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GENERAL NEWS

IKEA's India Bet Runs Into Thicket of Rules

Law requiring foreign retailers to acquire products locally slows expansion; red tape, few labor laws

By Preetika Rana

Updated Feb. 23, 2016 5:34 p.m. ET

BHADOHI, India—Swedish retailer IKEA wants to sell its flat-pack dining tables, cotton dish towels and Scandinavian-sounding sofas to India's blossoming middle class. Under Indian law, roughly one-third of those items must be made locally, and that is proving a formidable obstacle.

IKEA has scoured the country for new products that meet its standards and come up nearly empty-handed. Laminated table tops from Indian suppliers contained unsafe levels of formaldehyde and steel dinner plates leached chemicals into food, company scouts found.

When IKEA helped set up a carpet factory seven years ago in the northeastern district of Bhadohi, it found most rugs from the area were knotted at home—often with the help of children—and women weren't permitted to work outside. Workers had to be taught how to use a bank account, in addition to taking workshops on carpet weaving. Last year, only 3% of IKEA's global inventory came from India.

INDIA REAL TIME

- Are You Indian? IKEA Wants to Peek Inside Your Home

For global companies banking on India to pick up the slack left by a slowing Chinese economy, IKEA's struggle is a sobering reminder of the limitations of that idea. Foreign manufacturers have long

complained about red tape and poor quality. Now retailers, including Wal-Mart Stores Inc., and French supermarket chain Carrefour SA, who had once bet on an emerging new class of wealthy Indians, have dropped their plans to open supermarkets in the country.

"It hasn't been easy," said Sandeep Sanan, IKEA's new business head tasked with ramping up production in India. "Change is a slow and painful process—and cannot happen overnight."

Previous efforts

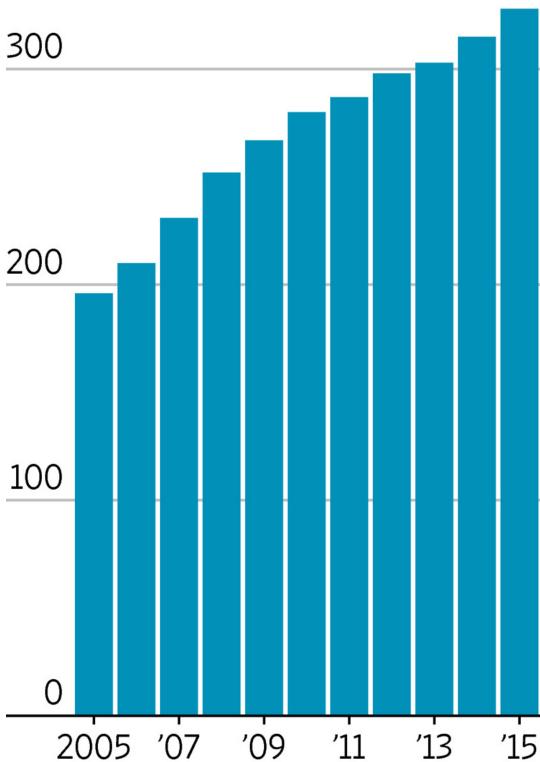
IKEA had previously fought, and lost, a battle to do business here. In 2007 it arrived and set up a retail team in hope the government would relax its norms and let it run its own stores, rather than open them with a local partner. The lobbying didn't go as planned and IKEA had to fold its tents.

In 2012, when the government finally signed off on full foreign ownership of retail outlets, it added a requirement that at least 30% of the value of its inventory must be manufactured in India, and said that target had to be reached within five years—in some cases, before setting up shop.

IKEA Chief Executive Peter Agnefjäll flew to New Delhi in November to personally lobby Prime Minister Narendra Modi for a change to the timetable. The Indian government

Buildup

IKEA stores world-wide



Source: the company

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said the clock could start from the time retailers open their first store, giving them a grace period of a few years.

For IKEA that means it now must comply by 2022.

Indian officials warn that foreigners shouldn't expect additional concessions. "We have liberalized India as much as possible," said Amitabh Kant, the senior-most bureaucrat at India's Department of Industrial Policy and Promotion, which oversees foreign-investment rules.

In 2012, Indonesia unveiled a rule that required franchisees, including IKEA's, to obtain 80% of its goods locally, although the time frame for meeting that requirement was unclear. The government gave IKEA a pass after the retailer argued the policy would thwart business.

The Swedish company potentially has much to gain. While the current restrictions might seem like a headache, IKEA executives acknowledge

that making goods in India will help them lower overall production costs. The company also has large manufacturing operations in Europe and China.

Along with IKEA, U.K.-based grocery giant Tesco PLC is plowing ahead in the hopes of eventually opening retail stores with an Indian partner. Trent Hypermarket, a joint venture between Tesco and India's Trent Ltd., declined to comment on the country's local-production rules.

With 1.2 billion people and a middle class bigger than the population of the U.S. by some estimates, India is one of the last big untapped frontiers for international retailers. Last year, it dethroned China to become the world's fastest-growing big economy.

That said, the country is bedeviled by an unskilled labor force, poor infrastructure, outdated technology and red tape, which have kept manufacturing at 17% of the country's economy, versus 36% for China.

Housewares, IKEA's area, are particularly underdeveloped, with an estimated 90% of domestic sales coming from tiny players and craftsmakers, who make everything from cupboards to cushion covers in cramped homes and neighborhood bazaars.

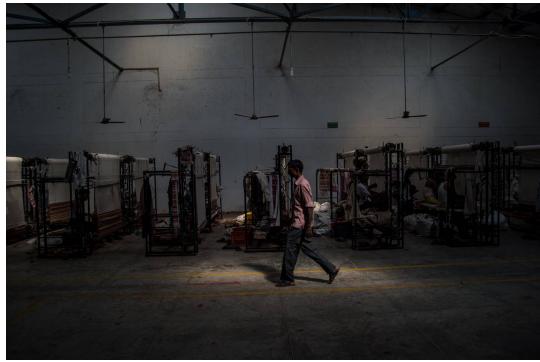
"Just to get people to use the right kind of glue, the right kind of paint—it's difficult. It's very difficult," said Bedraj Tripathy, an associate vice president at Godrej Interio, one of India's largest domestic furniture makers.

In 2012, IKEA started the process of vetting a factory owned by SEL Manufacturing Co mpany Ltd. near the northern city of Ludhiana, which made bath towels. The facility had an impressive client list, including Wal-Mart, Target Corp. and Bed Bath and

Beyond Inc. And it met basic IKEA standards in areas such as forced labor and minimum wages, which meant it could start producing for the retailer on a trial basis.

To permanently qualify for IKEA's coveted business, the factory had a year to meet the rest of the company's standards. IKEA adheres to European Union criteria that, for example, sets limits for chemical content in items including table tops and cutlery. India has no binding safety standards for housewares.

The retailer also has a list of workplace rules its suppliers must meet, including no child labor and a requirement employees be trained in firefighting and first-aid, as well as deposit their monthly wages in a bank account—a tall order in a country where nearly half the adult population doesn't have one.



This facility in Bhadohi, a district in northern India, employs 2,000 workers to weave carpets for IKEA's stores around the world. Here, men knot carpets on traditional looms. PHOTO: VIVEK SINGH FOR THE WALL STREET JOURNAL

IKEA auditors found SEL's towel factory wasn't storing hazardous chemicals properly, and that bureaucratic snarls had delayed the issuance of a required environmental permit. What's more, many of the factory's laborers were working 12 to 14 hours a day, taking advantage of an Indian law that requires employers to pay double for time worked beyond nine hours a day.

IKEA proposed the factory divide workers into three shifts of eight hours, its own daily limit for working hours. The proposal cut deep into worker pay. Many laborers quit and joined other factories. Dozens threatened to leave.

"People were turning against us," said V.K. Goyal, SEL's chief executive. "We had nearly given up. We told IKEA it's not possible to do what they want—that too in a year."

IKEA granted the factory another year to meet its standards and worked out a new plan: Hire fresh workers and offer subsidized housing as an incentive instead of overtime.

During the next two years, the factory organized recruitment drives in neighboring towns and villages of the predominantly Sikh region. Managers made announcements on loudspeakers outside Sikh temples and urged local priests to encourage people to sign up. It doubled the size of its housing complex to accommodate 2,000 people and built separate quarters for men and women.

Some success

SEL's factory became fully compliant with IKEA's standards in December 2014, two years after they began working with the retailer. Last year, the facility shipped about eight million towels to IKEA's stores in Europe and North America, including its popular Hären range. Homes for another thousand workers are under way.

Things were tougher in the traditional carpet belt of Bhadohi, where IKEA began purchasing rugs in the 1990s. In 2009, the company hired carpet supplier Eastern Mills Ltd. to build a factory there, to ensure that its rugs weren't made with child labor. Eastern Mills had sold rugs to retailers such as Macy's and J.C. Penney Co., but had only bought and packed the goods—never produced them.

IKEA asked Eastern Mills to build a plant that would handle spinning yarn, weaving and packaging—a type of facility that didn't exist in Bhadohi at the time.

In India, IKEA Weaves Change in the Workplace

Ramping up IKEA's business in India has entailed building factory resources and testing cultural norms



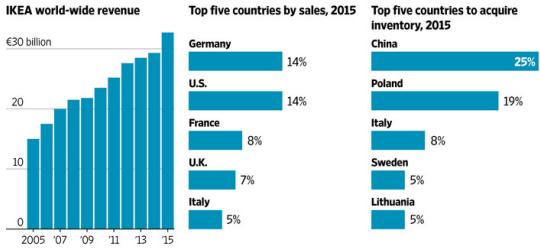
Women use wool yarn to weave a carpet on this loom. One such carpet takes four days to weave, and will ultimately sell in IKEA's stores for \$139. VIVEK SINGH FOR THE WALL STREET JOURNAL

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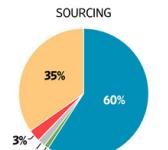
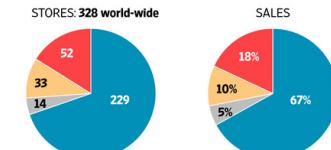
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Wall-to-Wall Coverage

IKEA has been trying to build a network of suppliers in India, from which it currently pulls 3% of global inventory, in order to open retail stores there.



Regional comparison, 2015



Note: €1 billion = \$1.09 billion at the current exchange rate
Source: the company

"We had to go door to door to convince people to come out and work," recalls Zafar Ansari, the managing director of Eastern Mills. Hiring women was particularly hard in the Indian countryside; the factory had none when it opened in 2010.

Mr. Ansari persuaded parents and village leaders to allow women to work, and eventually organized tours around the facility to assure locals it was a safe place. About a dozen women enrolled the next year.

Some who took the leap say they were chastised—at times by their own friends and family. Young mothers faced opposition from their families, who accused them of choosing work over their children.

"They would say, 'Do you have no shame? How can you dare to work outside your home,'" said Fatima Begum, who started working at the factory in 2012 with her husband.

To help ease child-care concerns, Mr. Ansari built a nursery in the plant. IKEA mechanized traditional looms, while Mr. Ansari got everyone to open bank accounts. The factory gave classes on personal hygiene, which discouraged workers from defecating outdoors and spitting in the open.

It took two years before the factory was running full tilt. Now, its 2,000 workers produce 175,000 rugs a year for sale in IKEA outlets around the globe. Over its entrance is a sign



It was a big challenge convincing women to work at the carpet-making facility. Factory officials went door-to-door to assure them it was a safe place to work. Fatima Begum, who joined the factory in 2012, says her neighbors initially chastised her for working outdoors. PHOTO: VIVEK SINGH FOR THE WALL STREET JOURNAL

reading “no child labour” in big block letters. Another sign that says “no spitting” has been less effective: The base of the factory’s whitewashed walls is stained red by betel-nut chewing workers.

IKEA currently has more than 45 local suppliers making mostly textile products such as bedcovers, carpets and curtains—around 10 of them signed during the past three years. All those suppliers together would still account for less than 5% of inventory if IKEA were to open a shop in India now, a long way from its target.

IKEA hopes to sign 10 new suppliers this year, including those that can make mattresses, sofas, bookshelves and wardrobes. It will likely have to import most of its furniture, drinking glasses, metal products and ceramics when the first planned shop opens in 2017.

Mr. Sanan, the IKEA official, and his team, are getting creative in their search for more local inventory. One lamp supplier has started making wardrobe hangers. A few others are experimenting with mango bark, bamboo, coconut fiber, jute and sugar cane—resources indigenous to the South Asian nation—to develop chairs and chopping boards.

“We want to continue making more in India,” says Mr. Sanan. “But it will take time to do it right.”

—Sara Schonhardt contributed to this article.

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