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Abstract

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Externalities from foreign direct investment in the Mexican retailing sector

Cédric Durand*

This contribution to the discussion on the impact of foreign direct investment in developing countries is based on an empirical study of the consequences of transnational corporations' presence in the Mexican retailing sector, particularly Wal-Mart. First, it is shown that the arrival of foreign firms accelerates the modernisation but has a negative impact on local firms' performance as well as local worker remuneration as a result of the growing competitive pressure in the sector. Second, the changes that occurred in supply chain governance and the tremendous increase of imports initiated by Wal-Mart are described, and some probable implications for local suppliers are suggested.

Key words: Foreign direct investment, Retailing, Mexico, Spillovers, Trade
JEL classifications: F23, L14, O19, O54

1. Introduction

It is generally supposed that foreign direct investment (FDI) leads to substantial positive effects (OECD, 2002) through horizontal (Blomström and Persson, 1983; Blomström and Kokko, 1998) or vertical spillovers (Smarzynska, 2004). But a growing literature has shown that there is nothing automatic about such a positive mechanism. Despite services accounting for approximately 60% of FDI flows in developing countries (UNCTAD, 2003), most of the discussion focuses on the impact of FDI in manufacturing industries (Mortimore and Vergara, 2003). In this paper, we aim to bring new elements into the discussion by studying the impact of FDI on the Mexican retailing sector.

The internationalisation of retailing accelerated dramatically in the late 1990s (Wrigley, 2000). A small group of elite transnational multi-format retailers expanded rapidly in the developing world. Because of the high level of territorial embeddedness of this very specific kind of transnational corporation (Wrigley *et al.*, 2005), the organisation of consumers' markets and the supply networks of consumers goods in host countries have been significantly transformed (Coe and Hess, 2005; Coe, 2004; Reardon *et al.*, 2003; Reardon and Berdegue, 2002). Indeed, the Mexican retailing sector has been fundamentally

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affected by the pressures resulting from the entry of foreign companies in the early 1990s (Chavez, 2002), especially since Wal-Mart took a majority stake in the main Mexican retailer, Cifra, in 1997. Focusing on the four main actors of the sector, we shall establish that FDI played an active role in modernising the retailing sector, although this was done at the expense of local firms and employees. We shall also analyse the impact of the reorganisation of the supply chains and show how this reorganisation has substantially weakened local firms' position.

However, we shall not discuss the generally accepted fact that the entry of global retailers has a positive effect on consumers prices (for example, McKinsey, 2003), although this is not necessarily the case for all products (for example, fresh products: Schwentesius and Gómez, 2002). First, foreign retailers are assumed to work more efficiently than local retailers owing to the competitive advantages acquired in more developed markets. Moreover, as these global retailers aim to gain market share against local competitors, they will not use the oligopolistic market structure to benefit from rents. On the contrary, at least at the early stages, the entry of new players is expected to increase competition. Nor shall we examine the implications of changes in the consumption patterns related to the presence of foreign retailers.

In Section 2, we briefly explain the conceptual and methodological framework of this study. In the next section, we present the main FDI operations and their consequences for the retailing sector. Section 4 concerns backward externalities. We show that the entry of foreign actors allows improvements in supply chains by introducing more efficient practices and growing imports. However, it also has strong negative consequences for local suppliers. In conclusion, we explain the contribution of this work to the general debate about the impact of FDI in developing countries and offer some proposals for the construction of appropriate policies.

2. Conceptual and methodological framework

Some authors suggest that FDI is a source of ideas for host economies which provide them with the capabilities to grow (Romer, 1993; Markusen, 1995; Teece, 1977; Grossman and Helpman, 1991; Pack, 1994; Ramirez, 2000). These positive consequences are supposedly derived from two types of mechanism. First, the entry of foreign companies that are more efficient than their local counterparts is expected to produce benefits in terms of higher wages for workers, lower prices or better quality for consumers and/or higher fiscal income for public collectivities (Fuji Olechko, 2004). Second, the diffusion of new ideas to local firms produces productivity gains in these firms and growing returns for the host economy as a whole (De Mello, 1997).

However, it appears highly presumptuous to generalise a priori such a positive mechanism. Diverse factors may prevent the diffusion of new ideas. The diffusion of ideas from transnational corporations to local firms is not automatic, and the growing competitive pressure may even negatively affect the productivity of local enterprises and destroy their ability to incorporate new ideas, or lead them to bankruptcy (Aitken and Harrison, 1999; Hanson, 2001; Kugler, 2000; Markusen and Venables, 1999; Smarzynska, 2004; Ibarra and Moreno-Brid, 2004; Dominguez and Brown, 2004). Moreover, owing to their specific advantages, transnational corporations may obtain distributional benefits from their market power or asymmetrical information structures at the expense of local actors (Dussel Peters, 1999; Sacchetti and Sudgen, 2003; Kaplinsky, 2000; Dutrenit and Vera-Cruz, 2004).

Figure 1 shows how these mechanisms may occur in the case of FDI within the retailing sector of a developing country. Because of the ideas gap, FDI from developed to developing countries is expected to be accompanied by new productive knowledge. Positive or negative externalities of these ideas may occur in forward, backward or horizontal relationships as the investing firm seeks to supply the local market, establishes relationships with local suppliers and confronts local competitors. However, as retailing concerns basically the distribution of consumption goods to households, there are only possibilities of backward and horizontal productivity spillovers to local firms.

Within this general framework, we shall focus on two hypotheses concerning the transformation of the retailing sector and its impact on local suppliers in our analysis of the Mexican case.

First, we suggest that FDI accelerates the modernisation of the retailing sector but reduces the share of national capital within the modern sector and negatively affects the sector's wages. With regard to horizontal externalities, FDI in the modern retailing sector accelerates the transformation of the sector as a whole by reducing the market share of traditional retailing channels (markets, specialist stores, groceries, etc.). However, it appears difficult to identify either a positive or a negative productivity spillover in this area because of the qualitative distinction between the services offered in the modern segment in comparison with the traditional segment, and the scarcity of the data. The competitive pressure exerted by the entry of foreign actors leads to the diffusion of a large set of organisational innovations (new formats, reorganisation of supply chains) among local modern retailers. Nonetheless, the destructive effects of competition counterbalance the diffusion of new ideas, so that there is no significant effect on productivity. Moreover, as foreigners acquire local firms and gain market share, we observe a relative decline of national capital in the sector.

The impact on wages is expected to be negative. As retail processes use mainly low-skilled labour, there are no incentives to increase wages to compete with local firms. On the contrary, increasing competitive pressure prevents any upward evolution of remuneration.

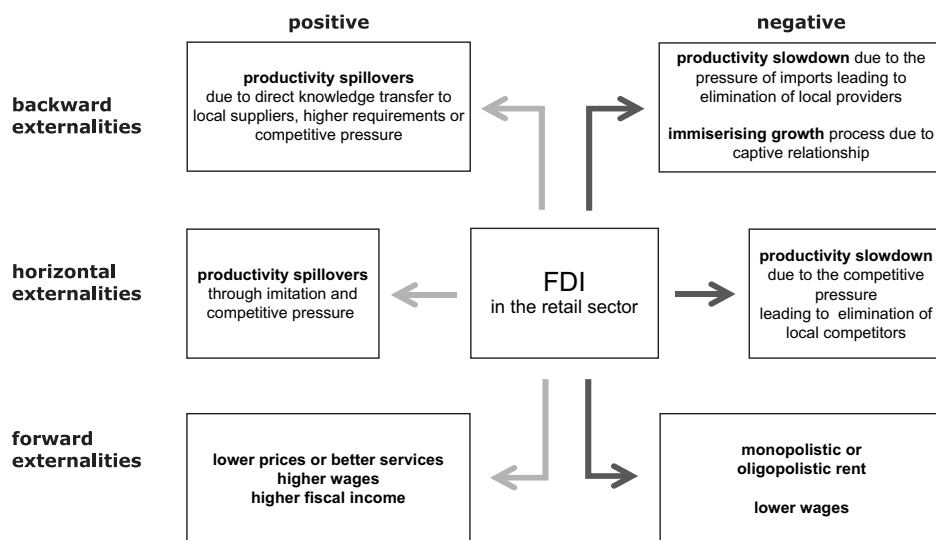


Fig. 1. Potential externalities from FDI in the retailing sector of a developing country.

We shall not examine the fiscal impact, which is assumed to be quite low as the tax burden is low and many traditional retailers are already in the formal economy (McKinsey, 2003).

The second hypothesis is about the growing imports' pressure and the risk of uneven development of local suppliers that follow the entry of global retailers. Positive productivity spillovers from foreign firms to local suppliers could be expected as a result of direct assistance in their operations and more demanding requirements. Even so, we propose that the net effect to local producers is negative. First, transnational retailers are better connected to global commodity chains, so they will import more than their local counterparts. This phenomenon is accentuated by the institutional context. With the normative changes adopted at the constitutional and legal level with the 1993 *Ley de Inversión Extranjera* and international treaties (Dussel Peters *et al.*, 2003, pp. 56–64; De Mateo Venturini and Lopez Hoher, 2003) the government is no longer allowed to impose local contents conditions or to limit imports. Second, as foreign retailers initiate a process of increasing control on supply chains, they weaken the bargaining power of suppliers. In this way, many local suppliers may be able to increase their efficiency while simultaneously suffering a slowdown in accumulation (the uneven development mechanism), which supports a concentration process.

This research draws on an eclectic set of sources. First, we use aggregate statistical information provided by the *Encuesta Mensual sobre los establecimientos Comerciales* of the Instituto Nacional de Estadísticas Geografía e Informática (INEGI) which covers 33 metropolitan areas in Mexico from 1994. We also use complementary data from the INEGI and the Secretaría del Trabajo y Previsión Social (STPS), particularly where wages are concerned. Second, to get information at the company level we use the annual edition of *Las 500 compañías más importantes de México* edited by the Mexican business magazine *Expansión*. But owing to the low reliability of this source (missing data, errors in units, etc.), where possible we used the financial and operating data provided by companies in their annual reports. However, on the companies' websites, these reports are available only from 1997 and only for the largest companies. In order to obtain evolutions in real terms, we deflated the monetary data in pesos on the basis of the Índice Nacional de Precios al Consumidor of the INEGI.

To obtain operating data for a wider range of companies, we used the annual *Directorio* of the professional organisation ANTAD (Asociación Nacional de Tiendas de Autoservicio y Departamentales), though it does not provide financial information.

For company strategies and stakeholder information, we used press articles in addition to annual reports. In order to confirm our analysis, we also undertook some interviews with ANTAD officials and suppliers' managers.

3. Transformation of the Mexican retailing sector since 1991 under pressure from foreign companies

There are five main retail channels in the Mexican economy: public markets, mobile street markets, small traditional shops, specialised stores and big-box stores,¹ which include two chains from the state sector (ISSTE, DICONSA) (Schwentenius and Gómez, 2002). In this study, we focus only on the transformation of the private big-box stores segment, which represents about 20% of the retailing sector at the end of the 1990s (INEGI, 1999). We show that FDI accelerates the modernisation of the sector. However, it substantially

¹ 'Big-box store' is a term in the retail sector for a big superstore. 'Big-box' is a description of the physical characteristics of the building: large, free-standing, rectangular, with a flat roof.

reduces the weight of national actors, does not improve productivity among modern retailers and exerts downward pressure on wages.

3.1 Main FDI operations in the retailing sector and the rise of Wal-Mart

In the early 1990s, just before the NAFTA was signed, US companies which had access to information on the negotiations began looking for strategic alliances in order to benefit from the new context in Mexico (free trade and protection of foreign investors). Participating in a global movement of internalisation of retailing firms (UNCTAD, 2004; Kearney, 2004), this was the beginning of an important wave of FDI flows into the Mexican retailing sector (Chavez, 2002). Firms such as Wal-Mart, HEB, Price Smart, Costco, Safeway, K Mart, Fleming and also Carrefour and Auchan have tried to penetrate the promising Mexican market, mainly by joint-ventures with local competitors as well as by acquisitions, although there have also been some greenfield operations (Table 1).

Table 1. *Main foreign retailers' presence in Mexico*

	Date and mode of entry	Type of store
Wal-Mart (USA)	1981: Buys 49% of Futurama 1991 and 1992: 50/50 JV with CIFRA for different formats 1997: Acquisition of majority ownership stake in CIFRA 2000: Increases its share to 60%	All big formats and specialised stores (clothes) and restaurants
Carrefour (France)	1994: JV with Gigante to develop hypermarket chain 1998: Acquisition of Gigante stake in JV 2005: Announces the end of its activities in Mexico	Hypermarkets
Auchan (France)	1995: 50/ 50 JV with Comercial Mexicana to open hypermarkets 1997: End of JV with Comercial Mexicana 2002: Sells its 5 hypermarkets to Comercial Mexicana	Hypermarkets
Safeway (USA)	1981: Enters a 49% JV in Casa Ley	Supermarkets
HEB (USA)	1997: Opens 5 stores in northern Mexico 1991: JV of price club with Comercial Mexicana	Supermarkets Discount club
Costco (USA)	1995: Costco buys the Price Club share one year after the merger between Costco and Price club	
Pricesmart (USA)	2002: JV with Gigante to open membership club discount stores	Discount club
FLEMING (USA)	1992 JV with Gigante to open supermarkets 1998: sells stake in JV	Supermarkets
Kmart (USA)	1993: JV with Puerto de Liverpool 1997: KMART and Liverpool sell their 4 stores to Comercial Mexicana	Supermarkets

Source: Press articles; Annual Reports; McKinsey (2003).

Though some of these actors sold their Mexican assets after a few years (Fleming, K Mart, Auchan, Carrefour) others are still operating in the country. Wal-Mart bought a majority of CIFRA in 1997 and became the leading player in the sector.

The modern private retailing channel is dominated by four main groups (Wal-Mart, Gigante, Comercial Mexicana and Soriana) that represented about 60% of sales and trading space in 2004. But Wal-Mart is the unquestionable leader. In fact, because of its more efficient use of capital, it has a comparatively higher portion of sales (43% of big-box store sales) than of retail space (28% of floor of sales) (ANTAD, 2004). Wal-Mart has increased its net sales by nearly 100% in real terms since 1994, while Comercial Mexicana and Gigante only maintained their positions. Soriana grew rapidly but from a much lower starting basis than Wal-Mart/CIFRA (Figure 2). Moreover, it is important to note that the increasing competitive pressure has not affected these enterprises uniformly, mainly because of their geographical locations. Indeed, three-quarters of Wal-Mart stores, Gigante and Comercial Mexicana are located in the centre of the country and the capital, whereas Soriana has most of its stores in the northern states.

There are different analyses of the causes of Wal-Mart's success in Mexico, a success which contrasts with the limited growth of other foreign companies such as Carrefour. The more common explanations focus on a supposed set of superior management techniques and technologies. Nonetheless, these reasons do not explain why Wal-Mart is so successful in Mexico and not in other Latin American countries such as Brazil and Argentina. To explain this, Tilly (2004) suggests circumstantial advantages, such as the opportunity to purchase the retail leader at the right time and the benefit deriving from first mover position *vis-à-vis* other transnational corporations. The geographical positioning that allows Wal-Mart to use its US supply chains to supply Mexican stores is also another advantage over its main global rival, the French firm Carrefour.

3.2 The growing weight of the modern retailing segment and of new retailing formats

The growing inequalities in Mexican society may constitute a barrier for modern sector development *vis-à-vis* the informal retailing segment (Tilly, 2004; ANTAD, 2004), but this phenomenon is, by definition, difficult to corroborate. However, during the last decade,

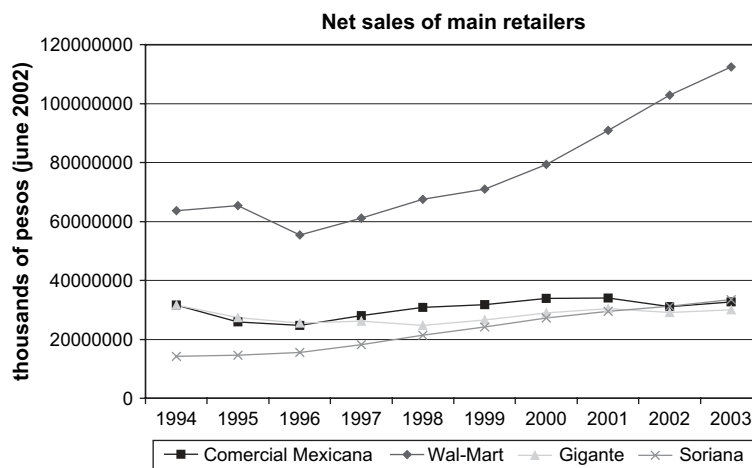


Fig. 2. Evolution of the four main modern private retailers' sales.
Source: Annual Reports.

the modern and private self-service channel is clearly gaining market share to the detriment of traditional and formal retailing formats. In the 33 urban areas covered by the INEGI's monthly study about commercial establishments between 1994 and 2003, modern retailers have increased their sales by 40% in real terms, while traditional shops have reduced or just maintained their sales levels (INEGI, 2004). This is consistent with the analysis of some actors such as Comercial Mexicana, which considers that its progression up to 2001 resulted mainly from the decrease in small independent retailers (Annual Report, 2001). Department stores (modern stores selling mainly clothes and various equipment) have also benefited from significant growth.

In terms of employment, we observe the same contrast, but it seems that the increase in employment in the modern retailing sector does not imply a destruction of jobs in the other kinds of establishment. This last conclusion has to be taken rather cautiously because the 'employment' category of the INEGI does not take into consideration the number of hours that each employee worked.

The weight of foreign capital is more important for those types of store introduced since the beginning of the 1990s such as discount clubs, hyper and megamarkets but also hard discount shops that cater to lower income shoppers. All the discount clubs have a main or majority stake of foreign capital (joint venture Gigante–Pricesmart; joint venture Comercial Mexicana–Costco; Sam's Club of Wal-Mart). Wal-Mart has a commanding share of the hard discount segment with its chain called Bodega (Warehouse). In the hyper- and megamarkets segment, actors in a joint venture (JV) or having a majority stake of foreign capital represent 32% of retail space. Meanwhile, Comercial Mexicana and Gigante which have had a JV with Carrefour and Auchan in this segment represent another 28%. By contrast, actors linked with foreign capital represent only 14% of retail space in the supermarket segment (ANTAD, 2004; Annual Reports).

These elements suggest that FDI plays a decisive role in transforming the retailing sector: while introducing new formats, it manages to enlarge the portion of the population that buys products in the modern retailing sector. At the same time, local firms act as second movers in these changes or rely on JVs) with foreign companies for their development in new formats.

3.3 Productivity gap and distributional consequences

Most of the local competitors have lost market share because of the competitive pressure of new actors, specifically of Wal-Mart. This phenomenon causes a decrease in productivity. The evolution of the 'sales per employee' indicator—a proxy for labour productivity—shows a strong decrease for the main actors after the sharp devaluation of 1994 and a slow recuperation since that moment, with the exception of Soriana, which has continued to decrease. It is worth noting that the recuperation of Wal-Mart is stronger than that of its competitors and, especially, that its productivity is significantly higher (Figure 3).

The relationship between sales and trading space (floor of sales) provides a proxy of so-called 'capital productivity'. The data show a tremendous gap between foreign retailers, especially Wal-Mart, and local firms (ANTAD, 2004) confirming that transnational corporations possessed specific efficiency advantages. In dynamics, the comparison of Wal-Mart with Comercial Mexicana and Soriana since 1997 shows that Wal-Mart is improving its performance, while the others are deteriorating (Figure 4). This means that the arrival of new productive ideas and the possibility for local firms to imitate transnational corporations do not compensate for the destructive consequences of higher competitive pressure.

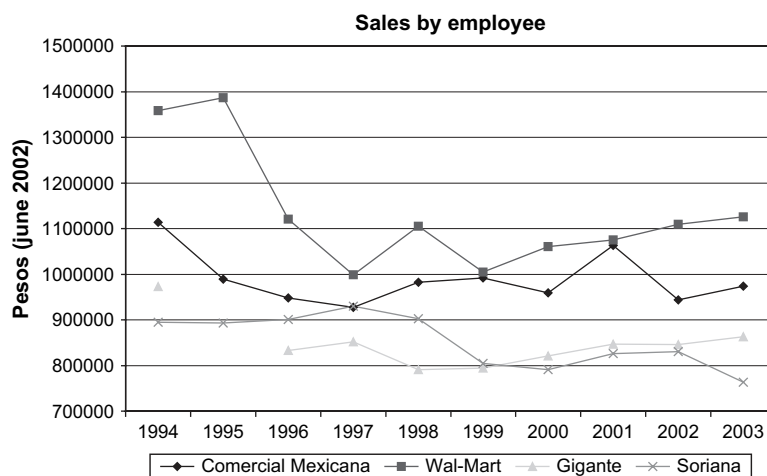


Fig. 3. Sales by employee for main modern retailers between 1994 and 2003.
Source: Annual Reports; Expansion.

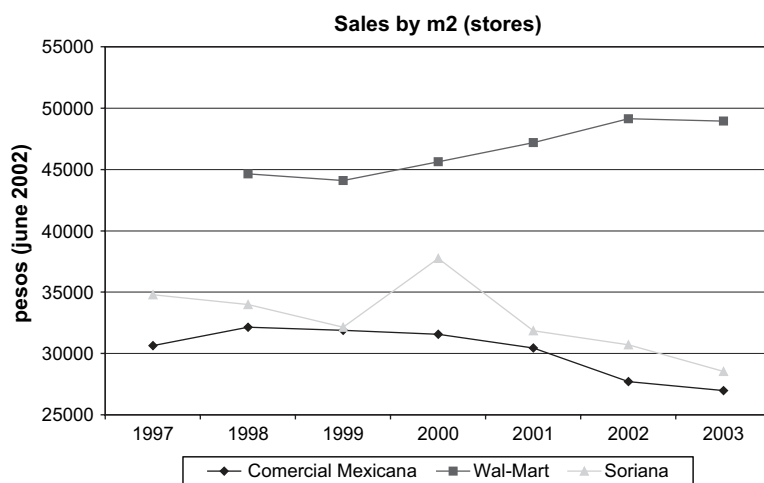


Fig. 4. Annual sales by m2 in the stores of Wal-Mart, Comercial Mexicana and Soriana between 1997 and 2003.
Source: Annual Reports; Expansion.

The consequence of this productivity slowdown is a decrease in the rate of earnings in the modern sector as a whole. We observe an immediate recuperation after the devaluation of 1994, with a rate of earnings about 6% for Comercial Mexicana and Cifra/Wal-Mart, nearly 9% for Soriana and about 3% for Gigante. But since 1997–98, we observe a clear decrease before stabilisation at a lower level in 2002–03. As a result, the rate of profitability is nearly 5% for Wal-Mart and Soriana but less than 3% for Comercial Mexicana and only 1% for Gigante (Annual Reports, *Expansion*). This evolution suggests that FDI, while increasing competitive pressure in the sector, has allowed disruption of previous oligopolistic rents.

The evolution of net earnings in real terms demonstrates even more clearly a strong distributive effect. Whilst earnings in real terms for Gigante and Comercial Mexicana fall dramatically between 1995 and 2003 and Soriana stabilises them, Wal-Mart manages to increase its earnings by about 30% (Figure 5).

At the same time, workers in the sector suffer a decrease of wages of 18% in real terms between 1994 and 2003. As reported in Figure 6, the self-service segment of the retailing sector where most of FDI is concentrated is the one where the evolution of remunerations is the worst for workers. This evolution is also negative in comparison with manufacturing. In 2004, wages in the commercial sector were about 14% lower than in other sectors of the formal economy, especially the manufacturing sector (Secretaria del Trabajo y Previsión

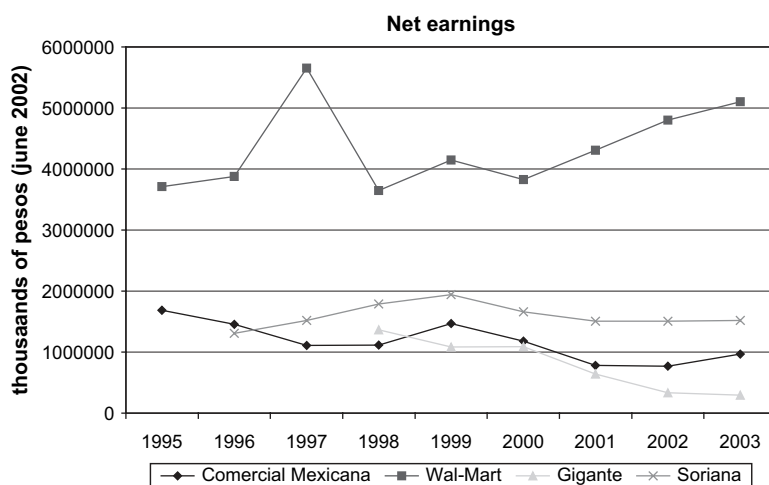


Fig. 5. Net earnings for the main retailers from 1994 to 2003.
Source: Annual Reports; Expansion.

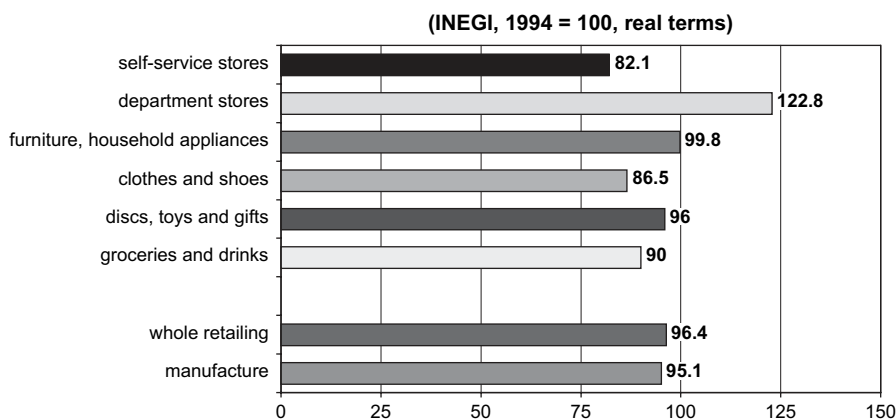


Fig. 6. Evolution of personal remunerations for different class of retailing establishments between 1994 and 2003.

Social, 2005). But data from collective bargaining contracts¹ in the Federal District establishes that the situation for workers was significantly worse. Although they are heterogeneous because of regional disparities, we can see that the daily rate of pay for a salesman of general merchandise was only about 50% of the average wage in the economy (Junta Local de Conciliación y Arbitraje del Distrito Federal, 2005). Wages at Wal-Mart are mostly at the same low level as at other main retailers, and workers in this group get even lower social benefits (Tilly, 2004). Indeed, while local retailers try to prevent turnover by offering social benefits, Wal-Mart prefers to stabilise its workforce by selling shares to its employees (ANTAD, Interview; Wal-Mart Annual Reports).

These elements confirm that, within the modern retailing sector characterised by a low-skilled, unstable and weakly unionised labour force, FDI does not produce positive effects in terms of wages for the workers. On the contrary, the increasing competitive pressure is a factor that tends to reduce wages.

4. Changes in the supply conditions and its consequences for local suppliers

FDI in the retailing sector is having a profound impact on local supply networks. Indeed, foreign retailers already have global supply chains and also specific know-how in managing relationships with suppliers (Coe and Hess, 2005; Coe, 2004; Reardon *et al.*, 2003; Currah and Wrigley, 2004). These innovations imply a direct impact on suppliers as foreign companies win market share but also, indirectly, as local retailers adopt new practices through imitation.

4.1 The growing competitive pressure of imports

In 2003, Wal-Mart was not only number 6 on the list of main importers in Mexico, as noted by *Expansión*, but also the greatest contributor to the Mexican commercial deficit, with a negative balance of USD706 millions (*Expansión*, 2004). This represents approximately 50% of the imports of the four main retailers, 3.5% of consumption goods imports and 0.5% of global imports (Table 2).

These facts about Wal-Mart underline an important aspect of the impact of FDI in the retailing sector. As multinational retailers have a global sourcing organisation, they are expected to use this specific advantage and their strong global market power against their local competitors. And Wal-Mart is the paragon company for the buyer-driven global economy. It has both the capacity to shift production from one country to another and

Table 2. Wal-Mart's imports in 2002 and 2003

	W-M imports (USD)	% of the four main retailers imports	% of the imports of consumption goods	% of total imports
2003	705,859,000	50,8	3.28	0.41
2002	827,944,000	55,5	3.9	0.49

Source: Annual Reports; INEGI.

¹ The collective contract is a contract at the enterprise level between employer and employee representatives that defines social benefits, wages and working conditions. Within the retailing sector, these contracts are typically approved by virtual trade unions that are created by the employer (union simulation) only to respect the legal constraint (Tilly, 2004; Bouzas and Vega, 1999).

a solid partnership with China (*Frontline*, 2004). Moreover, the overvalued peso, in the real exchange rate, favours imported products against local ones. As expressed in the annual letter to shareholders (Wal-Mart, 1998, 1999) this element is a critical one for global retailers. Local retailers have therefore also been focusing their attention on increasing their share of imports (Soriana Annual Reports, 2001, 2003; Comercial Mexicana Annual Report, 2002). Simultaneously, the dispositions of the North American Free Trade Agreement (NAFTA) allow mechanisms of fiscal evasion that favour imports, as well as triangulation of imports from Asia while benefiting from NAFTA tariffs (CANACINTRA, interview).

Using data from companies about their imports could help us evaluate this phenomenon better. Nonetheless, we have to keep in mind that these data are only a proxy: all the imported merchandise sold in stores is not necessarily imported directly by the retailers, since they may buy locally from other importers. After 1997, we observe a faster increase in Wal-Mart's imports in real terms compared with its competitors' (Figure 7). If we look at the imports/purchases ratio (Figure 8), we see that all the enterprises have been significantly increasing the share of imports in their purchases, but also that Wal-Mart has shown a much more dramatic evolution: from 20% in 1997 to more than 55% in 2002 and 2003. Over the entire period, Soriana has a higher share of imports as compared with its two main national competitors, but this can be explained by the fact that this group is mainly located in the northern part of Mexico, close to the US.

After 1997, we observe a process of intensification of imports by modern retailers in both absolute and relative terms. We also note Wal-Mart's proportionally higher share of imports as compared with local firms. Considering the Chinese connection to Wal-Mart, this evolution is consistent with the new importance of China's exports to Mexico (especially in such sectors as toys and shoes) and the growing concern about the challenge that it represents for the Mexican economy (Dussel Peters and Xue Dong, 2004).

This growing pressure of imports due to the increasing global sourcing of modern retailers is not the only relevant consequence of FDI for local suppliers. The transformation of the organisation of supply chains' has had a major impact as well.

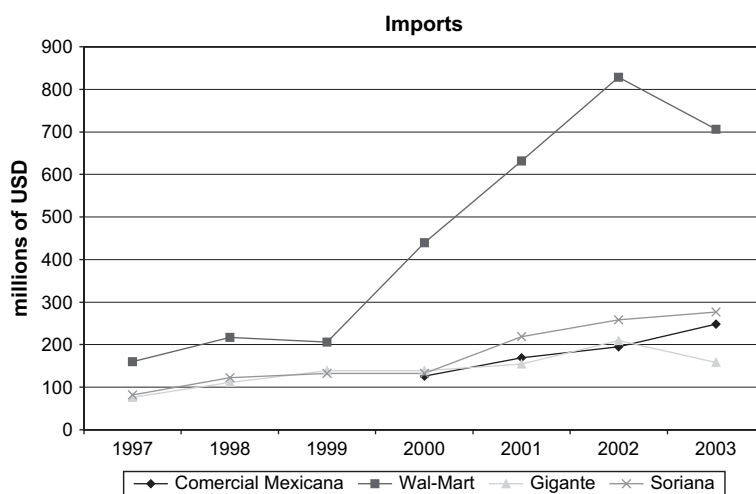


Fig. 7. Imports of main modern retailers between 1997 and 2003.
Source: Annual Reports; Expansion.

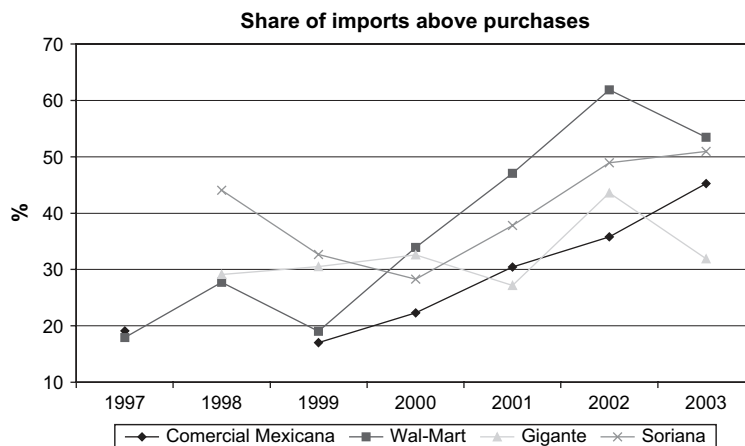


Fig. 8. Evolution of the ratio imports/purchases for main retailers between 1997 and 2003.
Source: Annual Reports; Expansion.

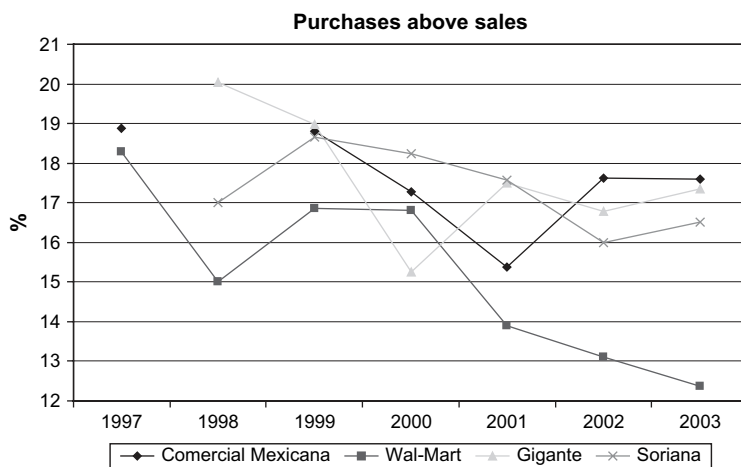


Fig. 9. Evolution of the ratio purchases/sales for main retailers between 1997 and 2003.
Source: Annual Reports.

4.2 The increasing control of supply chains by retailers

After 1997, we observe a severe decrease in the purchases/sales ratio, especially in Wal-Mart (Figure 9). This change may have two explanations. First, retailers may have managed to obtain lower prices from their suppliers but, as they did not pass on the benefits, using their market power position, consumer prices did not benefit from this evolution. This may partially explain the situation: however, since there is no growth in margins over the last years, it is not sufficient to explain the severe decrease in the purchases/sales ratio. The second explanation may be found in the reorganisation of supply chains. By increasing their centralised-distribution capacities, retailers may have internalised one part of the distribution service which is then no longer paid to suppliers.

In Mexico as well as in other emerging markets (Coe and Hess, 2005; Reardon *et al.*, 2003) global retailers have made a significant effort to centralise their purchases and integrate technological improvement (real-time electronic information systems connecting stores to suppliers, centralised buying systems). In 1999, 80% of the products sold in Wal-Mart stores were distributed by its own distribution centres, when at that time this was the case for only 13% of Gigante's products and less than 20% of Comercial Mexicana's. In 2003, this rate was about 50% for Gigante and 79% for Soriana, while Comercial Mexicana aimed for 60%. Simultaneously, local retailers attempted to build as efficient informational tools as Wal-Mart's, which drastically reduce the autonomy of suppliers, as their costs are better known and the production process better controlled. Moreover, to counterbalance the strong negotiating position *vis-à-vis* suppliers resulting from Wal-Mart's increasing market share, Gigante, Comercial Mexicana and Soriana decided to react by creating a purchasing association, Sinergia, in 2002. We also note a shift to a permanent low prices strategy generalised by Wal-Mart in 1999 and adopted by Soriana and Comercial Mexicana in 2002 (McKinsey, 2003; Annual Reports)

Suppliers to the retailing sectors are strongly affected by these changes (Schwentenius and Gómez, 2002). The growing market power of buyers (Wal-Mart and Sinergia) increases cross-regional competition, requires bigger suppliers and tends to weaken the negotiating power of suppliers, who are forced to accept very unfavourable prices or payment conditions. For example, Wal-Mart typically pays its suppliers at a 120 days term but also asks them to grant rebates to maintain the business and even to provide initial stock free of charge when Wal-Mart opens a new store (CANACINTRA, Interview). At the same time, the generalisation of a permanent low-price strategy also increases the financial pressure on suppliers. The growing internalisation of the distribution process by retailers implies that local and regional distributors become redundant, with a loss of distribution revenue to suppliers with proprietary channel and higher costs for supplying traditional retailers.

As shown in Figure 10, in addition to the growing pressure of imports, the likely outcomes of these elements are the elimination of numerous local suppliers, a dynamics of concentration but also a process of *immiserising growth* (Kaplinsky, 2000) for the surviving firms whose margins are reduced even if they improve their performances.

5. Concluding remarks

As transnational corporations have introduced new ideas (new formats, new organisational and informational structures and new marketing strategies) and mobilised knowledge, skills and competences accumulated in other contexts (Currah and Wrigley, 2004), FDI flows into the Mexican retailing sector have led to rapid transformation of the modern self-service segment. This study has examined the externalities that result from the presence of foreign firms within the retailing sector and for the related suppliers. We hope that this study will contribute to the general discussion about the impact of FDI in developing countries.

Within the Mexican retailing sector, there are two main consequences. First, transnational corporations, especially Wal-Mart, have accelerated the growth of the big-box stores segment. This comes at the expense of traditional retailers, as larger population segments are now able to buy in modern stores. Such a 'de-fragmentation' of the retailing sector also occurred in other emerging countries in Africa, Asia and Latin-America (Reardon *et al.*, 2003). However, in parallel, the increasing competition has put local

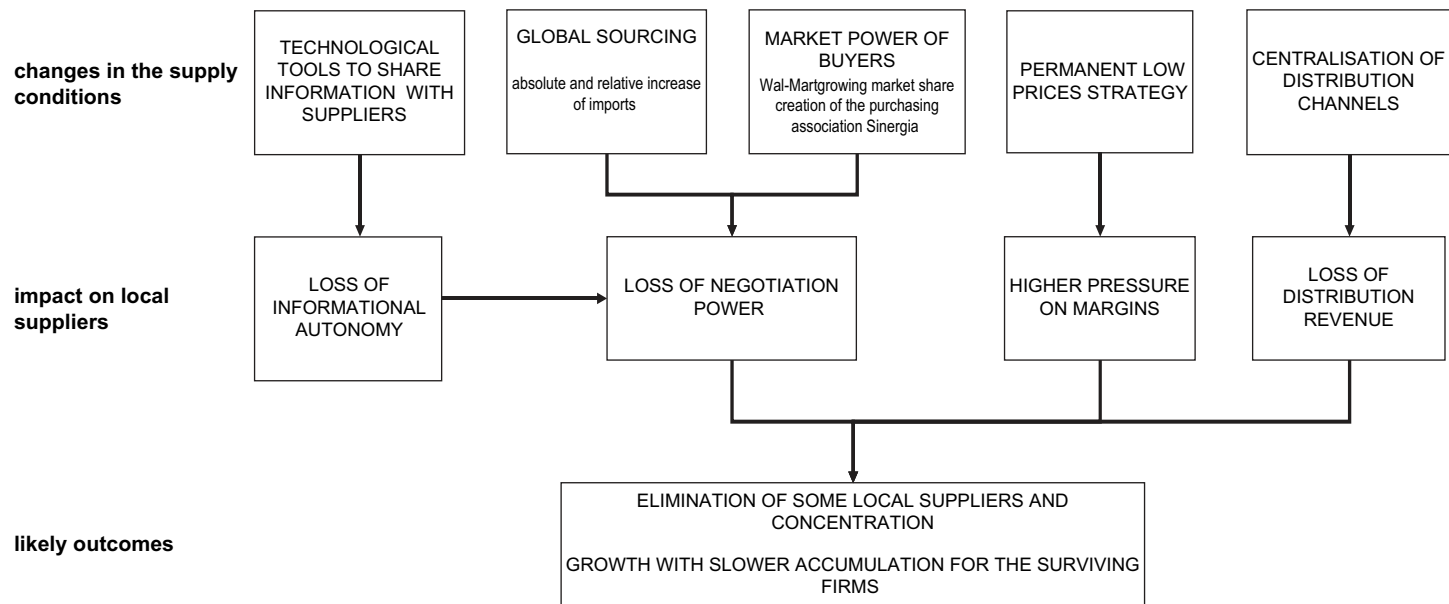


Fig. 10. *Changes in the supply conditions and its consequences for local suppliers.*

modern retailers in difficulty, their productivity and margins decreasing. As a result, we do not observe a positive intra-industry effect on productivity. This is consistent with recent literature about FDI in manufacturing which establishes the absence of a positive correlation between foreign presence and growing sector productivity (Aitken and Harrison, 1999; Kugler, 2000; Smarzynska, 2004). It is worth noting that the positive effect on consumer prices that is associated with competitive pressures may be transitory, since once Wal-Mart has built a strong dominant position, it may use its market power in the coming years to benefit from oligopolistic rents.

Second, we observe that FDI flows in retailing have a negative effect on remuneration: wages in retailing are still far lower than the average wage in the economy and have suffered a worse evolution than those in the commercial and manufacturing sectors. This result is not consistent with studies in manufacturing which show that FDI in developing economies has a positive effect on wages (Lipsey and Sjöholm, 2001; Aitken *et al.*, 1996). Indeed, the characteristics of labour in retailing (low level of unionisation, low skilled, high turnover) contrast with the conditions in manufacturing, where transnational corporations are expected to pay higher wages than local firms in order to attract skilled labour and prevent knowledge diffusion by turnover. In the context of aggressive competition among the main retailers, attracting skilled labour is less important than reducing costs in order to gain market share by lowering prices. One regulatory response to improve wages and social compensations while limiting union opposition could be to upgrade the negotiation of collective contracts from the enterprise level to the sector level.

Significant backward externalities were also observed. Following Wal-Mart's lead, local retailers have reorganised significantly by internalising the distribution of goods within distribution centres, centralising their purchases and pursuing a permanent low prices strategy. Using new informational technologies, buyers have increased their ability to exert governance on value chains (Gereffi and Korzeniewicz, 1994; Humphrey and Schmitz, 2001). These changes have affected local suppliers negatively, as they lose negotiating power and suffer higher pressures on their margins. The consequences of such an evolution are examined in the literature: the asymmetries between local firms and transnational corporations are often deemed to be negative factors, diminishing their capacity to learn and to grow (Dussel Peters, 1999; Dutrenit and Vera-Cruz, 2004; Sacchetti and Sudgen, 2003; Kaplinsky, 2000).

In parallel, the global sourcing capacities of foreign firms and the configuration of international integration (type of exchange, free trade agreements) have increased the competitive pressure from imports that account for a higher part of the products sold within self-service retailers at the end of the period. Wal-Mart even became the main contributor to the Mexican commercial deficit. Negative effects on external balance of FDI are considered in the literature, but they are typically expected to result from financial flows (royalties, interests and utilities) and from imports of capital goods (Krugman and Obstfeld, 2000; Peres, 1990). In developing countries, manufacturing industries oriented to export import intermediary goods as well, but transnational corporations with market-seeking strategies are expected to work mainly with local suppliers (Smarzynska, 2004). The increasing imports related to FDI in retailing constitute quite an original feature with regards to the literature although some empirical studies support such a view (Chudnovsky and Lopez, 2004). The probable outcomes of the growing pressure of imports and the increasing governance power of retailers are the elimination of some local suppliers and a concentration process in supply chains (Coe and Hess, 2005; Reardon *et al.*, 2003) with a risk of immiserising growth for the surviving firms. In order to limit the coercive

bargaining power of the main retailers, the empowerment of suppliers by the way of professional associations may be important, but probably not sufficient. The legal regulation of quasi-formal contracts between retailers and vendors and the prohibition of the most aggressive commercial practices may also be necessary to protect suppliers from abusive quasi-monopsonistic practices. However, the current institutional framework for the international integration of the Mexican economy prevents the government from limiting the pressure of imports and its consequences.

Although further analysis is needed, the arguments presented here are consistent with other studies concerning the internationalisation of retailing, and suggest that FDI flows in this sector may negatively affect the growth of a developing economy. Low consumer prices may affect demand positively, but this phenomenon is partly counterbalanced by the negative effect on wages. Moreover, the competitive pressure of imports and the subordination of suppliers in value chain governance structure limit their ability to accumulate. The ideas gap between developed and developing countries is clearly exploited by transnational corporations in their global strategies. However, because of the characteristics of the sector concerned and the institutional context, these new ideas do not benefit the host economy. This result and the specific mechanisms analysed here emphasise the need not to confine the discussion about FDI consequences to the arguments produced by manufacturing case studies.

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