect to foreign investment and international interactions, then it can face a downward curve in the future in terms of its economic and financial growth and development. Foreign direct investment (FDI) has emerged as an integral part of the international investment landscape in the last few decades and it has come to play an important part in the development strategies of developing countries (OECD, 2002). Within that, e-commerce, in particular, has come to take up an important position, especially in the developing nations of the world. In recent years, FDI and e-commerce have grown tremendously in developing countries, especially the BRICs (Brazil, Russia, India, China) countries, and India of all has risen to the challenge and shown immense growth potential in the past decade by becoming the fastest growing economy in the world (GlobalEdge, 2016).

However, despite all the positives demonstrated by the growth potential of e-commerce in India, the sector still faces challenges, in particular a lack of a comprehensive set of rules and regulations with respect to the functioning of this sector (Huang & Tang, 2012). The government of India introduced a new set of policy reforms in March 2016 to address the issues (DIPP, 2016). While this policy reform is expected to bring a positive change in the Indian market, it also potentially brings negative effects on different parts of the Indian economy, not least the domestic retail sector. The booming e-commerce sector is at the forefront of the Indian economy and the new policy reform is going to set the direction for the development of this sector. It is important to investigate the potential impact of this recent policy because of its significance to the Indian economy in the long run. Since the policy is a recent development, its impact cannot be measured. Therefore, the aim of this study is to analyse the potential consequences of this recently introduced e-commerce policy on the Indian retail sector. The overarching question for this study is:

- How is the recent government permission of 100% FDI in the e-commerce sector in India expected to impact the Indian retail sector?

This dissertation contains seven chapters. Chapter One discusses the important role that foreign direct investment has come to play today in the growth and development of a country, and illustrates the significance of the research topic. The chapter also introduces the research question, the objective behind it, and outlines the structure of this study. Chapter Two reviews past research literature on FDI, particularly its effects on home and host countries, its impact on developing countries and the policies adopted by various countries around the world. Chapter Three provides the background of FDI in India and discusses the emergence of e-commerce including the current market trends of this sector. Additionally, the chapter mentions the issues leading up to the formulation of the new e-commerce policy, and discusses the policy

and the intentions behind it. Chapter Four presents the research methodology of this study. The research paradigm, methods, sources and data analysis techniques adopted in this study are outlined in this chapter. Chapter Five presents the findings of this study by identifying the key themes from the data analysis. In Chapter Six, the findings are discussed in light of the academic literature to provide a wider contextual understanding of the empirical data analysed. The impact of the new policy on the e-commerce sector and the Indian economy is outlined in this chapter. Chapter Seven concludes the research by presenting the research conclusions. Limitations of this research and recommendations for future research are also presented in this chapter.



## **CHAPTER 2: LITERATURE REVIEW**

### **2.1 Introduction**

As outlined in the introduction, the aim of this study is to analyse the potential impacts of the recently introduced e-commerce policy on the Indian retail sector. This chapter will review past research literature on FDI that constitutes the theoretical background of this study. In particular, the background to FDI, the policies adopted by various countries around the world, its effects on home and host country economies, especially that of a developing country, will be outlined in the following sections.

Foreign direct investment is an investment made by a company or individual of one country into the business interests of another country, in the form of either establishing business operations or acquiring business assets in the other country, such as ownership or controlling interest in a foreign company. Foreign interaction among countries on a global scale exists in part because no country has all the resources in the world. Therefore, foreign trade and foreign investment came into existence. The Organisation for Economic Co-operation and Development (OECD, 2002) states that since the mid-20<sup>th</sup> century, foreign direct investment has come to play an important role in the growth and development of countries around the world. Appearing frequently in the literature, developing economies see FDI not only as a source of income growth and employment, but also as a source of providing technological and operational efficiencies for their domestic businesses (OECD, 2002). A government's development objectives, along "with the ability to choose the degree of policy intervention and factor endowments, determine a country's FDI strategy" (Willem te Velde, 2001, p. 3). FDI laws of a country can be with respect to either outward FDI or inward FDI. Outward FDI refers to investment done from a country into a foreign market/another country. Inward FDI refers to investment done from a foreign country into the sectors of a local economy (OECD, 2002).

There are several international institutions that promote FDI interactions globally. Some of the key international institutions relevant to the government of global FDI are World Trade Organisation (WTO), United Nations Conference on Trade and Development (UNCTAD), and the Organisation for Economic Co-operation and Development (OECD). These international institutions play an important role in advising and governing FDI policies of their member countries to promote trade and foreign investment, and achieve collective economic and social growth and development around the world.

According to Hill (2015, p. 245), “until the 1990s, there was no consistent involvement by multinational institutions in the governing of FDI. This changed with the formation of the World Trade Organization (WTO) in 1995. The WTO embraces the promotion of international trade in services”. The main aim behind the formation of WTO was to standardize and regulate the flow of FDI across the globe. In 1997, two extensive multinational agreements were reached to liberalize trade in the telecommunications and financial services sectors. The WTO member countries were made to liberalise their inward FDI policies with respect to these sectors, thus opening up their economies, as a part of these multinational agreements (Hill, 2015).

Moreover, the increasing involvement of the United Nations Conference on Trade and Development (UNCTAD) in international trade has further helped in the setting up of universal guidelines to promote FDI on a global scale. The UNCTAD principally deals with trade, investment and development issues and aims to “maximize the trade, investment and development opportunities of developing countries and assist them in their efforts to integrate into the world economy on an equitable basis” (UNCTAD, 2001, p. 1).

In addition, 35 of the major countries of the world have also come together to form the intergovernmental economic organisation, The Organisation for Economic Co-operation and Development (OECD). Established in 1961, the organisation “provides a forum in which governments can work together to share experiences and seek solutions to common problems” (OECD, 2017, p. 1) to improve the economic, social and environmental well-being of people around the world. Since their inception, these organizations including the OECD have played a prominent role in governing the FDI rules across the globe (OECD, 2002).

## **2.2 Government policy instruments to influence FDI**

It is commonly agreed in the literature that the government plays a critical role in determining a country's FDI policies as these policies will direct the way in which a country will progress with the incoming and outgoing of foreign investment (Willem te Velde, 2001). The government can influence this by either putting restrictions and strict laws for certain sectors, or by relaxing laws and providing incentives to foreign investors to invest in certain sectors of the host country economy. Lall (1995) explains four approaches to the degree of government intervention, involving both restrictions and incentives to investment, depending upon the government's objectives. The first is the passive open-door policy, which involves limited intervention from the government. The second is the open-door policy with selective intervention in order to improve supply conditions. The third approach strategically targets FDI. The fourth approach focuses on a restrictive policy. Governments use different policy instruments to control the flow of FDI into the local economy.

Host country governments use a wide range of controls to adopt policies that restrict FDI in certain sectors of the economy. Some of the common practices of restrictive policies are maintenance of a negative list, sectors where FDI is fully prohibited, and putting ownership restraints to limit ownership by a foreign entity up to a certain fixed limit (Hill, 2015). The host country can also discourage foreign investment by charging import tariffs and high rates of taxation. Governments usually adopt this stance to protect its domestic companies from competition or to safeguard and maintain control over certain key sectors of the economy on the grounds of national security (Peng, 2016).

On the other hand, governments can also adopt a lenient position with its foreign policies and open-up certain sectors of the economy to invite foreign investment. This can be done by giving tax benefits, grants, subsidies and investment incentives to the foreign investors (Hill, 2015). All this has also led to the emergence of Special Economic Zones (SEZs), wherein business and trade laws are different and much more relaxed than in other parts of the country. Woolfrey (2013) points out that the creation of SEZs by the host country may be motivated by the desire to attract FDI. According to the World Bank (2011), the aim of these SEZs is to increase trade, investment, job creation and effective administration. Bailey (2017) discusses that institutional factors have come to play a huge role in attracting FDI to the host country economy since the turn of the century. Factors such as foreign investment laws, political stability and democratic institutions attract inward FDI, whereas factors like cultural distance, corruption and tax policies block inward FDI (Bailey, 2017; Globerman and Shapiro, 2003; Loree and Guisinger, 1995).

In sum, governments adopt FDI policies for their countries depending upon their strategic objectives and industry requirements. The ultimate aim of the introduction of various international policies is generally the collective growth and development of the economy, while safeguarding and enhancing the well-being of citizens. Investment policies can be implemented either to support or restrict new foreign investments and this can be in relation to either specific sectors or industries, or over all industries.

### **2.3 FDI policies in the advanced economies**

As outlined above, the developed or the advanced economies of the world have dominated the foreign investment space historically. Countries like the United States, Germany, France, Australia, Japan, and other developed countries have been the major players in the foreign investment scene, especially in outward FDI (Jain, 2006). The government of these countries have adopted strict policies and security measures to safeguard their position on a global platform. For instance, according to the OECD (2013), Australia has adopted strict policies and laws with respect to inward FDI. However, once approved by The Australian Foreign Investment Review Board, foreign investors are given similar treatment as enjoyed by domestic investors. The Australian government also provides important guidelines that help them assess the potential impact of an investment on the country's economic, financial and competitive interests with respect to their environmental, trade and tax policies. Like most developed countries, Australia maintains a tight screening process and only gives restricted access to the real estate and natural resources sector (OECD, 2013).

The United States of America has been one of the strongest players and contributors of foreign investment. According to Lee (2010), major policy developments began in the 1980s through The Committee on Foreign Investment in the United States (CFIUS) with the increase in foreign investment transactions with Japan. However, the poor performance of American financial markets and its players during the global financial crisis in 2008, in addition to the rise of emerging economies, led to the implementation of a stricter foreign investment screening process for inward and outward FDI (Mathur & Dasgupta, 2013). Importance was laid on national security and reducing political uncertainty surrounding FDI (Truman, 2011). Amendments regarding labour standards and framework around foreign company's ownership limit and sectors where foreign investment will be allowed were addressed. The new, strict yet improved foreign policy and investment review processes were aimed at having a fair, transparent and a non-discriminatory business environment that benefited the American economy (Gaige, 2012).

In contrast, according to the OECD (2013), the European Union (EU) treaties signed by the German government play a critical role in the country's foreign interactions since most of their outward FDI targets countries of the EU. Researchers note that the German government provides strong and active support to their MNCs for outward FDI in the form of legal advice and mitigating political risk. The government has also adopted a stance to provide advisory services to help and ensure that investments made in developing economies are a success (OECD, 2013).

In sum, the literature shows that there is a running theme among most developed countries of adopting stricter policies in the FDI sector. These countries have held a strong position internationally over a long period of time due to their strong foreign policies and effective implementation of diverse laws, rules and regulations to maintain a smooth-flowing process of foreign transactions with various countries of the world (Nunnenkamp, 2004).

However, the last decade has seen a significant drop in investments to and from the developed economies of the world. According to the OECD (2013), the European Union saw a fall in FDI outflows by almost 50% from US\$977.8 billion in 2008 to US\$418 billion in 2012. Its FDI inflows fell from US\$538.4 billion to US\$323.8 billion in the same period. The United States saw a slight increase in outward FDI from US\$329.1 billion in 2008 to US\$351.4 billion in 2012 but experienced a significant decrease in its FDI inflows from US\$310.1 billion to US\$174.7 billion over the same period. Japan's FDI outflows went down slightly from US\$128 billion to US\$122.5 billion between 2008 and the first quarter of 2012, and its FDI inflows saw a massive 90% decline from US\$24.4 billion to US\$2.1 billion in the same period. Researchers believe that the global financial crisis played a major role in such a decline of FDI flows to and from the developed countries (OECD, 2013). According to UNCTAD (2017), the developed economies as a whole have seen a fall in FDI outflows from US\$1.8 trillion in 2007 to just over US\$1 trillion in 2016. Their FDI inflows have fallen from US\$1.2 trillion in 2007 to US\$1 trillion in 2016. However, they are slowly on the rise again. UNCTAD (2017) also mentions the decreasing growth rate of GDP in developed economies of the world from 2.1% in 2015 to 1.7% in 2017.

## **2.4 FDI policies in the emerging economies of BRICs**

In contrast to the poor performance demonstrated by the developed countries in the last decade, the same period has observed the tremendous growth of the developing economies of the world, especially the BRICs. Their strong performance during the global financial crisis backed up by reformed foreign investment policies and government support has helped them grow in importance in the foreign investment landscape. Additionally, the BRICs countries have managed to acquire more foreign exchange reserves than ever, thus making them financially solvent and enabling them to maintain a good liquidity position in the global market (Jaeger, 2009).

According to UNCTAD (2017), a quarter of the largest 500 multinational companies of the world are now from the BRICs group of countries. Moreover, their FDI outflows rose by 21% in 2016 alone, putting their outward stock at a value of US\$2.1 trillion. FDI flows into the BRIC countries have also risen by 7% in the last year to US\$277 billion. Researchers note that in the last decade, there has been a constant rise in FDI to and from the BRIC economies. Additionally, UNCTAD (2017) notes that the developing economies have shown a rise in GDP growth rate from 3.8% in 2015 to 4.4% in 2017. This demonstrates the changing trends and increasing influence of the developing economies of the world in global investment. Since the turn of the century, the emerging economies of the BRICs have altered the international investment landscape and these countries have started to strongly influence the patterns in which international business is conducted particularly in relation to the traditional developed countries of Europe and the United States. India cuts a prominent figure in the BRIC group of countries, and since this study is based in the context of India, it may be useful to look at what the other BRIC countries are doing in terms of their FDI policies.

Brazil has adopted a regional integration process by connecting together regional areas and neighbouring countries like Chile and Venezuela through investment, with major investments in the service sector. Its main investment policy aims to gain financial strength and access to foreign markets in order to reinforce the trade and distribution networks of Brazilian companies. The service sector, natural resources, and the food and beverages sector are given priority over the manufacturing sector by adopting liberalised foreign investment laws (Sauvant & Ortino, 2013). The government recently laid investment restrictions on various sectors like rural real estate, media and broadcasting, telecommunications, hydraulic power generation, and telegraph and postal services (Mathur & Dasgupta, 2013). Sauvant & Ortino (2013) note that significant support and encouragement in the form of financial and bureaucratic support is given to local investors to invest in foreign markets. Brazil's FDI policy has focused on strengthening outward FDI more than encouraging inward FDI.

Russia has seen constant increase in its outward FDI since 2003 and has focused its investment trends in the natural resources sector. Russia has adopted restrictive FDI policies in the country over a long time. Kalotay & Sulstarova (2010) note that the Russian government implemented restrictive policies for investment in the media and broadcasting sector in November 2011 with a market cap of 50% ownership for foreign investors in this sector. In addition, certain sectors were taken off the strategic industries list in order to broaden and increase foreign investment participation in them. Recent investment trends suggest an increase in investments in the telecommunications sector (Kalotay & Sulstarova, 2010). Private investors are motivated to invest in foreign markets with the aim to improve operational efficiencies and escape high taxes, bureaucratic constraints, regulatory restrictions and other uncertainties back home. However, the government is trying to change that trend now by making more and more state-owned enterprises (SOEs) invest in foreign markets instead. Sauvant & Ortino (2013) mention that inward investment restrictions are being adopted by the Russian government, with any investment over US\$10 million requiring mandatory Central Bank approval, in order to maintain control over all sectors.

State-owned enterprises (SOEs) have dominated the investment scene in China for a long time. The services sector, manufacturing sector, IT sector and natural resources sector have enjoyed relaxed FDI laws for a number of years now with major foreign investments being made in these sectors in particular (Kolstad & Wiig, 2012). According to the OECD (2013), the government liberalised additional sectors like real estate and media and broadcasting sectors after 2008, to further open-up the Chinese economy to the world. The government not only focuses on inward FDI but it also encourages Chinese firms to increase their participation in outward foreign investment by making significant policy changes. This was initiated way back in 1999 with the implementation of the 'Go Out' policy to encourage outward FDI (Wang & Wanxia, 2016). China has in the last decade emerged as an important investment player, both in terms of inward FDI and outward FDI, with their domestic firms increasingly indulging into international mergers and acquisitions to expand their business operations across national borders (OECD, 2013). China's decision to become a member of the WTO in 2001 played a huge role in reforming their international trade and investment policies.

These markets of developing nations have become new targets for international investment (Tarzi, 1999). One of the major reasons behind it is that the developing countries, especially the BRICs, have been massively untapped markets of the world until recently. Their sizes in terms of population and growing middle class show great potential for success of foreign invested ventures. In addition to that, the high rates of economic growth demonstrated by them in the last decade has strengthened their attractiveness to foreign investors. And finally, the strength and stability shown by these economies during the global financial crisis in 2008, while the developed economies struggled badly, has further cemented the case (Sauvant & Ortino, 2013).

## **2.5 FDI effects on home and host countries**

Over the past half century, governments of developing economies have tended to liberalise their laws and rules and regulations with respect to the admission and establishment of foreign investment projects in their country. Foreign direct investment brings certain benefits and costs with it for the home (source) countries and host (recipient) countries. In the previous section, we discussed the different types of FDI policies adopted by various developed and developing countries around the world. In this section, we expand on the impact of FDI and the benefits and costs experienced by such countries.

Traditionally, the process of investing in other countries used to be an exclusive privilege of the developed and industrialized countries of the world (Aykut and Ratha, 2004). Up until the 1990s and early 2000s, developed countries like the United States, Germany, Japan, and France have been the main sources of outward FDI with around 60% of the world FDI stock distributed among them in mid 2000s (Jain, 2006). Nunnenkamp (2004) points out that these countries enjoy such a strong position in the global market due to their strong currencies and the considerable length of time that they have held it for. As major home countries of FDI, these countries face certain benefits and costs as a result of their foreign investments.

Two of the most prominent costs of FDI on home country is capital outflow and job loss (Peng, 2016). With investments being done in foreign countries, the home countries naturally suffer from an outflow of capital. Hill (2015) points out that the balance of payments of the home country suffers as a result of outward FDI, especially if FDI is used as a substitute for direct exports. With respect to job loss, investments made abroad by MNCs lead to a loss of jobs in the domestic economy and takes away potential job creation scenarios with it (Peng, 2016). This is especially the case when FDI is seen as a substitute for domestic production (Hill, 2015).

However, FDI also brings certain benefits to the investing home country. Some of the most common benefits are earnings from profits from FDI, increased exports and learning of valuable skills from foreign markets resulting in a reverse resource-transfer effect (Hill, 2015). In addition to that, Hill (2015) and Peng (2016) observe that FDI provides home country MNCs access to a cheaper source of resources to conduct their business operations. It also provides an opportunity to expand their market across international borders and foresee growth (OECD, 2002).

In contrast, there are also specific benefits and costs of FDI on the host country. The government of the host country usually encourages foreign direct investment by providing investment incentives to foreign investors that will act as crucial drivers in reaching the government's economic developmental objectives (Lim, 2005). Researchers widely agree that a lack of such investment incentives could lead to inefficiency of the FDI policy and eventual failure of a foreign investment project (Lall, 1995). Therefore, it is important for the host country to establish a sound investment incentive system in order to maximise the impact of foreign investments. Theoretically, it has been well documented by researchers that with the transfer of technology, operational efficiencies, technical know-how, productivity and managerial skills, FDI helps in the modernization of the host country economy, especially if it is a developing country (Grossman and Helpman, 1991; Hermes and Lensink, 2003; Barro and Sala-i-Martin, 1995; Jensen and Jensen, 2006). Battena and Xuan Vinh (2009, p. 1622) support the view by noting that "FDI can create an international network that optimizes the movement of the domestic products across borders, create cost savings and related scale and scope economies for the corporations" of the host country.

Hill (2015) and Peng (2016) point out the three common costs of FDI on the host country. First, increased competition from foreign entities sometimes proves to be too much for local small-scale companies and this puts them out of business. In certain cases, this also leads to the market getting monopolised by the foreign MNCs. For example, as Peng (2016) documents, the global cola war between Coca-Cola and PepsiCo has wiped out most of the small, local beverage companies around the world. Second, outflow of profit from the foreign subsidiary to its parent company in the home country can result in a negative balance of payment for the host country. Third, experts argue that inward FDI leads to a loss of sovereignty in the host country since the economic interests of home countries and hosts countries do not necessarily always match.

However, inward FDI benefits generally outweigh its costs for the host countries. Buckley and Casson (1985) and Nunnenkamp (2004) stress the importance of FDI by pointing out the typical positive economic effects of inward FDI on host countries like advancement of the domestic industrial structure, increase in foreign exchange reserves, rising employment and job creation, improvements in the export sector and regional development. Scholars commonly agree that FDI interactions have also helped improve political relations between the home and host countries and lead to the creation of a global, improved business environment to work in (Jensen and Jensen, 2006). The rise in international trade and investment has enabled governments to come out with flexible and cooperative laws, foreign policies, and rules and regulations with the aim to maximise the positive impact of FDI on the home and host countries (Luo, Xue, & Han, 2010).



Lim (2005) has classified different countries as per their primary inward FDI objectives. While regional expansion has a local, area specific developmental effect, objectives like job creation, enhanced exports, advancement of industrial structure and an increase in foreign exchange reserves have a national level effect on the country. Figure 1 demonstrates the different objectives a host country government sets out to achieve by attracting inward FDI. What is also worth noting is that India has prioritised achieving all five of the inward FDI objectives.

<i>Local</i>		<p><b>Regional expansion</b> Chile, France, India, Indonesia, Ireland, Japan, Nigeria, Rumania, Taiwan, Thailand, U.K., U.S.A., Uruguay, Libya, Myanma (15 countries)</p>
<i>National</i>	<p><b>Advancing industrial structure</b> Bangladesh, Canada, Côte d'Ivoire, Czech, Denmark, Dominican Republic, Guatemala, Hungary, Italy, India, Indonesia, Japan, Kenya, Korea, Malaysia, Morocco, Myanma, Nigeria, Norway, Oman, Panama, the Philippines, Poland, Portugal, Rumania, Saudi Arabia, Singapore, Slovenia, South Africa, Sri Lanka, Taiwan, Turkey, Ukraine, Uruguay, Venezuela, Zimbabwe (37 countries)</p> <p><b>Enhancing exports</b> Chile, Egypt, Germany, India, Indonesia, Myanma, Nigeria, Oman, Pakistan, Peru, Rumania, Saudi Arabia, Slovenia, South Africa, Taiwan, Thailand, Uruguay, Zimbabwe (18 countries)</p>	<p><b>Creating employment</b> Austria, Belgium, Brazil, Columbia, Côte d'Ivoire, Denmark, Egypt, France, Germany, Greece, Guatemala, Italy, India, Indonesia, Ireland, Japan, Kenya, Lebanon, Mexico, Morocco, Myanma, the Netherlands, Nigeria, Oman, Panama, Peru, the Philippines, Poland, Portugal, Rumania, Saudi Arabia, Slovenia, South Africa, Spain, Sri Lanka, Taiwan, Thailand, Turkey, U.K., U.S.A., Ukraine, Uruguay, Venezuela, Zimbabwe (44 countries)</p> <p><b>Increasing foreign exchange reserves</b> Bangladesh, Dominican Republic, Guatemala, India, Jordan, Kenya, Lebanon, Nigeria, Pakistan, Peru, Rumania, South Africa, Thailand, Uruguay (14 countries)</p>

*Figure 1: Primary inward FDI objectives for host countries around the world (Source: Lim, 2005, p. 69).*

## 2.6 Impact of FDI on developing countries

FDI plays an important role on a global scale today as it helps to bridge the gap between developed and developing countries (Sharma and Kumari, 2015). Although a host country government invites FDI with the intention to improve its economy, it is worth noting that this decision may backfire as inward FDI brings some negative aspects with it as well. Zwinkels et al. (2008) suggest that inward FDI can impact the growth of the local economy in different ways, depending on the nature of investment undertaken by the foreign investors. Despite a vast amount of existing literature on FDI and its impact on the growth of host economies, empirical studies have shown mixed results with some reporting a positive effect while others reporting a negative effect (Buckley et al., 2007; Meyer, 2004; Meyer & Sinani, 2006). While most developed countries have demonstrated a positive impact of FDI on their economy's growth, studies on developing economies have showcased either negative or no relation between FDI and growth for their economies (Borensztein et al., 1998; Schneider, 2005; Akinlo, 2004).

Zwinkels et al. (2008) point out that most studies look at the impact of the foreign MNC within the same industry, and that macroeconomic studies focusing on knowledge spillover effects of inward FDI are scarce. As noted earlier, one of the major drawbacks of allowing FDI to a host country economy is the increased competition in the market for local companies from foreign MNCs, thus resulting in an unstable market, small-scale local companies going out of business, and the foreign MNC monopolising the market (Blomstrom and Kokko, 1997; Hill, 2015; Peng, 2016). Caves (1971) proposes that increasing competition from a foreign company can stir up the established patterns of 'gentlemanly competition'. A more active rivalrous behaviour will either improve market performance of that industry or it will eventually lead to the downfall of domestic companies and run them out of business, thus destabilising the market equilibrium (Caves, 1971).

According to an investigation by Aitken and Harrison (1999), it was discovered that the correlation of increasing levels of foreign participation in the host country economy with increased productivity for domestic companies was limited to only certain small enterprises. While searching for spillovers in their study between joint ventures and companies with no foreign investment, they found that foreign investment was "negatively correlated with the productivity of domestically owned firms in the same industry. The gains from foreign investment appeared to be entirely captured by the foreign joint-ventures" (Moran, n.d, p. 294). Additionally, studies by Haddad and Harrison (1993), Encarnation and Wells, Jr. (1986), and Wasow (2003) provided further supporting results that FDI had a negative net contribution to the host country economy and that it failed to show a significant beneficial impact on the host country economy and its domestic companies.

Moreover, Truman (2002) reviewed the economic performance of 12 major emerging economies of the world, on a scale of FDI as a percentage of the GDP, from 1980 to 2000 to assess the impact of FDI on host country economies. Truman noticed that South Korea and Thailand, the two countries with the greatest growth performance were at the opposite ends of that scale. While Thailand was above the group average,

South Korea was found towards the lower end of the scale. Moreover, of the two countries with good growth performance, Malaysia showcased a high rate of FDI, whereas India showed the lowest. Countries with moderate growth performance – Egypt and Turkey – and weak growth performance – Mexico, Brazil, Argentina, Philippines – had either average or below average reliance on FDI. However, countries with negative growth performance like Venezuela and Nigeria had average and above average participation of FDI in their GDP respectively. Thus Truman (2002, p. 16) concluded that “on the whole, this is not a very convincing picture in favour of FDI as providing a valuable and stable stimulus to growth”.

Since its inception, the relation between international business and host country governments has gone through three different eras of evolution, namely Confrontation, Accommodation and Competition (Boddewyn, 2016). Historically, the rules and regulations of foreign investment have been very tight. “Fearful of the economic and industrial power of foreign investors (and particularly of Western multinational corporations), many states in the nineteenth and early twentieth centuries kept exceedingly tight reins over the companies that invested in their territory” (Rugman and Brewer, 2011, p. 214). However, in recent years, “hungry for the capital and technology of foreign firms, many states are anxiously competing to attract investors, offering them financial incentives and the promise of preferential treatment” (Rugman and Brewer, 2011, p. 214). Investment incentives play a major role in attracting FDI to a country, especially in a developing economy like India. OECD (2000) noted that a foreign investor’s decision to invest in a state in India was highly dependent of availability of good quality infrastructure like water, energy, transportation and telecommunications to support its business activities. Hence, a state’s provision of investment incentives play a significant role in attracting foreign private investment into the country (Rugman and Brewer, 2011). A great example of this would be when the state government of Tamil Nadu granted various incentives to the giant automobile company, Ford, for its joint-venture plant with the Indian firm Mahindra. The incentives included providing a location for the plant that is close to an international seaport and international airport, availability of skilled and literate labour, a 14-year exemption on sales tax levied from both state and central government, free-hold ownership of the land, availability of a parts supplier close to the plant, and other tax-relief incentives. However, the OECD (2000, p. 58) does point out that competition among the state governments of India to attract FDI “tends to exacerbate rather than to ameliorate long-term growth differentials and income inequalities among regions within the country”. Tavares-Lehmann et al. (2016) suggest that this constant competition among states to capture foreign investment is nothing but a race to the bottom, and that careful formulation of investment policies is crucial to efficiently guide public and private resources for improved social, environmental and economic outcomes in the host country economy. In terms of policy implication, increasing attention is being given to social, environmental, cultural and political implications of international business activity, particularly within the context of global FDI flows into a developing host country (Rugman and Brewer, 2011). However, the developing economies of the world face an important decision today whether to limit the competition from foreign companies and eventually

its negative effects. Similarly, it is also important to address whether to limit policy competition and its negative effects among state governments of a country. There is an urgent need for transparency and accountability among government bodies with the policy competition leading to creation of “graft, corruption and rent-seeking behaviour. It raises the delicate question of how to ensure the accountability of government officials, particularly those involved in the negotiation of incentives, and points to the need for governments to be able to monitor their own use of incentives” (OECD, 2002, p. 122). Moreover, the OECD (2002) also argues that policy makers in the developing countries should seek to agree on a certain level of basic principles when it comes to formulation of international investment policies.

According to Jensen and Jensen (2006), the liberation of entry conditions for foreign investors during the last decade has become one of the most important changes in FDI laws in developing countries like India. Although some consensus exists on the positive impact of FDI on the host country economy, many scholars have also been critical of FDI in terms of its negative impact on the domestic economies and societies. However, the impact of FDI on economic growth largely depends on the domestic conditions prevailing in the host country economy. Therefore, the host country governments, especially in the emerging economies, have a critical role to play in formulating the correct policy frameworks and create investment conditions in a way to maximise the positive effects of inward FDI and minimise the negative effects of inward FDI on the host country’s economic growth (Forte and Moura, 2013).

## **2.7 Summary**

A large body of research literature on international business and FDI has emerged in recent years with an overall recognition that foreign interactions have a positive influence on the development of a country. This chapter reviewed previous literature on FDI that underpins the empirical part of this study. The theories suggest that FDI plays a significant role in economic growth and development of the host country economy. This is of particular importance to the developing countries of the world. These countries see FDI as a source of income growth, job creation, and technological and operational advancements. However, FDI also brings certain costs with it especially in the case of the developing countries. The developed economies of the world are known to adopt stricter FDI policies to safeguard their economies from foreign investment. However, the developing economies, especially the BRICs, have adopted relatively open-door policies to welcome FDI into their countries. The aim of this research project is to contribute to the international business literature on the effects of FDI on the host country economy, especially that of a developing country, by analysing potential impacts of the recently introduced e-commerce policy on the Indian retail sector. The next chapter will provide background information on the FDI scenario in India, emergence of the e-commerce sector and outline the recently introduced policy reforms that will form the basis of this study.

## **CHAPTER 3: FDI AND THE EMERGENCE OF THE E-COMMERCE SECTOR IN INDIA**

### **3.1 Introduction**

The previous chapter provided an overview of past literature on FDI, the policies adopted by various countries around the world, and the impact such policies have on them. This chapter will provide background information on the FDI scenario in India, the emergence of the e-commerce sector and outline the recently introduced policy reforms in this sector.

### **3.2 FDI policies in India**

India welcomed foreign investment with the introduction of economic reforms in 1991 by focusing on liberalization, privatization and globalisation. This set of policy reforms opened the doors of the Indian economy to the world. This led to a massive rise in inward and outward FDI of the country (OECD, 2002). According to Hattari and Rajan (2010), outward FDI increased with the government's increased support to domestic companies to invest in the United States, Russia, and other developing economies of the world. One of the main motives behind such investments was to acquire operational and technological efficiencies for the domestic businesses. India also saw a massive rise in inward FDI from US\$50 million in 1990 to US\$6 billion in 2004 (Hattari and Rajan, 2010).

The government of India has allowed inward FDI through automatic and government approval routes to the foreign investors since 1999. Under automatic route, inward FDI is allowed without the foreign investor requiring prior approval of the government or the Reserve Bank of India, that is, they are not required to go through a screening process (Reserve Bank of India, 2017). Under government approval route, "foreign investment in activities not covered under the automatic route requires prior approval of the Government which are considered by the Foreign Investment Promotion Board (FIPB), Department of Economic Affairs, Ministry of Finance" (Reserve Bank of India, 2017, p. 1). The government saw FDI as an integral part of the globalisation of the Indian economy.

Researchers observed that the manufacturing sector saw a significant upsurge in investments in the initial years. Kang (2012) noticed that the pharmaceutical industry, in particular, received massive influx of foreign direct investment post 2001, after the government allowed investment up to 100% in pharmaceutical manufacturing through the automatic route. "This decision was based on belief in popular economic theory, views of policy makers and the government regarding the benefits offered by private FDI" (Kang, 2012, p. 52). The initial investment trends started with a policy focus on the manufacturing sector, however, that changed at the turn of the century when investment trends were shifted towards the IT and business services sector 2004 onwards (Mathur & Dasgupta, 2013). Big companies like Wipro, Infosys and Tata were great beneficiaries as a result of this change of trend, and their success encouraged many small-scale businesses to venture into foreign investment (Sauvant et al., 2010).

Moreover, the government has allowed over 50% of ownership limits to foreign investors across various sectors of the Indian economy, including manufacturing, telecommunications, financial services, agriculture and mining, petroleum and natural gas (DIPP, 2017). According to the OECD (2013), the broadcasting sector has seen liberalised FDI laws since 2011 to attract inward FDI, and the Indian government made policy amendments in the following year to allow domestic MNCs additional operational flexibility in their foreign investment operations around the world. The defence sector, too, saw the light of the day in 2016, when the government allowed “foreign companies to own as much as 100% equity in the local defence sector through the government approval route in cases where it is likely to result in access to modern technology” (Bhasin, 2016, p. 232). The motive behind the decision was to attract prospective investors that would help achieve greater FDI and a boost in productivity (Bhasin, 2016).

Between 2007 and 2014, the FDI inflows had become stagnant in the country with only slight increase in 2009 and 2011. FDI inflow had only risen by around US\$2 billion, from US\$34.84 billion in 2007 to US\$36.05 billion in 2014 (DIPP, 2017). However, the country took a major step, under Prime Minister Narendra Modi, towards drawing additional foreign investment in September 2014 with the launch of the ‘Make in India’ initiative which aimed to “transform India into a global design and manufacturing hub” (Make in India, 2014, p. 1). This resulted in a massive influx of foreign investment money into the Indian economy. By the end of the financial year 2016-17, the FDI inflows to India had reached a record US\$60.08 billion as against US\$36.05 billion from the financial year 2013-14. Mauritius, Singapore, Japan and United Kingdom have emerged as the top investing countries in India with around 65% of FDI inflows shared among them (DIPP, 2017). Total FDI inflows have seen a 51% rise since the launch of Make in India initiative (Financial Express, 2017), with the service sector, manufacturing sector, IT sector, construction development and telecommunications sector witnessing highest inflow of FDI (DIPP, 2017).

According to a release by Ministry of Commerce and Industry, India has now become “the topmost attractive destination for foreign investment” (Ray, 2017, p. 1). Since assuming power in May 2014, the Modi government has transformed the face of the Indian economy by relaxing 87 FDI rules across 21 sectors in order to accelerate economic growth and boost jobs (Ray, 2017). Bhasin (2016) noted that since the launch of the Make in India initiative in 2014, the Indian government has liberalised previously conservative sectors like rail infrastructure and defence, in addition to introducing reforms in the construction development sector, medical sector and financial sector. Other sectors like retail trading, broadcasting, air transport, insurance and pension have also seen an overhaul of policies to promote ease of doing business in the country, as per the ministry’s release (Financial Express, 2017). In 2015, the government also permitted 100% FDI in retail trade on food products on the condition that the products were manufactured or produced in India (Ray, 2017).

This growing importance of FDI in India has intersected with the advancement of internet and information and communication technology (ICT) in recent years. Skudiene et al. (2015) suggest that usage of internet

to conduct international business is becoming more prevalent by the day. Additionally, McCreary (2009) points out that the internet has revolutionised the way in which business is done today and this has had a great impact on business execution and innovation. Therefore, acquiring expertise in this sector has played a great role in India emerging as a global market leader in this sector.

Information technology has played a considerable role in the development of India's economy. At the turn of the millennium, India shifted its FDI focus towards information technology and the business services sector (Mathur & Dasgupta, 2013). Singh (2017) highlights that the benefits of government investment in IT can be seen in many sectors of the economy including software export, IT-Business Process Outsourcing services, rural development, e-commerce, the manufacturing sector, and various forms of e-governance, including public systems and services. India saw great success in this industry due to the operational and managerial success acquired through foreign investments. This in turn positively affected various sectors of the Indian economy (Singh, 2017). FDI has promoted economic development by improving productivity growth, as in the case of IT sector in India, but the exact relationship between foreign MNCs and their impact on the host country economy varies from industry to industry, and country to country, among most emerging economies (Blomstrom and Kokko, 1997). The privately owned MNCs of India focused on improving their core competencies first and foremost before getting into increasing their scale of business operations on an international level (Gammeltoft, 2007; Kumar, 2007). Bhaumik and Driffield (2011) note that special economic zones (SEZs) have played a very important role in India, since their introduction in April 2000, in attracting inward FDI into the country and ensuring the smooth transition and success of foreign invested ventures in the country.

This convergence of FDI with internet and ICT development has resulted in the growth of the e-commerce sector in India, the foundations of which were laid in June 2000 when the government of India came out with the Information Technology Act. The purpose of the act was to facilitate electronic governance across different sectors of the economy and give legal recognition to e-commerce transactions in the country. Cyber laws were introduced and a regulatory framework was established as a part of the Act (Pawar & Kolekar, 2015).

In simple terms, e-commerce refers to an online platform or marketplace that facilitates buying and selling of goods and services electronically. Since its inception in the 1970s, e-commerce has seen substantial development over the years (The Guardian, 2013). It claimed worldwide popularity during late 1990s and early 2000 when it experienced a period of extreme growth in the importance and usage of internet by businesses and consumers. On a global level, companies like Amazon and Alibaba have emerged as market leaders in this industry. In 2017, the e-commerce industry demonstrated global retail sales over US\$2.29 trillion. Moreover, the global retail e-commerce sales are projected to grow to US\$4.47 trillion by 2021 (eMarketer, 2017).

In India, the development of e-commerce has helped micro, small and medium-sized enterprises (MSMEs) in generating business opportunities at a low cost by providing them with means of finance, technology and training. Today, e-commerce is seen as an opportunity for business-to-business (B2B) and business-to-consumer (B2C) start-ups (IBEF, 2017). However, despite the many positives of this sector, foreign investors still face many obstacles doing business in India due to the lack of a comprehensive framework in government policies regarding FDI. Consequently, authorities have been advised to reduce obstacles for foreign investors (Huang & Tang, 2012). Until 2016, FDI in e-commerce was not allowed for the single brand or multi-brand retail companies. The government only allowed 100% FDI in B2B e-commerce but none in the B2C e-commerce. However, that changed in March 2016 when The Department of Industrial Policy and Promotion (DIPP) introduced new reforms, which allowed 100% FDI in B2C e-commerce under automatic route in the marketplace based model of e-commerce. This included a faster clearance window and no prior approval from the Foreign Investment Promotion Board (FIPB) for the foreign investors (DIPP, 2016). The reforms were introduced to provide clarity on the e-commerce sector on account of prior lack of guidelines in relation to this sector, and to clearly define and legitimize existing business of e-commerce companies operating in India.

### **3.3 The e-commerce sector**

As discussed in the previous section, the seeds of e-commerce in India were sown in June 2000 with the formulation of the Information Technology Act to facilitate electronic governance across different sectors of the economy and give legal recognition to e-commerce transactions in the country (Pawar & Kolekar, 2015). Essentially, there are two kinds of business models under e-commerce: the inventory based model and the marketplace based model. “Inventory based model of e-commerce means an e-commerce activity where inventory of goods and services is owned by e-commerce entity and is sold to the consumers directly. Marketplace based model of e-commerce means providing of an information technology platform by an e-commerce entity on a digital and electronic network to act as a facilitator between buyer and seller” (DIPP, 2016, p. 2).

With investment funding booms in 2011 and 2014, the e-commerce sector in India witnessed massive growth and this laid the stepping stones for the sector to become the giant that it is today. According to ASSOCHAM & PWC (2014), the e-commerce sector grew at a compounded annual growth rate of 37.2% between 2009 and 2013. TechSci Research company expects the Indian e-commerce sector to grow at a compounded annual growth rate of 36% between 2015 and 2020 (TechSci, 2015). An advantage of having a large population is the potential market strength when it comes to the e-commerce sector of India. Ravi Shankar Prasad, Union Minister for Communications and IT, revealed that India’s total internet user base is expected to cross 500 million in 2017 (Taneja, 2016), and touch 829 million by 2021 (IBEF, 2017). The multi-billion dollar valuations of e-commerce companies in the international markets have created enormous investor interest in the Indian e-commerce sector. India Brand Equity Foundation suggests that “much growth of the industry has been triggered by increasing internet and smartphone penetration” (IBEF, 2017, p. 1).



Amberber (2015) points out that venture funds, private equity funds, and other investors put a record amount of US\$9 billion in the Indian e-commerce sector in 2015. According to India Brand Equity Foundation, venture capital-backed firms in India raised a record US\$9.6 billion of fresh capital between January-September 2017, which is more than twice the amount of capital raised during the same period in the previous year (IBEF, 2017). Last year, India's retail e-commerce sales clocked a total of US\$16 billion, up from US\$3.9 billion in 2009 (Sharma, 2017). As per recent reports, domestic Indian companies like Flipkart, Snapdeal, Paytm and the MNC Amazon India were the largest e-commerce companies in India with a combined market share of 90% among them (Maheshwari, 2016). The advent of e-commerce has transformed the way in which business is done in India. Today, the sector has reached a value of approximately US\$20 billion (IBEF, 2017). Moreover, according to a 2016 Morgan Stanley research report, the Indian e-commerce sector is expected to grow up to US\$120 billion by 2020 (The Times of India, 2016), and hit US\$200 billion by 2026 (Gupta, 2017). According to a report from property consultant Knight Frank India Pvt Ltd and Retailers Association of India (RAI), the share of e-commerce retail was a meagre 2% of the total retail market in 2014, however, it is expected to grow to 11% by 2019, while the share of organised traditional retail is expected to shrink from 17% to 13% in the same period (Mishra, 2016). Colin Sebastian, an analyst at Robert W. Baird & Company, said that "with a growing middle class and propensity to shop online, the revenue potential in India is enormous" (Wingfield & Goel, 2016, p. 1). This shows great potential in development of the e-commerce sector in India.

However, despite the massive growth seen in the initial years, the government of India had not laid down clearly defined regulations or guidelines to monitor the business activities of this sector until 2016. This led to market players exploiting market conditions and turning to unconventional business practices, like providing heavy discounts to the customers in order to capture market share (Rai, 2011). This also gave rise to various forms of anti-competitive conduct in the market, which the government set out to address with the new policy reform in 2016. However, before we get into the details of the policy, it is important to learn how discounting works in e-commerce to fully understand the issues leading upto the introduction of the new policy reforms.

### **3.4 Discounting in e-commerce**

One of the key dynamics enabled by e-commerce is essentially "buying and selling of goods and services including digital products over digital and electronic network" (DIPP, 2016, p. 1). Big companies like Flipkart, Snapdeal, Ola Cabs, Uber, Amazon and Alibaba use the marketplace based model to provide a convenient platform for buying and rendering of goods and services at economical rates as compared to the traditional brick and mortar retail stores (Sharma, 2016). It is worth knowing how these companies afford to provide such heavy discounts for the products and services listed on their platforms.

According to Mishra (2016), e-commerce companies encourage sellers on their platform to reduce the rates of their products and sell them at discounted prices, after which these companies reimburse the difference in price to the said sellers. This is essentially how the heavy discounting works in e-commerce. In most cases, the seller becomes a subsidiary of the e-commerce entity so as to ensure a smooth process of reimbursement (Singh, 2016). The question now, is, how do they afford to reimburse said sellers on their platforms over such prolonged periods? The answer is, essentially, by making losses. E-commerce entities do not account these reimbursements as losses but as customer acquisition cost. Amazon calls this route 'promotional funding', treating it as a marketing cost reimbursement tool (Mishra, 2016). Experts note that international e-commerce entities have the financial muscle to afford these losses in the name of customer acquisition cost but Indian e-commerce entities certainly do not have such deep pockets (Chakraborty, 2016). The intention behind acquiring customers on such high priority basis is to capture a significant share of the market and try to force out competitors (Rai, 2011). Foreign companies like Amazon, with enough financial backing to take up such strategies of customer acquisition, provide heavy discounts to their customers in order to capture the Indian market. Indian companies also followed suit because of fears of losing market share, which has eventually resulted in market instability, since the fundamentals of the business model are gravely flawed (Chakraborty, 2016; Mukherjee, 2016; Rai, 2011).

Earlier this decade, when the e-commerce culture spread in India with funding booms in this sector, the e-commerce model was still brand new and insufficiently tested. Initial investments in the Indian e-commerce sector were more speculative than fact-based. Kothandaraman Vaitheeswaran, one of the pioneers of the online shopping space in India, noted that one of the major issues faced by the investors was that while the demographic dividend was present, the ground work, in terms of environmental and industrial factors, was not ready for the model to prosper (Rai, 2011). Things like tax regulation, government laws, secure internet servers, logistical support, credit/debit card culture etc. which are inseparable from a healthy e-commerce ecosystem were not in place. Moreover, companies in this sector faced a huge task of changing people's buying behaviour and their perceptions of online buying and selling (Mishra, 2015). Therefore, giving heavy discounts and the process of selling at losses began. This gave rise to the big e-commerce companies exploiting market conditions and indulging into various forms of anti-competitive conduct in the market (Rai, 2011).

### **3.5 Introduction of new policy reforms**

Having witnessed the development of unhealthy market conditions on account of prior non-existence of guidelines in this sector, the Indian government tried to change that scenario on 29<sup>th</sup> March 2016 when the Department of Industrial Policy and Promotion released Press Note 3 (DIPP, 2016). The announcement brought on clearly defined guidelines and regulations in this sector. The new reforms allowed 100% FDI in B2C e-commerce under automatic route in the marketplace based model of e-commerce. This included a faster clearance window and no prior approval from the Foreign Investment Promotion Board (FIPB) for the

foreign investors (DIPP, 2016). Moreover, the press note also said that the marketplace e-commerce companies would be allowed to provide support services to sellers like warehousing, logistics, order fulfilment, call centres, payment collection and other services. However, DIPP still does not permit FDI in the inventory based model of e-commerce and states that companies following the marketplace model will not be allowed to exercise ownership over the inventory as this will render the business an inventory based model. There are also additional conditions on marketplace e-commerce entities to not allow more than 25% of its sales to come from one vendor or companies in their group, and the condition to maintain a level playing field and not influence the sale price of the goods and services listed on their platforms. Additionally, the e-commerce entities, are from now on, also required to provide the name, address and other contact details of the seller to the customers. However, after-sales services, customer satisfaction and warranty/guarantee of the goods and services will remain the responsibility of the seller (DIPP, 2016).

Experts note that with this policy reform, the government of India intends to achieve multiple objectives. First, it intends to bring long overdue clarity with respect to FDI policies in this sector by formalising foreign investments in the e-commerce sector by clearly defining and recognising the two models of e-commerce. Second, it wants to attract additional foreign investment in this sector as part of its Make in India initiative by allowing 100% FDI, while also continuing with its policy of not permitting foreign companies to sell directly to the consumers. Third, the policy reform is intended to put a stop on unhealthy business practices like predatory pricing, and maintain a level playing field in the Indian retail market. The government also hopes to encourage domestic SMEs to increase their participation in the online market with this policy reform (Mishra, 2016).

### **3.6 Summary**

This chapter has provided a brief background on the FDI scenario in India, the various reforms introduced by the government of India around its FDI policies and the transformation it has gone through over the last two decades. It also discusses the emergence and the growing importance of the e-commerce sector in India and the issues leading upto the formulation of the recently introduced policy reforms in this sector. Given the massive growth potential demonstrated by this sector and its significance to the Indian economy, it is important to analyse the potential impact of this policy change. Therefore, this study is framed around the research question “How is the recent government permission of 100% FDI in the e-commerce sector in India expected to impact the Indian retail sector?”. The methodology and research paradigm used to explore this question will be covered in the following chapter.

## **CHAPTER 4: RESEARCH METHODOLOGY**

### **4.1 Introduction**

The previous three chapters outlined the aim and focus for this dissertation. The study is framed around the research question “How is the recent government permission of 100% FDI in the e-commerce sector in India expected to impact the Indian retail sector?”. This chapter will discuss the research methodology behind this study. The research paradigm, methods, sources and data analysis techniques adopted for this study are outlined in this chapter.

### **4.2 Research paradigm**

This research study will analyse potential consequences of the recently introduced e-commerce policy on the Indian retail sector. A qualitative analytical stance is adopted as it allows the researcher to develop a deeper understanding of a topic (Gray, 2014). The e-commerce sector is important for India’s development and the recent policy change can have a major impact on the country. Since it is a recent development, the impact cannot be measured but it is important to analyse expected consequences, both positive and negative, in order to get a sense of where the policy change is leading. Bryman and Bell (2011) note that qualitative research gives the researcher a certain degree of flexibility to balance the research through self-reflection and inquiry of the data. Consequently, this helps the researcher to understand the cause-effect relationship between the events and their consequences (Myers, 2009). Therefore, qualitative research is best suited here.

Gray (2014) defines a research paradigm as a set of beliefs that guide the researcher in the implementation of the research and interpretation of the findings. This research study will build on interpretivism as its research paradigm as it requires a comprehensive conceptual understanding of the FDI and e-commerce sector in India, and an interpretive approach will provide a degree of openness to acquire data and develop knowledge from it (Gray, 2014). According to Crotty (1998, p. 67), interpretivists seek “culturally derived and historically situated interpretations of the social life-world”. Henn et al. (2006, p. 16) argue that the aim of an “interpretive research design is not to explain why something happens, but to explore or build up an understanding of something of which we have little or no knowledge”. The aim of this dissertation is not to measure an impact but rather to analyse the content of publicly available documents and explore perceived consequences of the e-commerce policy on India’s retail sector. The study is focused on documenting experiences of people, or what different people think is going to happen, and it is interested in the people’s interpretations of the situation. Hence, interpretivism is an appropriate research paradigm for this study.

### **4.3 Method of analysis**

Data collection focused on finding empirical material addressing the new e-commerce policy in India. The internet services and AUT databases made available in the university library were used for data collection. The data for this study is drawn from secondary sources. These sources include press notes and publications from various statutory bodies of the Government of India; publications and reports by intergovernmental organizations, legal experts and agencies; economic reports by national and international forums and publishing houses; newspaper articles and other media publications in print and/or on the internet; and media discussions and analysis by industry experts, government advisors and the public. Altogether, 54 different sources of data surrounding the recent policy reform were analysed with the vast majority being media publications and social media content. Initially, all of them were collected in one folder and then based on the key contents of each source, they were further organised into groups according to the overarching themes derived from them. These sources form the basis for my data analysis to obtain a comprehensive understanding of the topic. Indian media sources like Livemint, a financial daily newspaper, were especially analysed to obtain commentaries, opinions and discussions by industry experts and the public.

In the analysis, the method of document analysis and content thematic analysis is used. Guest et al. (2012) mention that thematic analysis is one of the most commonly used methods to analyse qualitative data. Braun and Clark (2006) explain that thematic analysis focuses on the identification, investigation and documentation of themes from the data, and that this method allows the researcher to interpret the data in a rich, detailed and complex manner. Fereday and Muir-Cochrane (2006) point out that the derived themes form the basis of analysis for the researcher.

Since the policy change in question is a recent development, adopting an inductive exploratory approach in the analysis is most appropriate to derive key themes from the data. An inductive exploratory approach is appropriate for content analysis because of the subjective nature of the empirical material analysed and its ability to allow the researcher to obtain a broader set of results to acquire a better understanding of a research topic (Elo and Kyngas, 2007). To identify the key themes from the data, a process of open coding was undertaken to find patterns, comments and discussions surrounding the e-commerce policy (Cavanagh, 1997). In the end, the open codes were combined into focused codes and 7 key themes were identified to find the positive and negative implications of the policy as addressed in the empirical material. A discussion of the expected effects of the new e-commerce policy is undertaken by analysing the empirical material.

### **4.4 Summary**

This chapter outlined the research methodology and method behind this study. An interpretive research paradigm is utilised to analyse qualitative data. The data for this study is drawn from secondary sources, and method of content thematic analysis is employed to analyse the empirical material. The key themes derived from the data are presented in the following chapter.

## **CHAPTER 5: FINDINGS**

### **5.1 Introduction**

The previous chapter outlined the research methodology behind this study to explore the research question “How is the recent government permission of 100% FDI in the e-commerce sector in India expected to impact the Indian retail sector?”. This chapter will present the key themes that have emerged from analysis of the empirical material.

Since India is only in its nascent stages in the e-commerce sector, it barely has enough guidelines to work with. Until recently, there were no policies or guidelines provided for the financing or functioning of this sector. However, with the new DIPP ruling, things have become much clearer in the e-commerce sector and this has had certain effects on the manner of doing business in this sector. The new policy was introduced in March 2016 on account of prior lack of guidelines and to tackle various issues of anti-competitive conduct to ensure a level playing field in the Indian retail market. In the long run, while this policy reform is expected to bring a positive change in the Indian market, it also potentially brings serious consequences for the domestic retail sector. Therefore, it is important to investigate and understand the potential consequences of this recent policy reform and come to a rationale conclusion, because of its significance to the Indian economy. In this chapter, we take a deeper look at the implications of this ruling.

Seven key themes were identified in the analysis of the data around the policy. They were: reduction of heavy discounts, hopes of bringing parity for traditional retailers, fear of less e-commerce because of policy restrictions, operational impact on e-commerce players and the reappearance of fraudulent transactions, continuing violation of rules, fears of effects on domestic companies, and fear of macroeconomic effects. Since our research topic focuses on exploring perceived consequences of the policy, we will first look at the positive effects of the policy and then move towards the negative effects it might have on the market and analyse its potential impact on the retail sector as a whole.

### **5.2 Reduction of heavy discounts**

The theme of reducing heavy discounting of goods and services received significant mention across the data around the new e-commerce policy. As discussed in the previous chapter, due to a prior lack of proper guidelines in this sector, the big players of the e-commerce sector started indulging in modern day predatory pricing or heavy discounting of products and services listed on their platforms. This gave rise to the development of unhealthy market conditions (Rai, 2011). So, the new policy reform set out to tackle that problem and it has brought certain effects with it affecting the way that business will be conducted now in the e-commerce sector in India. The Government of India has undertaken a huge step towards controlling heavy discounts, predatory pricing and those ‘Big Billion Day’ sales that were earlier used as bonus schemes or marketing cost reimbursement tools to fuel consumer demand, even as these schemes burnt millions of dollars in venture capital money (Bhardwaj, 2016; Singh, 2016). The government has put restrictions on the

e-commerce companies to decrease their influence on the sale price of goods and services with the new policy, thus, putting a stop to round-the-year discounting schemes (DIPP, 2016). Anurag Mathur, partner, Price Waterhouse Cooper, said “discount levels have declined and the trend is prominent post-Diwali. All big players, including Flipkart and Amazon, among others, have reduced discounts” (Mazumdar, 2016, p. 1). Experts note that with this policy reform, the government is heading towards achieving its objective of maintaining a level playing field in this sector (Bhardwaj, 2016; Madhavan, 2016). However, Singh (2016, p. 1) mentions that “consumers have been the biggest beneficiaries of the deep discounts available at marketplace platforms. And if the guidelines result in a reduction in these discounts, they will be the biggest losers”. While the new regulations’ need to maintain a level playing field softens the burden of cash burn on these companies by controlling heavy discounting, it also leads to added pressure on them to now find a new way to acquire these customers (Singh, 2016).

### **5.3 Hopes of bringing parity for traditional retailers**

Another prominent theme was that of traditional retail traders welcoming the policy announcement with hopes that it will put an end to unfair business practices in the current system and bring parity for them. With the rise in usage of internet and smartphones, the traditional brick and mortar stores have lost a significant amount of its customer base to these e-commerce companies (IBEF, 2017; Mishra, 2016). But clearly laid down guidelines and conditions for the two models of e-commerce has given hope to traditional retailers that they might regain their lost market from the e-commerce companies (The Economic Times, 2016). Kishor Biyani, CEO of Future Group, the country’s largest brick and mortar retailer, said in a statement that the policy is “a huge step in bringing parity for retailers in the country. It changes everything. They can’t operate as a retailer and will just be technology providers. That’s how they should have been in the first place” (The Economic Times, 2016, p. 1). Additionally, Biyani echoed concerns of being undercut by the e-commerce companies in cost price of goods and services, and the increasing control these companies have on such prices due to heavy discounting. He called this policy reform a ‘blessing in disguise’ for both traditional and online companies as the policy aims to bring a level playing field in the Indian retail market and it also forces the online companies to reduce their cash burns/losses by putting a stop on heavy discounting (The Economic Times, 2016). Similarly, Snapdeal co-founder Kunal Bahl too expressed his support for the new policy (Sharma, 2016). Devraj Singh, executive director – tax and regulatory services – at Ernst and Young, believed that the move will help to ensure that there are no monopolies developing in the market and that the new regulations will keep the actions of e-commerce platforms under check (The Economic Times, 2016).

### **5.4 Fear of less e-commerce because of policy restrictions**

When news outlet *The Quint* undertook a sample survey among regular e-commerce customers and small retail shop owners, convenience and discounts emerged as two primary reasons behind the increasing usage of e-commerce platforms among the public (Aadeetya, 2016). However, when made aware of the new DIPP

ruling, it came out as a rude awakening to them. Consumers have become accustomed to buying products and services at a cheaper rate from online stores thanks to the heavy discounting made available to them by the online platforms. While some people believe that newly introduced restrictions on discounting will not affect current trends, a large section of the group did not welcome the new policy reform (Aadeetya, 2016). The strong possibility of online prices of products reverting to the levels of offline, brick and mortar stores will make the online marketplace a less attractive destination for shoppers and investors, according to legal expert Stephen Mathias (Mishra, 2016). There have also been predictions of lower discounts leading to thinner traffic on e-commerce websites and eventually leading to a decrease in sales volume (Pyne, 2016; Sharma, 2016). Flipkart co-founder and Executive Chairman, Sachin Bansal, discussed the existence of a tough financial climate in the e-commerce sector after the announcement of the new policy reform last year (Pyne, 2016). Similarly, ShopClues co-founder Sanjay Sethi mentioned how investors are now rethinking their business strategies regarding businesses that have not demonstrated a profitability pathway for them (Pyne, 2016). This potential downfall of online buying and selling is expected to reduce e-commerce transactions in the country and help traditional brick and mortar stores to regain their lost market and revive their failing businesses. Mishra (2016) points out the growing fear in the industry that the policy reforms will bring negative implications for the e-commerce sector, instead of positive.

### **5.5 Operational impact on e-commerce players and the reappearance of fraudulent transactions**

The policy reform also lays down operational guidelines on the e-commerce companies with its conditions and companies like Amazon and Flipkart especially will require a restructuring of their business models in respect of their seller base (Singh, 2016; Varadarajan, 2016). The data provided insights that the condition of not permitting “more than 25% of the sales affected through its marketplace from one vendor or their group companies” (DIPP, 2016, p. 2) has left two of India’s largest online retail companies – Amazon and Flipkart – in a fix. According to industry experts, Flipkart’s largest seller, WS Retail Services Pvt. Ltd., easily generates around 35% of the sales for the platform, while Cloudtail India accounts for over 40% of sales for Amazon India. Both WS Retail and Cloudtail India are subsidiaries of Flipkart and Amazon respectively (Singh, 2016; Sharma, 2016). Flipkart holds a majority stake in WS Retail while Cloudtail India is a joint venture between Amazon.com and Indian business magnate N. R. Narayana Murthy’s Catamaran Ventures (Sharma, 2016). While Flipkart and Amazon have been understandably quite on the matter, another one of the largest e-commerce companies of India, Snapdeal, has publicly voiced support for and welcomed the new rules, which according to them, “will pave the way for accelerated growth of the sector in India” (Sharma, 2016, p. 1). Unlike its competitors, Snapdeal does not have a single large seller. Varadarajan (2016) points out that Cloudtail India is particularly dominant in electronics and fashion sales, which happen to be two of the largest categories for Amazon India, and therefore, the new regulations call for Amazon to reduce its reliance on a single retailer like Cloudtail, either by forming more joint ventures with Indian companies or by finding new sellers for its platform (Wingfield & Goel, 2016).



NASSCOM, a trade association of the Indian IT and BPO industry, has objected to this condition. They released a statement saying that “restricting sales of a vendor to only 25% of the sales in a marketplace may prove to be restrictive, more so if the vendor sells high value items. The industry might face difficulties in case of sale of electronic items, where a vendor may be offering exclusive access to certain items or discounts” (Singh, 2016, p. 1).

There was also an indication of a return of fraudulent transactions in the data as a result of this policy reform. While the aim of this guideline was to ensure a broad base of vendors in e-commerce and promote domestic SMEs to increase their share in the online market (DIPP, 2016; Mishra, 2016), it has also brought back one of the weaknesses of the marketplace model of e-commerce. One of the major problems that marketplace e-commerce faced during its inception years was that the quality of product, service, delivery and overall customer satisfaction was low. The fact that any seller, regardless of quality and background, could sign up to be a seller at Snapdeal or Flipkart marketplace led to frequent occurrences of fraudulent transactions or faulty delivery orders (Rai, 2011). One of the famous examples in recent times is when a man ordered 2 Samsung phones from Flipkart but received a bar of soap and a packet of washing powder instead (Rajput, 2017). To deal with such cases, companies like Amazon and Flipkart had adopted a primary seller for their e-commerce platforms to ensure verifiability and accountability of sellers, and maintain a standard of quality for the products and services listed on their platforms. But by limiting the contribution of a vendor to only 25% of the total sales of an e-commerce platform, the new policy reform brings back the risk of reappearance of fraudulent transactions in this sector.

## **5.6 Continuing violation of rules**

With the introduction of the new e-commerce policy, the competition has become fierce in this sector. This has led to the big e-commerce players indulging in unfair and anti-competitive business practices to capture market share. Here, we take a brief look at the example of alleged anti-competitive conduct in the e-commerce sector to understand the ongoing violation of rules in this sector.

Taking the case of ‘Mr. Mohit Manglani vs M/s Flipkart India Private Limited & Ors.’, it was alleged that three of the major companies of the e-commerce sector – Flipkart, Snapdeal and Amazon India – have indulged in anti-competitive conduct. This conduct of going against the norms of business behaviour could adversely affect competition in the relevant market, and potentially disturb the sector. The case was filed to the Competition Commission of India (CCI) against the said companies for their contravention of Section 4(2) of The Competition Act, 2002, i.e. abuse of dominant position by getting into exclusive agreements with sellers and practising predatory pricing (CCI, 2015).

The Competition Act has defined abuse of dominant position as occurring when an enterprise imposes unfair or discriminatory conditions in purchase or sale of goods or services, imposes predatory prices in purchase or sale of goods or services, or restricts production or denies market access in any manner (CCI, 2002).

Whereas, predatory price is defined as “the sale of goods or provision of services, at a price which is below the cost, as may be determined by regulations, of production of the goods or provision of services, with a view to reduce competition or eliminate the competitors” (CCI, 2002, p. 9).

Such practices have always been known to disturb an industry as they put both the customer as well as the competition of a dominant business enterprise in a difficult situation; either by creating entry barriers for new businesses or by eliminating existing competition out of the business. Additionally, the inability of CCI to recognize online shopping platforms as a relevant market, and instead calling it just another channel of distribution of the total retail market has allowed such e-commerce giants to continue to sidestep the law and practice unfair business practices (Madhavan, 2016). The e-commerce sector is only a small segment of the total retail market in the country, therefore, e-commerce giants like Flipkart, Amazon and Snapdeal cannot be said to be dominant players of this market, which is a pre-requisite condition if one seeks to proceed for anti-competitive practice against them (CCI, 2002; Madhavan, 2016; Mishra, 2016). This has ignited fears of the new policy reforms being too restrictive on its effect on controlling anti-competitive conduct in the market.

Recent examples of companies sidestepping the law include Reliance Jio offering free services to its subscribers to capture market share or Xiaomi mobile phones getting into an exclusive supply agreement with Flipkart. The new policy reform, having failed to address this issue, has led to market conditions getting worse than before (The Hindu, 2016). It is noted from the data that large scale predatory pricing and heavy discounting still takes place to an extent despite the introduction of new laws by the DIPP, for example, seasonal/festive heavy discounts during massive quarterly sales, Summer Bonanza sale, Diwali Dhamaka and New Years’ limited period sale (Bhardwaj, 2016; Madhavan, 2016). Additionally, Mishra (2016) points out that the Retailers Association of India (RAI) have argued that the current retail policy does not allow the e-commerce platforms to directly sell to customers, but that, in the garb of the marketplace model, such transactions are still taking place, thus violating rules.

### **5.7 Fears of effects on domestic companies**

Another theme that emerged from the data was that of the policy’s impact on India’s homegrown companies. Singh (2016) mentions that trade analysts and experts in the field have not accepted the reforms with open arms. He notes how there is a feeling among the industry that the language of the guidelines is such that it is open to interpretation, and may result in litigation. “While the guidelines say, for example, that an e-commerce company providing marketplace services cannot directly or indirectly influence the sale price of goods or services and shall maintain a level playing field, experts feel there is ambiguity on what exactly constitutes a move to “directly or indirectly influence”” (Singh, 2016, p. 1). Additionally, The Confederations of All India Traders (CAIT) stated their unhappiness towards this policy reform. CAIT secretary, Praveen Khandelwal, believed that FDI in e-commerce will act as a backdoor entry for global retailers to bypass

restrictions in multi-brand retail as there are no geographical restrictions in e-commerce. The federation said in a statement that traders across the country will strongly oppose this move (The Economic Times, 2016). Similarly, Swadeshi Jagaran Manch (SJM) co-convener Ashwani Mahajan too slammed the move by saying that the policy reform will allow e-commerce entities to legally indulge into predatory pricing and business malpractices. He believes that this move will reward online companies instead of punishing them for their unfair business practices (The Economic Times, 2016).

By allowing 100% FDI under automatic route, the new policy has increased foreign competition for India's homegrown companies in the e-commerce sector. Instead of levelling the playing field amongst players of the e-commerce sector, it has created a paradigm shift for the homegrown companies (Chakraborty, 2016; Mishra, 2016). Now the foreign companies have the license to operate in the country and challenge Indian companies.

Shankar Sharma, VC and joint MD of First Global, feels that by introducing 100% FDI in marketplace model of e-commerce, the Government of India has dealt a huge blow to domestic Indian e-commerce companies. Allowing global e-commerce giants such as Alibaba, Amazon and now Walmart to enter and gain full access to the Indian market will stop homegrown companies like Flipkart and Snapdeal from reaching their full potential of becoming giant global companies themselves (Chakraborty, 2016; Mishra, 2016). Sharma labelled this as a 'stupid policy' by comparing it with China's restricted policy and demonstrating how the e-commerce sector in China has grown into a trillion-dollar market capitalisation industry, with global giant Alibaba at its forefront. Additionally, he also draws parallel with India's banking sector and mentions how restricted local competition and zero foreign competition has allowed India's private sector banks like HDFC and ICICI to become "behemoths, rivalling many global players in terms of profits and market capitalisation" (Chakraborty, 2016, p. 1). Many other leading investors and market experts have echoed Sharma's sentiment. The data indicates there is a growing concern of foreign e-commerce companies eating into the Indian market, as homegrown companies like Flipkart and Snapdeal are a long way from reaching Amazon and Alibaba's level in terms of experience, market share and expertise.

With the introduction of 100% FDI in the marketplace model of e-commerce, fears for the grave effects of foreign competition have only multiplied, and homegrown companies have started to feel the effects of the policy. Recent market reports suggest that Amazon has already started to test Flipkart and Snapdeal's tenacious grip on the Indian e-commerce market, after it was reported that the two homegrown companies had lost substantial market share between March 2015 and March 2016 to the American giant (Dettoni, 2016). Jeff Bezos, Founder and CEO of Amazon Inc, recently announced plans to further increase the e-commerce giant's investments in India to develop its infrastructure and technology. Additionally, Amazon has also received an approval from the Reserve Bank of India to launch its own digital payment wallet in India, thereby tapping into India's fastest growing digital payments business (IBEF, 2017). China's largest e-commerce player Alibaba too "has planned to set up its first India office in Mumbai, in order to be a part of

India's growing e-commerce market" (IBEF, 2017, p. 1). This further highlights the growing fear of the policy's negative impact on homegrown companies.

The foreign companies not only are ready to take on the market but they also have the expertise and financial backup to carry them out thanks to years of experience behind them. Chakraborty (2016) points out that these foreign companies have taken years growing their parent company and collecting market data. The Indian market is a way of expansion for them from the demographic point of view. In contrast, the Indian e-commerce companies were introduced to this sector barely a decade ago. Moreover, in contrast to the foreign companies, the Indian companies do not have such expertise or deep pockets to be able to burn cash in the name of customer acquisition (Chakraborty, 2016). According to Mumbai-based equity broker Kotak Securities, the combined revenue of the 22 e-commerce companies currently active in India increased by 191% in 2015, but losses grew at an even faster rate of 264% year on year, as ever-increasing foreign investments and the eventual price competition decreased the profit margins (Dettoni, 2016). Devangshu Dutta, Chief Executive at Third Eyesight, summed up this market concern perfectly. He said, "if a company is losing money on every transaction, then the business model is not sustainable" (Mukherjee, 2016, p. 1). Therefore, allowing 100% FDI in this sector is only going to multiply the policy's negative effect on India's homegrown e-commerce companies (Mishra, 2016).

Pandey (2016) notes that while e-commerce valuations in India are constantly increasing, little has changed fundamentally despite the introduction of the new policy. Inadequate hard infrastructure, low internet penetration, lack of concrete acts, weak cyber law compliance, ambiguous tax laws, and policies, continue to hinder the creation of a flourishing e-commerce ecosystem in the country (Pandey, 2016).

As per the studies conducted by Yadav and Jauhari (2012), the perceived consequences of increasing the FDI threshold in the Indian retail sector "will lead to widespread closure of small and traditional retail outlets, sharp decline of non-formal sector, and undermining of the livelihood and employment opportunities" (p. 34). It is noted that FDI will only cater the needs of the wealthy and this will have adverse effects on the employment in this industry (Yadav and Jauhari, 2012). Lakatos and Fukui (2014) analysed the effects of opening-up multi-brand retailing to foreign investment in India, in their research study. They deduced that "the unilateral reduction of barriers to FDI in distribution services in India benefits the economy as a whole, consumers, and foreign producers but hurts domestic distributors" (Lakatos and Fukui, 2014, p. 327).

## 5.8 Fear of macroeconomic effects

The empirical data also spoke about macroeconomic effects of the policy and how it could potentially have long term effects on the Indian economy. They are discussed here.

Even though most of the challenges that confronted the Indian e-commerce sector in 2011 continue to haunt it, valuations and funding activity in the industry have surged. However, despite being almost a decade into the e-commerce boom in India, the e-commerce companies, including the leading ones, continue to incur deep losses (Mazumdar, 2016). It is hardly surprising that no Indian e-commerce company, incorporated post 2007-08 is listed yet. The data indicates an evident disconnect between the valuations and the fundamentals of the business model of e-commerce companies. According to Mukherjee (2016), the above discussed fears and issues as a result of the new e-commerce policy reforms, when brought together with the price boom and overvaluation of e-commerce companies, have sparked a fear among investors that there is a speculation bubble being created in the e-commerce sector in India. The gap between market realities and investors' inaccurate perception of the market realities have led to overvaluation of e-commerce companies in the market (Mukherjee, 2016).

Heavy discounts have been the topmost attraction tool of Indian e-commerce companies in the last few years with the sole focus on customer acquisition and market share growth (Rai, 2011). In order to win this battle of customer acquisition, these online companies have been incurring huge losses to fund such discounts to the customers (Mishra, 2016; Mazumdar, 2016). But the question remains, how are e-commerce companies able to raise huge investments from private equity investors without any profits at all? Moreover, how did they get their companies to be valued at such astronomical figures? The answer is Gross Merchandise Value (GMV) (Pyne, 2016). GMV is a term used in online retail to indicate the total value of merchandise sold over a given period of time through a marketplace based model. It is used as an indicator of growth or future potential (Pyne, 2016). According to Mazumdar (2016), the cumulative losses of Flipkart, Amazon India and Snapdeal stood at Rs.5000 crores (approximately US\$750 million), in the year ending March 2015. Despite this, all these companies were valued in billions during the year (RBSA, 2015). All this cash burn, as a result of heavy discounting, help in accelerating and holding the company's GMV and market value. "Take that away, the valuation falls, and 'growth' suddenly seems stagnant" Pyne (2016, p. 1) notes. The consistent rising valuations of Indian e-commerce companies is bringing more and more money into a bloated-up Indian e-commerce sector. There is an evident link in the data between heavy discounting, increased foreign competition, overvaluation of e-commerce companies, and the eventual bubble creation, all of which are connected to the recent e-commerce policy reforms (Mukherjee, 2016; Pyne; 2016).

Reserve Bank of India governor Raghuram Rajan has himself expressed reservations against opening-up sectors fully to foreign investment. "The most stable form of financing, FDI, has the additional benefit of bringing in technology and methods. But India should not be railroaded into compromising its interests to

attract FDI,” Rajan had said last year in a commentary posted on the website of Project Syndicate. He added that “any signs of growth can attract foreign capital, and if not properly managed, these flows can precipitate a credit and asset price boom and exchange rate overvaluation” (The Hindu, 2016, p. 1).

## **5.9 Summary**

After a thematic analysis of the secondary data, it was found that seven key groups of themes emerged from the empirical material, to help explore the potential impact of the recent e-commerce policy on the Indian retail sector. These themes have been presented in this chapter. In particular, it was found that the recent policy reforms have led to a reduction in heavy discounts, and the policy has given hopes to traditional retailers of achieving a level playing field in the market. But the policy has also brought on negative implications like less e-commerce, fear of reappearance of fraudulent transactions, a continuing violation of rules, and the negative impact of increased foreign competition on the domestic companies. Additionally, there is also evidence of creation of a speculative bubble in the e-commerce sector, which potentially brings grave consequences for the Indian retail sector when it bursts. The implications of these findings will be discussed in the following chapter.

## **CHAPTER 6: DISCUSSION**

### **6.1 Introduction**

The purpose of this research is to analyse the potential consequences of the recently introduced e-commerce policy on the Indian retail sector. The primary question guiding this study is “How is the recent government permission of 100% FDI in the e-commerce sector in India expected to impact the Indian retail sector?”. The previous chapter presented the key findings of this dissertation based on analysis of the secondary data gathered. This chapter discusses the key findings in the context of the academic literature reviewed in Chapter Two.

### **6.2 Implications of findings**

Welcoming FDI into developing countries impact on specific sectors or industries, or all industries of the economy depending on various political, economic and environmental factors (OECD, 2002). A consensus in the international business and FDI literature is that inward FDI brings benefits like transfer of technology, productivity, operational and managerial efficiencies among others to the host country economy which lead to advancements in the industrial structure, regional development, and modernization of the economy (Barro and Sala-i-Martin, 1995; Buckley and Casson, 1985; Grossman and Helpman, 1991; Hermes and Lensink, 2003; Nunnenkamp, 2004). This is well reflected in the case of India with advancements in various sectors of the economy as a result of inward FDI (DIPP, 2017). The literature highlights that advancements in sectors like manufacturing, construction, finance, telecommunications, service, IT-BPO, e-commerce and e-governance have played a huge role in modernization and economic development of the Indian economy (Gammeltoft, 2007; Kumar, 2007; Singh, 2017).

The literature review also addressed the topic of costs of inward FDI on the host country economy. Hill (2015) and Peng (2016) pointed out that foreign competition was one of the major concerns of opening up an economy to FDI, and how in certain cases it leads to the market getting monopolised by foreign MNCs. This is supported by Chakraborty (2016), Dettoni (2016), IBEF (2017), Mazumdar (2016), Mishra (2016), Mukherjee (2016), Pandey (2016) and Singh (2016), as outlined in chapter five in the findings, who assert that allowing 100% FDI in India’s e-commerce sector is having negative implications and the homegrown e-commerce companies of India are feeling the effects of foreign competition. The findings indicate how increased foreign competition is driving the market players to indulge in unfair business practices and how this is having massive effects on the market conditions. The e-commerce companies have been constantly incurring significant losses and as a result, the domestic companies are either going out of business or losing significant market share. This in turn is affecting the market stability in the Indian retail sector. These findings are running parallel with the research study conducted by Caves (1971). Additionally, there is also the fear of foreign e-commerce companies slowing down the growth of India’s homegrown e-commerce companies,

and how this policy will not allow the homegrown e-commerce companies to fulfil their potential of becoming global e-commerce giants themselves.

Furthermore, the findings suggested that allowing 100% FDI in e-commerce retail in India is starting to have negative implications on this sector. Such claims are echoed in the literature review by Truman (2002), (Moran, n.d), Haddad and Harrison (1993), Encarnation and Wells, Jr. (1986), Aitken and Harrison (1999), and Wasow (2003) who found that FDI may not necessarily have a positive impact on an industry or sector of a developing economy, and that it can also have a negative net contribution to the host country economy and fail to show a significant beneficial impact on its domestic homegrown companies.

The literature speaks about the impact of FDI on domestic companies but findings suggest not all domestic companies are against the new e-commerce policy in India, in fear of foreign competition. One of India's biggest e-commerce players Snapdeal has welcomed the new e-commerce policy believing that the new guidelines will accelerate growth in this sector and give opportunities to domestic SMEs to increase their participation in this sector (Sharma, 2016; Wingfield & Goel, 2016).

However, what the literature review has not identified is the macroeconomic effects a host country might face as a result of completely opening up its economy to foreign direct investment. The findings show a constant abuse and violation of rules, and how problems of heavy discounting, exclusivity agreements and fraudulent transactions have become prevalent in the e-commerce sector with the introduction of new policy reforms (Bhardwaj, 2016; Madhavan, 2016; Mishra, 2016; The Hindu, 2016). While some of these issues also existed before, and the new policy reforms were introduced in part to address these issues, commentators doubt that it has or will succeed in the future in putting a stop to these practices. Linking them to the issues of increased foreign competition and overvaluation of e-commerce companies, it becomes apparent that the new policy reforms have brought on fears of creation of a speculative bubble in this sector among industry experts, and this bubble can potentially have widespread consequences across different sectors of the Indian economy, not least the domestic e-commerce and retail sector (Mishra, 2015; Mukherjee, 2016; Pandey, 2016; Pyne, 2016; Rai, 2011; The Hindu, 2016).

Considering the inconsistency between the valuations and harsh realities of Indian e-commerce companies, the speculation of a bubble in the Indian e-commerce sector is hard to dismiss. Some analysts say that there is a bubble about to burst; whereas some others have taken the stand that it is highly unlikely that there is a bubble at all, let alone the phenomenon of the bubble bursting (Mukherjee, 2016). Considering the possibility of an inherent bubble growing in the e-commerce sector and its eventual burst, it is important to take notice and prepare for it considering the scale of consequences it could bring with it.

The consequences are wide ranging and could be anything from an economic collapse, to a mere slowdown in the form of a bust, inside the business cycle of the e-commerce sector. Add the negative implications of the new e-commerce policy to pre-existing market conditions, and it becomes evident that with little or no



money left for providing returns to their investors, small domestic players will decide to shut down and/or cut corners by laying off employees, as seen with the case of Indiaplaza.com (Mishra, 2015; Pyne, 2016). The investors, with all the wealth lost, may contemplate disinvestment from the companies. Or in some cases, companies may struggle to raise further rounds of funding on the same initial valuation. This may trigger a short-term fall in valuations, like with the case of Uber and Dropbox, and a decrease in investment activity as one of the many results of the speculation bubble burst (Pyne, 2016). The job creation that takes place in developing countries like India, will take a full circle only to find itself in its original position. Jobs in the manufacturing sector based on findings are likely to be lost because foreign giants will purchase their goods from the international market and not from domestic sources. This has been the experience of most countries which have allowed FDI in retail (Pandey, 2016). Incidents like unemployment further lead to decline in productivity of the remaining employees because it gives rise to doubts about job security and job satisfaction in the minds of the employees (Aitken and Harrison, 1999). This collateral damage will either be termed as an adjustment period or economic slowdown, depending on the control over the situation that the authorities will have (Pandey, 2016). As Chakraborty (2016) notes, increased competition from a superior foreign entity would have a negative impact on the future of the homegrown e-commerce companies. Findings suggest that there are fears of 100% FDI not allowing India's homegrown e-commerce companies like Flipkart, Snapdeal and Paytm the opportunity to fulfil their potential to grow into global e-commerce giants themselves (Chakraborty, 2016; Yadav and Jauhari, 2012; Lakatos and Fukui, 2014).

An economic collapse, i.e. a broad range of poor economic conditions, ranging from a severe prolonged depression and high unemployment (such as the Great Depression of the 1930s) to hyperinflation causing disturbances in normal commerce are some of the extreme consequences that could take place if the negative effects of e-commerce sector carry forward to other sectors/industries of the Indian economy. My empirical research and the findings acquired from it are consistent with those observed in existing research literature that FDI does not necessarily help in growth in all the sectors, and in many cases, it may lead to negative effects on a specific domestic sector or industry of a host country economy, which is the retail sector in India in this case.

### **6.3 Summary**

This chapter presented a discussion on the key findings of this dissertation in the context of the academic literature reviewed in Chapter Two. A number of interesting insights were highlighted in terms of the recent e-commerce policy's expected impact on the domestic retail sector. It was found that the introduction of the new policy in the e-commerce sector has enabled various forms of anti-competitive conduct in the market and the overall implications of this policy have the potential to have negative economic effects on the Indian retail sector which could also spillover to other sectors of the Indian economy. The following chapter will conclude the research by outlining the concluding remarks of this study.

## **CHAPTER 7: CONCLUSION**

### **7.1 Introduction**

The previous chapter provided a discussion of the key findings of this dissertation in light of the previous academic literature. This chapter will conclude the research by outlining the concluding remarks of this study. Limitations of this research and recommendations for future research are also presented in this chapter.

### **7.2 Concluding remarks**

This dissertation has dealt with analysing the effects of FDI inflows on a host country economy, particularly in context of the e-commerce sector in India. We reviewed past literature on FDI and in particular its impact on developing countries and analysed empirical material addressing the new e-commerce policy in India. The results of this research study suggest that the introduction of the recent e-commerce policy has significantly changed the market conditions in the retail sector in India. In particular, the policy has shown signs of reducing predatory pricing, and it has raised hopes of achieving a level playing field in the Indian retail market. However, the policy has also brought on negative implications like less e-commerce, the reappearance of fraudulent transactions, a continuing violation of rules, and the negative impact of increased foreign competition on homegrown companies. This has raised fears that the new policy is too restrictive in its effect on controlling the market, and that it will bring negative implications for the e-commerce sector, instead of positive, in the long run. The recent takeover of Flipkart by multinational giant Walmart is further proof that the Indian government needs to strengthen its FDI policies in the e-commerce and retail sector to safeguard its domestic companies. The global war between Amazon and Walmart has entered the boundaries of India and the domestic Indian companies of this sector are at a risk of either getting acquired by powerful foreign MNCs or running out of business (Dalal and Sen, 2018). Additionally, there is also evidence of fears that the policy has sparked a speculative bubble in the e-commerce sector, which potentially brings grave consequences for the sector when it bursts.

There is an imperative need of focusing on the big picture and keeping track of it through all the turmoil because it keeps reminding one of the larger goal of sustainable development. Keeping this view intact about the probability that foreign competition is bringing instability to the Indian market and that there is indeed a speculative bubble that could lead to various repercussions should it happen to burst, not only suggests damage to the Indian retail sector but also implies that the government is driving the economy at a speed, which it might not be ready for. Internet facilities in India are newer compared to the developed countries and hence, replicating those business ventures in India without proper safety and other precautions could be damaging for the country. India has not had a chance yet to create proper laws, policies or regulations for the impact that FDI would bring in. The findings suggested about the anti-competitive business behaviour of the e-commerce companies in the Indian market. The abuse of dominant positions by some companies is

taking a toll on the sector and such practices need to be brought under control with stronger policy frameworks in the e-commerce sector.

The growing concern among the e-commerce industry is that the Modi Government's new FDI policies have the potential to hurt national interests. There is a constant discussion of 'ease of doing business' being promoted in the country at the cost of socio-economic factors. It is worth noting from the academic literature that democracies with high income and low social strife have opened their economies to foreign capital in a major way only after achieving a reasonable degree of domestic economic stability, industrial technological competence and overall prosperity (UNCTAD, 2012). Opening a large economy to foreign investments without either adequate checks or having a strong domestic economy of suppliers, markets and technological capability could prove to be a dangerous move for the host country economy. It is a shortcut to growth, but one which will potentially bring grave consequences in the long run. It is also likely to produce a society beset with economic fault-lines that constantly trigger social conflicts. Therefore, it is very important for the Indian government to take foreign policy decisions with utmost care and with an eye to the future.

In order to compete with the global e-commerce behemoths, the homegrown companies need to be able to stand on their own two feet before proceeding to ask for investments from foreign investors. If the roots are not strong then a collapse is hardly surprising. If FDI is vital for the growth of a developing country like India, not more than half of the paid-up capital, which would provide only restrictive involvement of the foreign influence, of the companies under the automatic route should be allowed at the current stage. Later, when the homegrown e-commerce companies have lived up to their potential of growing to a market value of US\$120 billion (The Times of India, 2016), influence of foreign investments can be increased so as to provide resources for the companies to further expand its horizons. This is one way that could instil parameters of healthy competition in the Indian e-commerce sector. The only other way to be able to contend with global e-commerce players would be to call a merger between the existing domestic e-commerce companies and let the Indian e-commerce oligopoly gain dominance, as was done by the Indian government by merging 13 state oil companies to create a global giant (The Economic Times, 2016).

A nation needs both economic prosperity as well as security for its growth and development. For now, if there is a bubble growing, the possibility of which seems hard to ignore especially for Indian companies and investors, then the potential cost is immensely high. These companies will not be able to burn cash for much long, given the market forces with profitability as the sole motive. The Indian retail sector, albeit mostly unorganised and informal, is the second largest employer in the country after agriculture (DIPP, 2016). Therefore, there is an urgent need to control foreign participation in the e-commerce sector and restore prices to equilibrium to ensure sustainable growth of the e-commerce sector in India.

For the long-term question regarding formulation of foreign policies of this sector, this raises the question whether India's policymakers should return to the highly selective approval procedures of the pre-reform era, and discourage FDI in the e-commerce sector, or bring out reforms to control existing foreign competition so as to ensure sustainable growth and development of the different sectors of the economy.

### **7.3 Limitations and future research**

The research study analysed potential consequences of the recently introduced e-commerce policy on the Indian retail sector. The research, however, is not without limitations. This dissertation used secondary sources of data due to the limitations of scope and time to undertake this study. In addition, the study focused on the e-commerce sector in particular. Therefore, the application of this study to other sectors or industries is unknown in terms of governmental policy changes. Moreover, the scope of study was in the context of India, thus limiting the opportunities to derive generalisations for other contexts.

While this research found that opening-up of the Indian e-commerce/retail sector to 100% FDI could prove to be costly for the domestic industry, it cannot predict if the consequences or effects of the policy will be uniform across the country or not. Effects of this policy on local retailers will differ across regions of India within which they live or across income levels.

Future research could investigate the impact of the e-commerce policy by using primary sources of data. By utilising methods of sample survey and semi-structured interviews, researchers can discover detailed information and themes surrounding the policy. Additionally, future research could investigate FDI policies relevant to other sectors or industries of the country. Finally, researchers could also undertake a study in the context of countries other than India in order to derive generalisations. This could be done by comparing the data acquired from different parts of the world. The relationship between foreign MNCs and governments has been, and will remain, an active area of research within the field of International Business, and it is crucial that research studies continue to take place in the future to keep obtaining comprehensive knowledge about the impacts of FDI policies on different industries in developing countries.

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