Walmart's Gamble and what it means for India*

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Much of the writing on Walmart's purchase of a dominant 77 per cent stake in Flipkart, touted for long as India's answer to Amazon, is focused on its size. At $16 billion, of which $14 billion goes to buy up the stakes of investors such as SoftBank from Japan and Naspers from South Africa, it is reportedly the biggest acquisition in the global e-commerce area, and way larger than $3.3 billion that Walmart paid for US web retailer Jet.com in a deal considered the largest purchase of a US e-commerce startup. With some existing shareholders exiting, Walmart now shares ownership with co-founder Binny Bansal, Tencent, Tiger Global and Microsoft. The size of the acquisition, and Walmart's keenness to acquire Flipkart it reflected, is seen as indicative of India's importance to the world economy, and not just to international capital. What is missed in this perspective is the impact that this kind of transition has for Indian-owned business, which is the instrument through which India can be seen as participating meaningfully in the global capitalist economy.

The reason why Walmart is interested in the acquisition of Flipkart, at a price which most observers feel implies an unwarranted premium and valuation, is clear. The company that had dominated the brick-and-mortar retailing business in the United States for long has, as in the case of many other players from the 'old economy', not been able to keep pace with the disruption that technology has caused. As the share of aggregate sales through online retail creeps up in the US, the company has lost market share to Amazon since its foray into the e-commerce realm has not been too successful.

In an effort to check the fall in US retail-revenue shares, Walmart has been trying to move out of its home base into international retailing, where too it has not been too successful. In the e-commerce space, countries like China and India are important markets with much potential. But in these markets firms promoted by domestic entrepreneurs, such as Alibaba in China and Flipkart in India, have hitherto been more successful than international players. However, there is a difference between the two Asian giants. The likes of Alibaba leave little space for foreign players in China's online retail expansion. In fact, Wal-Mart had sold its e-commerce business in China to JD.com, the second-largest online retailer in China after the Alibaba Group, in return for a 5 per cent holding in the merged entity. But in India, Amazon, which came in with deep pockets had mounted a challenge, though it has reportedly spent far less (around $5.5 billion) on its India operations than Walmart's investment. It has been gaining market share and reputation, though Flipkart, the leading Indian-promoted player, still dominates, having managed to outcompete other Indian players like Snapdeal and Infibeam.

Walmart clearly saw in Flipkart's dominance an opportunity. If it could acquire Flipkart it may be on the way to realizing two strategic goals. It could establish a major foothold in a large and growing international retailing space. It could also gain an edge over Amazon in that space, not in terms of retailing in general as in the US, but in the increasingly coveted online retail business. Acquisition in the online area also made sense to the giant, given its poor record with expanding within the still regulated (though increasingly liberalised) brick-and-mortar retailing business in

India. With just 21-stores in the wholesale cash-and-carry business into which entry of global multibrand retailers is permitted, Walmart had hardly made much progress since it first set up shop. On the other hand, it had courted controversy for its allegedly questionable tie up with Bharti Enterprises, to end which and go solo it had spent $330 million. For all these reasons, Walmart must have been willing to consider a premium to expand by acquiring Flipkart, though its offer had clearly risen significantly through what was reportedly a long negotiation period.

However, there are many issues that the deal raises. First, why did the promoters of Flipkart choose to sell after holding out from 2007 when they first began operations. One of them, Sachin Bansal, has sold his full stake of around 5.5 per cent for around $1 billion, and the other, Binny Bansal, has sold a portion and remains Chief Executive. If Alibaba could flourish under its original promoter in China, could the still dominant Flipkart not have stood its ground and won out in India. That it believed it could not is partly related to the nature of the e-retailing sector in India. It was not Indian big capital that went into the arena, but "start-ups" supported with venture funding. A substantial chunk of that venture capital funding came from abroad, from players who were interested not so much in the retail business in the country, but in the capital gains that would possibly accrue. So, these were players who were planning to sell when the moment was right. Since they together had a significant chunk of shares, the promoters could insure against a hostile takeover bid only if they themselves had been willing, and in a position, to acquire the stakes of these funders.

The reliance on external funding was all the more because competition, initially to consolidate control relative to other domestic players and subsequently vi-a-vis deep-pocketed international players like Amazon, kept net revenues low or negative. Flipkart, for example, recorder a net loss of $1.3 billion in the year ending March 2017. Facing up to the competition from the likes of Amazon required continuous rounds of funding that shrunk the relative shares of the promoters. Moreover, if the evidence is that the domestic firm is not standing up to the international competition, as was the case in this instance, the valuation of the company falls in a space where valuations are driven by the speculative bets finance capital is willing to place. All in all, the circumstances were such where the option of cashing in on any offer that gives them the benefit of doubt with regard to valuation was a good bet for the promoters. There was a real possibility that a hold-out could prove expensive both in terms of market share and debt, that might wipe out their capital values.

In this game, the two Bansals who were promoters of Flipkart lost control of their firm but did well in terms of the take they got. Walmart was clearly keen on pursuing an India strategy in which acquisition of Flipkart was the key move. But, given the presence of foreign investors in the stockholding, they needed to not only convince the Indian promoters, but the foreign investors who were there for the long haul, hungry for the maximum capital gains possible. Moreover, realizing that Flipkart was considering a sale, Amazon too expressed an interest in an acquisition. So, Walmart had to make an offer that Amazon, with its already established Indian e-commerce presence, would consider not worth its while to match. Valuation was therefore driven not so much by Flipkart's earnings or it strength in the e-marketplace, but by Walmart's no-holds-barred commitment to the acquisition, the hunger of foreign investors for super-profits, and the threat of competition from Amazon.

Paradoxically, keeping valuation's high to please investors and ensure success in periodic rounds of funding, often works against profitability in the internet space. In that space, valuations are not influenced by current profits but by user base since that is seen as an indicator of future profitability. So, investor funds are used to pay off users with no or low subscriptions or with discounts. Firms record losses but accrue "value". That suits the promoters as well since their wealth increases without recording profits. But high valuations mean acquisitions are expensive.

In the event Walmart had to pay an extremely high price. Nothing illustrates this more than the fact that Softbank, which was one of the largest shareholders in Flipkart, paid $2.5 billion for its stake in August last year, but sold it to Walmart for around $4 billion less than a year later.

Buying an overvalued entity when it is losing market share and facing intensifying competition has its problems. Walmart, knowingly or otherwise, has committed to bearing losses in the medium term in a desperate gamble to short Amazon's rise in India, even if it could not do that in the US. Its $16 billion investment includes $2 billion in fresh equity that would support Flipkart's operations. Till the final shake out happens, consumers would gain, with offers of discounts, bargain sales and free shipping. But once a monopoly is established, that honeymoon would end. But in the interim, the huge outlay of capital to attract users, would result in buyers walking into the e-commerce space, leaving behind the regular retail market. The casualty here would be the small retail business sector in India, which supports a large volume of self-employed and low-paid, hired workers. Even if Walmart and Amazon employ a few thousand more, they are unlikely to neutralize the employment loss associated with the collapse of the informal retail sector.

But the adverse effects on livelihoods and employment will not end here. If competition requires sale at a discount, competitive strategies would require sourcing from the lowest cost sources. If the trade regime had remained protectionist, relying on the cheapest domestic sources would have been inevitable, favouring local small businesses. But given trade liberalization with no quantitative restrictions and low or negligible tariffs, the lowest cost source could be outside the country. Walmart is known to have exploited low cost production in China to fill the shelves of its stores in the US. Such sources would now be used to flood the e-commerce distribution channels in India. In the case of brick-and-mortar retail, policy tried to prevent this by setting a minimum 30 per cent domestic sourcing requirement. A similar clause, even if contemplated, would be difficult to implement in the Tracking source and ensuring domestic procurement would be extremely difficult in an e-commerce marketplace, where the market-place organizer is not necessarily the supplier. Not surprisingly, the opposition has seen in the Walmart-Flipkart deal the promotion by the government of a trend to Make for India rather than the promotion of a programme to Make in India, as it claims.

Meanwhile, Walmart's stock values are falling as investors assess the implications of the deal. Walmart, which has paid an extremely high price for Flipkart, must now support the latter's effort to stall and reverse the loss of market share to Amazon. That effort would cost money, and in all probability result in continued losses in Flipkart's account. Walmart itself has projected large losses over the coming two years. If, as a result, Walmart takes a beating in the market, and is forced to retreat from India as it is doing in England, Amazon could step in and get itself a monopoly at a bargain price. That would amount to not just Making for India but buying out India, with disastrous implication for aggregate employment, gross income and inequality.

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