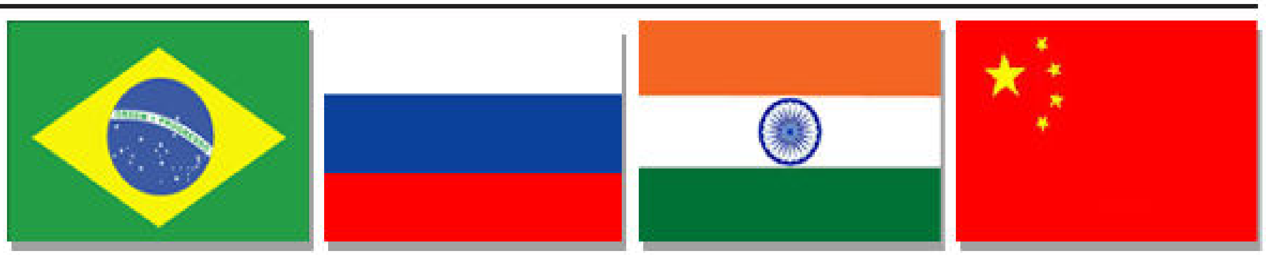
ATKEARNEY

The BRIC Promise



Introduction

Hardly a day goes by without a magazine or newspaper cover talking about retail opportunities in emerging markets. The four giants leading the charge amongst these economies are Brazil, Russia, India and China - BRIC Countries.

Although, these countries account for more than 42%[1] of the world's population, their economies account for only 26%[2] of the world's GDP. But these countries have been on a tear for the last 5 years - ~7% annual growth rate, and are projected to maintain the pace. The BRIC countries clearly outpace not only the developed world, but other emerging markets like Vietnam, Malaysia, Ukraine and Argentina. Given the recent spate of economic reforms in these countries and limited investment options in the developed world, the BRIC countries are clearly in for a long spell of sustained growth.

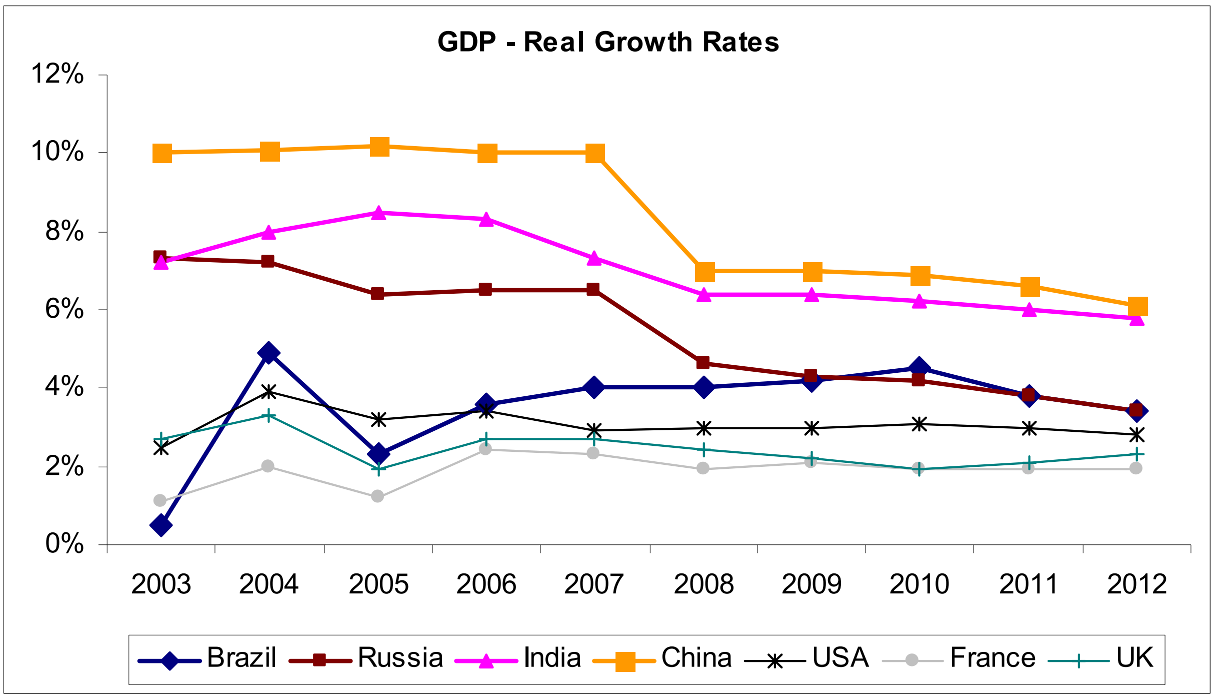


Figure 1: Real GDP Growth Rates for BRIC and Developed countries over 10 years

The retail markets in the BRIC countries are already sizeable - in India, retail today the second largest industry, after agriculture, employing more than 3 million[3] people. As disposable income increases and consumption patterns change, the retail industry in these countries is slated to grow even bigger. In Russia, the retail market is slated to grow by 10% after an impressive 13% last year. The picture is even more dramatic in India – the retail sector is expected to grow from $315 billion to $427 billion by 2010 and $635 billion by 2015.

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[1] Country Population Figures - CIA Factbook

[2] Country GDP Figures - CIA Factbook

[3] Retail Biz India

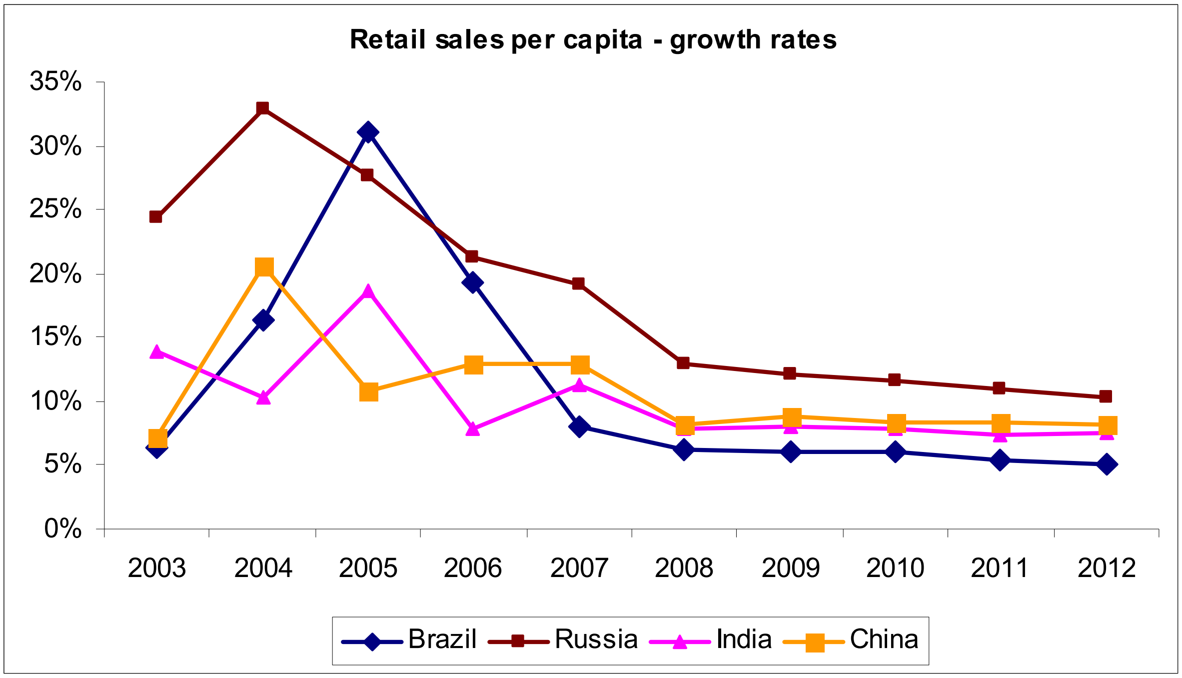


Figure 2: Growth of Retail Sales for BRIC countries over 10 years

Retail has additional factors that make the BRIC opportunity even more attractive. The retail market in these countries has, until recently, been largely unorganized. Organized retail accounts for only 15% across the BRIC countries – in the developed countries, the number is closer to 80%. Across the BRIC countries, the top 5 retailers only account for ~ 9% of the market. BRIC markets are largely fragmented with a high concentration of private owners and mom & pop shops.

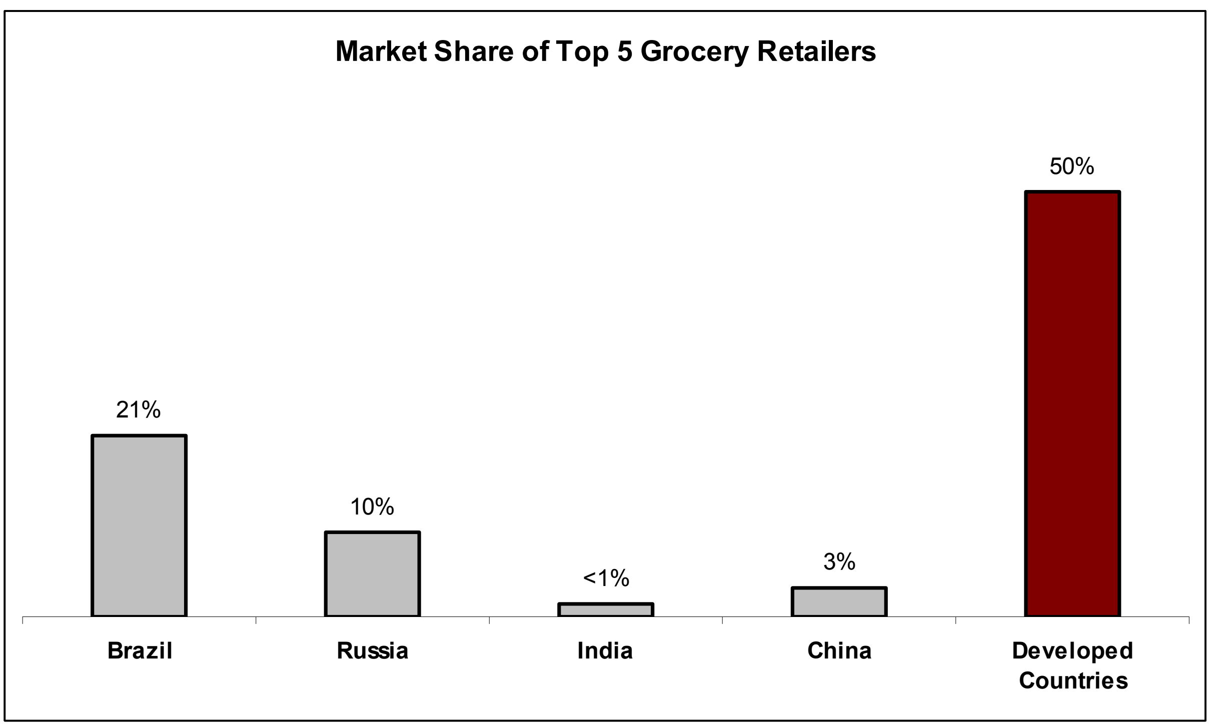


Figure 3: 2007 Market Share of top 5 Grocery Retailers in the BRIC and Developed countries

In India, while large retail outlets will bring low prices to customers and increase the potential for one-stop shopping, the millions of mom and pop shops will need to evolve to provide enhanced customer centric offerings or face significant risks - this is a socio-political challenge that the BRIC economies must overcome as they transition to organized retail. It is also a political challenge that various countries are grappling with that will require political leadership to overcome.

With the increased investment in these countries, the supply chain and other infrastructure supporting the retail industry are rapidly being upgraded. India alone expects an investment of $30 billion in the retail related infrastructure sector alone over the next few years The market is ripe for large retailers to establish their supply chains, drive efficiencies and increase consolidation across the industry.

BRIC consumers are changing their purchasing habits and patterns to drive organized retail growth in these countries. These consumers are demanding more:

➔ Shopping choices like malls, hypermarkets, supermarkets and convenience stores. In India alone, in the last 5 years, the number of big shopping malls went from zero to more than 100.

➔ Sophisticated merchandise including established brands and modern items

➔ Customer-friendly shopping experiences like concierge service

Easily accessible credit lines are spurring further growth in these retail markets - the Chinese credit card market will rack up more than $3 billion in annual revenues by 2010. Traditionally, given the low income levels in the BRIC countries, credit was a necessity and with no robust financial markets, it was provided by small scale inefficient sources like money lenders or the mom & pop retailers themselves.

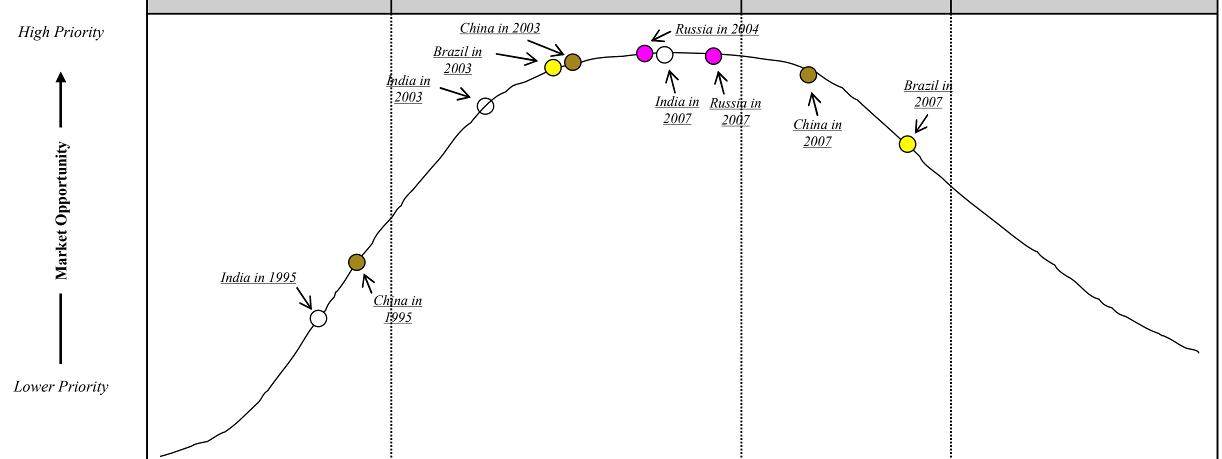
Thus, across the opportunities in the global retail landscape, the BRIC countries are undisputedly shaping up to be tomorrow’s crown jewels.

Timing

Market timing is increasingly important as BRIC opportunities continue to morph over the next few years. Retail opportunities across these markets are very attractive - the time to realize the potential is now. There are a number of factors driving the urgency –

Opening the economies

Recent macro-economic and geo-political changes have enhanced the market opportunities and increased accessibility in these markets. India and China have further reduced the regulatory and legislative burden of doing business especially in the retail sector. The retail market across these countries are also at different points in terms of the window of market entry. In Brazil, wave 1 (mass merchandise & discount) & 2 (apparel, drugstore, electronics etc.) retailer markets are already past the initial opportunity with the top 5 retailers accounting for upto 40%[4] of the market. In contrast, in India the market for all retailers is wide open but the opportunity is closing fast. In Russia and China, the opportunity of direct entry for Wave 1 retailers is past but opportunities for expansion into Tier 2 cities and market entry for Wave 2 retailers are large.



	Emerging	Peaking	Declining	Diminishing
Strategy	❑ Monitor markets. Potentially send 'research team'	❑ Open sourcing office and/or step up retail stores. Test the market	❑ Scale up openings to capture market share	❑ Are you a already a leader in your segment/profitable?
Formats	❑ NA	❑ Supermarkets/hypermarkets, Cash & Carry and c-stores seem to succeed better than others	❑ Discounter models have a high growth	❑ No pattern identified
Labour	❑ Identify skilled labour pool for market	❑ Hire and train local talent / Expatriate mix balance	❑ Switch balance from expatriate to local staff	❑ No pattern identified

Figure 4: Window of Opportunity Analyses[5] indicating market position

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[4] Planet Retail

[5] A.T. Kearney Analyses

Heightened Domestic Competition

As time passes, competition in these countries becomes more sophisticated, experienced and entrenched. Home-grown competitors are the biggest threat – with regional heritages, influential connections and a deep knowledge of the local culture, these companies pose a stiff challenge to new market entrants. Some of these companies even have the hallmarks of true global competitors (Bejieng Hulian, Reliance and Acatadao) – they grow stronger and larger by avidly learning from the global best and adapting it to the local environments. BRIC markets will become increasingly difficult to penetrate as these companies turn into true regional retail powerhouses.

Value-Chain Competitive Advantages

Early entry can help establish long-term competitive advantages (supply chain, brand etc.). There are large infrastructure opportunities in the BRIC countries – for e.g. cold chain distribution logistics in China, retail locations in Russia, contract farming in India and regional sourcing development in Brazil. Entering these markets at this stage will allow retailers to partner with key projects in these areas, lock upstream value chain components and build a long-term sustainable competitive advantage – for the last 2 years, Reliance Retail has been acquiring and signing agreements with large groups of farmers to build an exclusive and guaranteed source for its groceries in India.

BRIC: Comparing and Contrasting the Opportunities

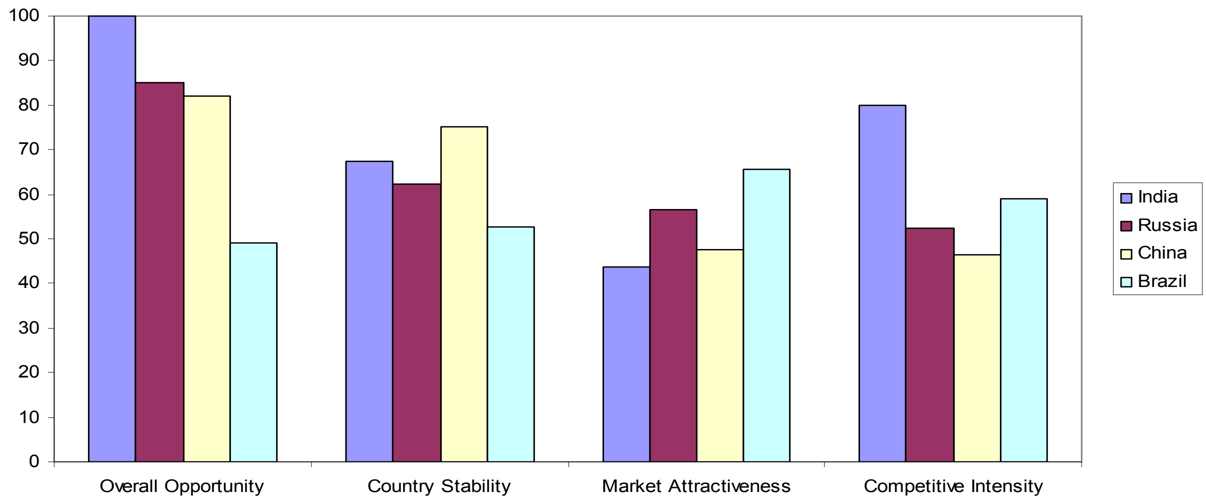

Figure 5: Comparison of the Retail Market Opportunity across the BRIC countries

Note: We have studied and analyzed the retail opportunities in the four BRIC countries across a range of parameters to highlight the retail market opportunity and attractiveness[6].

India leads the pack with the most attractive retail opportunity across the BRIC countries today. The recently relaxed regulatory requirements and dearth of domestic organized retail powers the sizeable opportunity in this market.

Russia and China still have significant potential in their retail markets – they face different challenges though. Low urban population proportions and high domestic competition in Tier 1 cities are impacting retail opportunities in China. In Russia, political and business environmental challenges abound – economic corruption is a key hurdle.

In Brazil, the recent political turmoil and economic missteps are reflected in the higher country risk. Despite that, the Brazilian retail market remains hugely attractive, especially with its huge urbanized and concentrated population (São Paulo and Rio de Janeiro together contain about 17% of Brazil's population) and potential for organized retail (the top five players accounting for only ~25% of the market).

[6] For more details on the study methodology, please refer to the Appendix

Country Stability

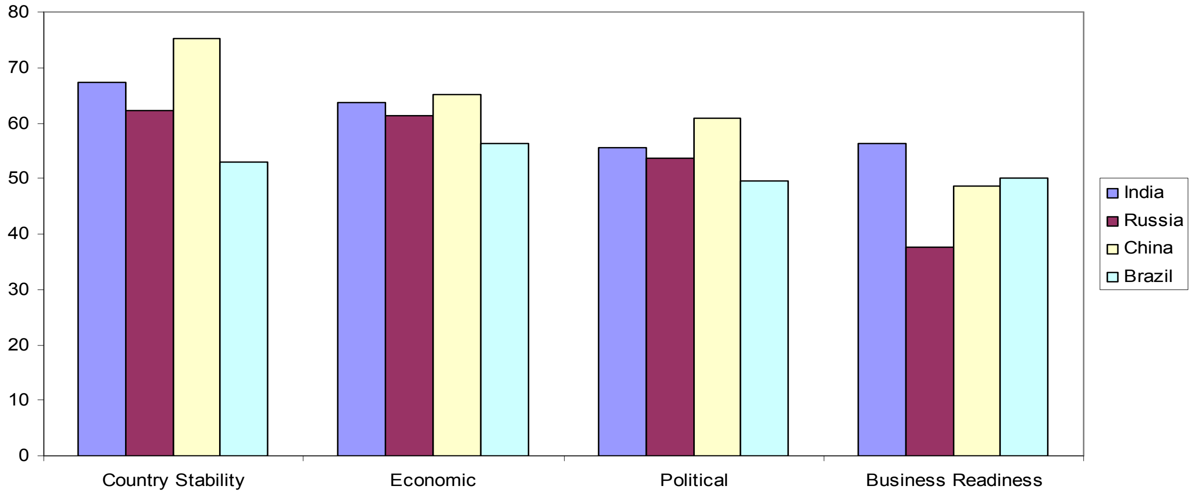

Figure 6: Comparison of Stability across the BRIC countries

China leads the BRIC countries in stability – the economic and political risk of doing business is low compared to the other countries. Over the last decade, the Chinese political establishment and bureaucracy has built its industry friendly credentials – it has resulted in $525 Bn (utilized) in foreign investment over the last 10 years. The new blend of economic capitalism and social communism in China gives it the flexibility to allow corporations, western and domestic, to flourish and push through tough decisions related to infrastructure and long-term growth.

At the other end of the spectrum, Brazil suffers from significant economic and political challenges. Brazil's economy grew a relatively anemic 3.7[7]% last year (China - 10.7% and India – 8.5%). The political system is fractured, with 15 parties in the Congress and a government sustained by loose coalitions. There is widespread impatience with high unemployment and depressed incomes. The government is being severely handicapped by a string of corruption scandals and there are significant challenges ahead in key areas like as tax and social security reform.

The cost of doing business in Russia is much higher than the rest of the BRIC countries - Crime and corruption are key issues. The inability of the government and justice system in this country to foster the business community is significantly impacting the retail market opportunity. In a recent World Economic Forum study of Government Effectiveness, Russia received a low score of 39 (India and China were even with 52).

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[7] All GDP figures are sourced from Planet Retail

Market Appeal

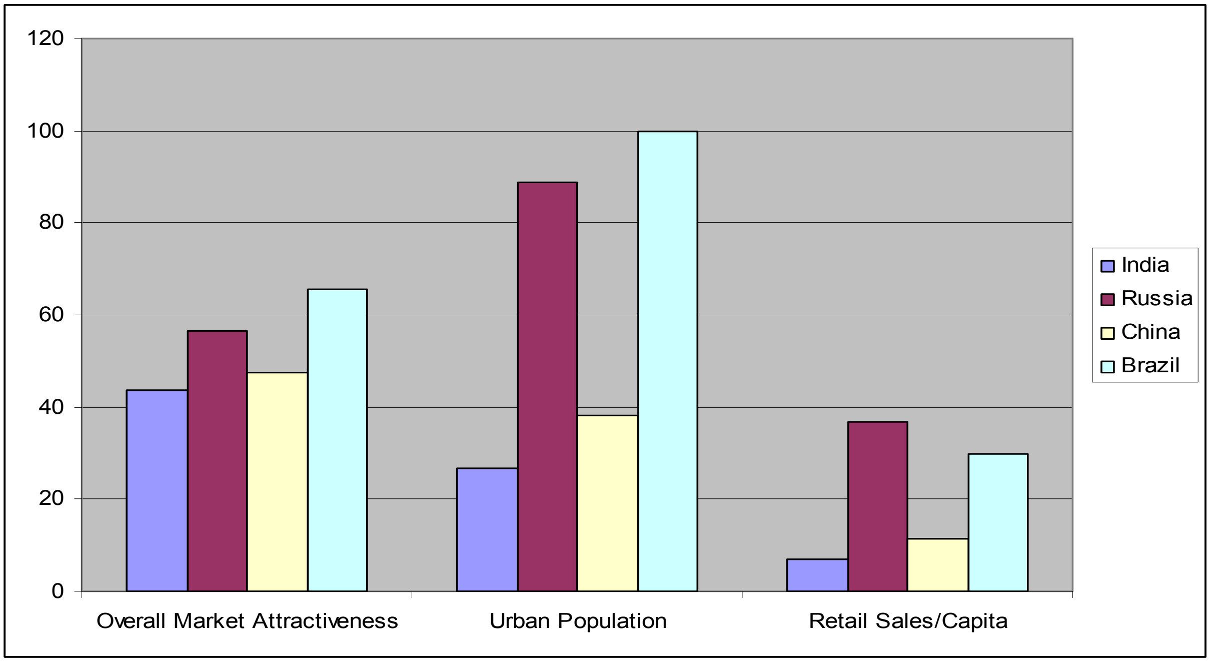

Figure 7: Comparison of the Retail Market Appeal across the BRIC countries

Increasing urbanization across the BRIC countries is a key driver of market appeal. Brazil (84%[8]) and Russia (77%[9]) lead the group with high population concentrations. Tier 1 cities, like Rio de Janeiro and St. Petersburg, have developed into huge urban sprawls allowing for the rapid growth of modern retail formats like hypermarkets and supermarkets. Also, retail sales per capita is higher in Russia and Brazil - driven primarily by a proportionally larger middle class, higher income levels and increased exposure to modern retail concepts.

[8] http://www.studentsoftheworld.info

[9] Planet Retail

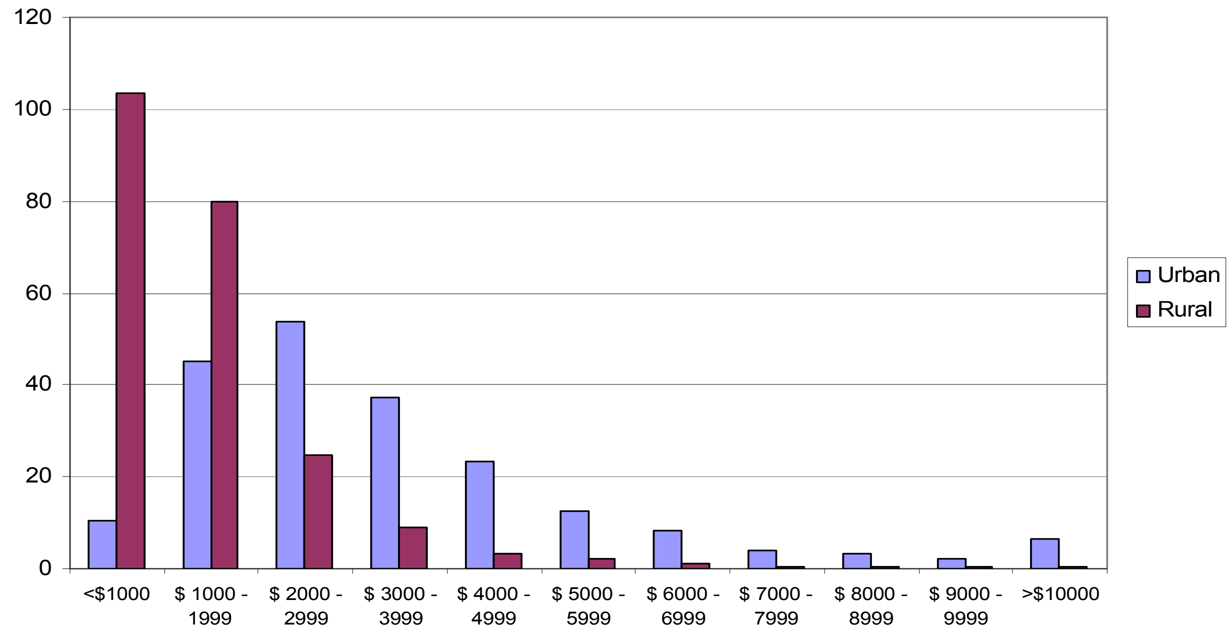

Figure 8: 2006 Rural vs. Urban Household Income in China[10]

Across China and India, new migration patterns are increasingly driving consumers from small villages to larger cities in search of a better livelihood. Yet, a significant bulk of these countries still live in their villages - less than 30% of India's population lives in urban areas. Apart from the urban consumer's preference for organized retail, the per-capita consumption of a rural consumer in the BRIC countries is significantly lower than that of an urban consumer (1/3rd in China).

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[10] Euromonitor, AT Kearney Analyses

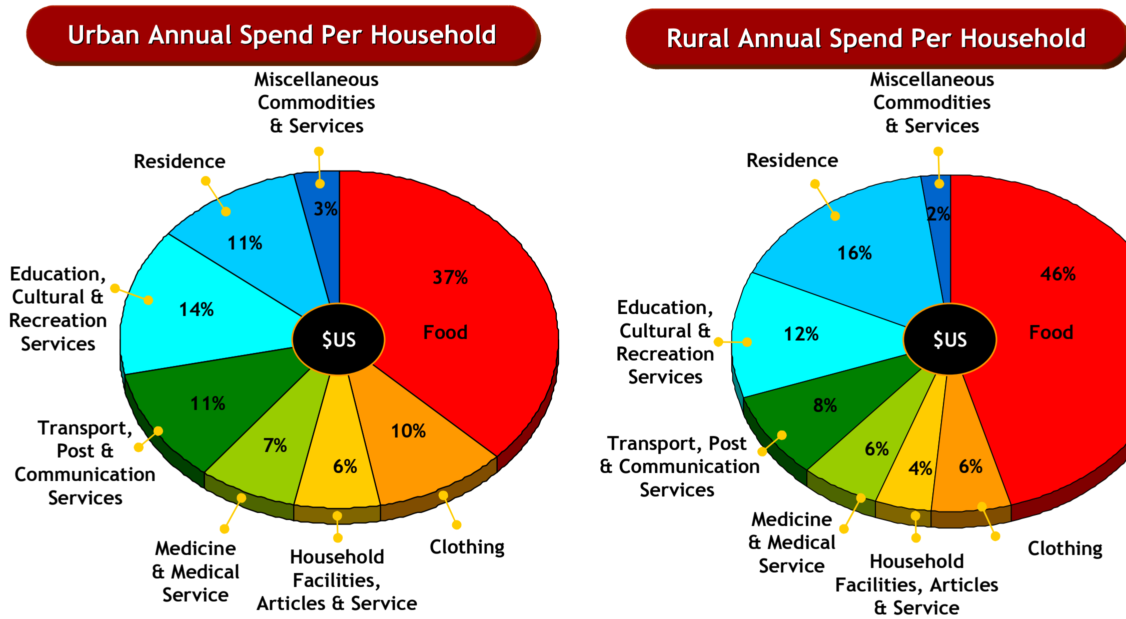

Figure 9: 2006 Rural vs. Urban Household Spending Patterns in China[11]

BRIC consumers are also evolving – with increased exposure to western concepts, tastes and needs are shifting. Global brands like Coke, Pepsi, Nestle and Cadburys are already household names in these countries – newcomers to these countries like Nike, Ikea and Wrigleys are finding a willing consumer base hungry for their products. Consumers are demanding the convenience, choice and modern merchandise offered by organized retail. Ready acceptance of the organized retail formats like hypermarts and supermarkets has led to the rapid growth of domestic powerhouses - X5 retail group in Russia, Pantaloon in India, Lianhua in China and Atacadao in Brazil.

[11] AT Kearney Analyses

Market Saturation

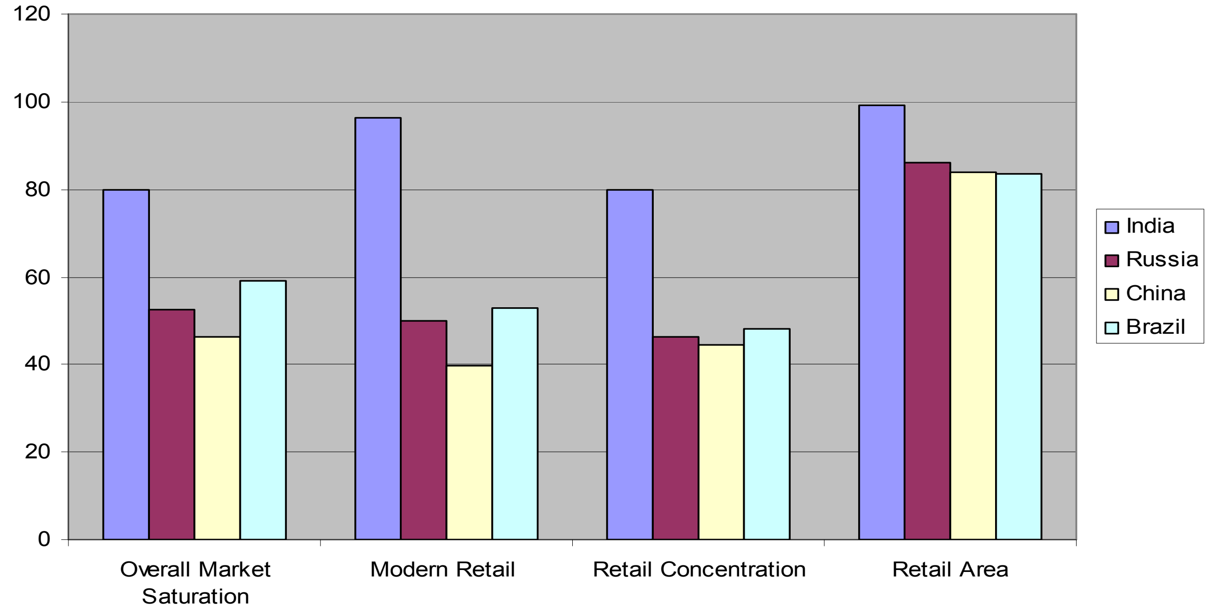

Figure 10: Comparison of the Retail Market Saturation across the BRIC countries

Closed economies across the BRIC countries have been slowly opening up over the last 10 years. Dismantling the bureaucracy and removing market entry hurdles has created opportunities for both multi-nationals and strong domestic firms. Nowhere in the world is this fact more evident than China – over the last decade, it has been slowly opening up its economy and in early 2005, it lifted most restrictions with its entry into the WTO. Leveraging the opportunity, global retailers like Carrefour and Wal-Mart have entered the market and established a strong presence. Local competitors like Lianhua and Hualian have strengthened their positions and are providing stiff competition to the new entrants. This cycle is repeating itself across other BRIC countries as well - India is starting to slowly dismantle its regulatory structure in the retail sector and is poised for explosive growth in organized retail. Only last year, it allowed 51% ownership in single brand retailers and allowed full ownership for wholesalers in the country – this has already resulted in a spate of retailers (Wal-Mart, Nike, Mango) entering the market.

The Indian opportunity is bolstered by lack of organized retail in the country - at less than 6%, it is one of the least concentrated in the world. Traditionally, the market has been dominated by millions of small independents. Currently, only three retail companies have a turnover higher than USD100 million – about the average sales generated by a single Carrefour hypermarket in France. The small share of organized retail and fragmented nature of most BRIC markets (even in Brazil, the top 5 retailers have less than 20% of the market), leave plenty of room for new entrants and market consolidation.

Conclusion

So what does all this really mean? Should retailers care about expansion into the BRIC economies? The simple answer is that companies can't afford not to care about these markets - take a look at the world's top retailers in terms of sales: Fifteen of the top 20 operate globally and have made these retail opportunities a cornerstone of their strategies. Early movers have been able to and will continue to reap the rewards in these markets – for example Wal-Mart has already succeeded in building a strong presence in Brazil, China and looks to do the same in India. It is by no means a walk in the park – domestic competition, different cultures, varied consumer behavior and volatile business environments make operating in these countries challenging. Retailers who adapt and succeed in these countries will emerge as tomorrows global leaders. As store saturation becomes a reality and early movers produce tangible results, retailers that are not in the BRIC markets will need to address this sizable opportunity—quickly.

Methodology

We compared the BRIC countries on a 100-point scale—the higher the ranking, the more attractive the retail opportunity in the country.

The scores are based on the following four variables:

1. Country Stability (20 percent)

- ➔ Political (40 percent)
- ➔ Economic (40 percent)
- ➔ Business Readiness (20 percent): terrorism, crime and violence, corruption.

The higher the rating, the lower the risk of failure - the calculation includes the business cost of terrorism threats.

2. Market Appeal (40 percent)

- ➔ Retail sales per capita (50 percent): A score of zero indicates that the retail sector (total annual sales of retail enterprises excluding taxes) is still underdeveloped. A score of 100 indicates that the retail market is already mature.
- ➔ Urban population (50 percent): Zero means the country is mostly rural; 100 indicates the country is mostly urban.

3. Market Saturation (40 percent)

- ➔ Share of modern retailing (35 percent): A zero weight means share of retail sales made through a modern distribution format is high. Modern formats include stores predominantly selling food (hypermarkets, supermarkets, discount stores and convenience stores), and mixed-merchandise stores (department stores, variety stores, U.S.-style warehouse clubs and supercenters).
- ➔ Modern retail sales area per inhabitant (35 percent): A zero weight means the country ranks high in total retail area per inhabitant, close to the average Western European level. Modern formats only include stores predominantly selling food (hypermarkets, supermarkets, discount stores, convenience stores).
- ➔ Market share of leading retailers (30 percent): A zero indicates that the market is highly concentrated with the top-five players (local and international) holding more than 55 percent of the retail food market. A 100 weight indicates the market is still extremely fragmented.

Data and AT Kearney analyses are based on the United Nations Population Division Database, the World Economic Forum's Global Competitiveness Report 2006-2007, National Statistics, Euromoney, World Bank reports, Euromonitor and Planet Retail databases.

Brazil

Country Fact-sheet

- Population: 188 million
- GDP size: $964 billion
  - Rise in disposable income: 4% (5-yr CAGR)
- Retail Market Size/Growth
  - Hypermarket, supermarkets and cash 'n' carry stores
  - Share of organized retail: ~28%
- Key retailers (market share): Casino (9%), Carrefour (5%), Wal-Mart (4%), Atacadeo (2%) & SHV Makro (2%)

By 2007, Brazil's population had reached around 190 million, the fifth largest in the world. The Brazilian population is predominantly young with more than 60% under 29 years of age. Consumer spending is expected to increase by around 10% during 2007, driven by a more stable economic situation and social policies carried out by the new government, such as the increase of the value of the minimum salary.

Wealth is concentrated in the south and southeast and population is concentrated on the coastal areas. The metropolitan areas of São Paulo and Rio de Janeiro together contain about 17% of Brazil's population. On the other hand, wide areas inside the country remain scarcely populated.

The Brazilian grocery market is consolidating rapidly as supermarket and hypermarket chains strive to acquire good locations, achieve economies of scale and increase their leverage with suppliers. However, with no group yet accounting for more than 10% of the market and the top five still claiming just around 25%, there is potential for still greater concentration in the future.

Hypermarkets are the main format used by the largest grocery retail groups in the country. The hypermarket is steadily gaining market share between the middle and lower classes, as Brazilian consumers value the convenience and money saving of shopping in these stores. Carrefour makes three quarters of its sales out of its hypermarkets and Casino makes half of its sales from its Extra hypermarket banner. Furthermore Wal-Mart´s sales of its Supercenter, Big and Hiper Bompreço banners account for more than half of its sales.

The large chains are now pursuing multi-format strategies encompassing hypermarkets, neighborhood supermarkets, discount stores and convenience stores. Also, weakness in the non-food sector has allowed supermarket groups to capture a share of domestic appliance and home entertainment sales.

The Brazilian retail market is highly internationalized, and in fact all but one (Atacadao) in the top five grocery retailers in the country are part of international retailers.

Russia

Country Fact-sheet

- Population: 143 million
- GDP size: $978 billion
  - Rise in disposable income: 11% (5-yr CAGR)
- Retail Market Size/Growth
  - Independent neighborhood stores, convenience stores and hypermarkets
  - Share of organized retail: 18%
- Key retailers (market share): X5 Retail (3%), Magnit (3%), Metro Group (2%), Dixi (1%) & Sedmoi Kontinent (1%)

Despite a shrinking population which has recently fallen below the 145 million mark, Russia is by far the largest consumer market in Central & Eastern Europe. Approximately 8.5% of Russians live in the capital Moscow and its suburbs, and there are 12 cities in the country with more than 1 million inhabitants.

Russia's economy is booming as is its retail sector. Consumer spending has been rising quickly for the past few years, which has been fueled by an income growth rate of 11% in 2005 and 10 % in 2006. The increased spending has translated into an overall retail sales growth rate of 13 % for 2006. These impressive numbers show no signs of slowdown in the coming year and will grow by at least 10 % in 2007.

As a result, the steady stream of new foreign retailers continues. Boots, the U.K. retailer, entered recently, as did The Body Shop, Lotte, and Marks & Spencer. Other retailers, including Tesco, Tengelmann, REWE and Casino are monitoring the Russian market closely. Some foreign retailers that have been in the market for a few years, such as IKEA and The Metro Group, are beginning to expand outside the popular markets of Moscow and St. Petersburg.

Local players including Sedmoi Kontinent, Perekryostok, Park House, Petrovsky and Kopeika are also expanding aggressively. Some are even investing outside Russia, as illustrated by Pyaterochka's move into Kazakhstan and the Ukraine.

Moscow and St. Petersburg account for most of this spending and retail growth - retailers such as Ralph Lauren, Debenhmas and Starbucks are setting up shops in these two major cities in 2007.

Russia's food retail market is extremely fragmented, and it is only in the cities of Moscow and St Petersburg that significant consolidation has taken place. On a countrywide basis, the top five grocers capture a combined share of around 9% of the modern grocery distribution.

Country Snapshots

India

Country Fact-sheet

- Population: 1.1 billion
- GDP size: $855 billion
  - Rise in disposable income: 12% (5-yr CAGR)
- Retail Market Size/Growth
  - Share of organized retail: 6%
  - Small supermarkets and hypermarkets
- Key retailers (market share): Pantaloon (0.5%), Subhiksha (0.3%), Margin Free Market (0.3%) & RPG Group (0.2%) Dairy Farm (0.1%)

The Indian retail market is more attractive than ever - India's GDP is projected to grow 9.2% in Fiscal Year 2007. Projections for 2008 are around 10%, which will most likely surpass China's growth rate. Organized retail, which accounts for under 6% of the market, is expected to grow at 40% CAGR from $8 billion to $22 billion by 2010. Overall, India's retail sector is expected to grow from $315 billion to $427 billion by 2010 and $635 billion by 2015. And, then, of course, there are the one billion consumers, which help make it the fourth largest retail market in the world.

There are also fundamental changes underway. Early last year, the government announced that it would allow foreign companies to own up to 51 percent of a single-brand retail company, such as Nike.

The relaxed regulations, however, don't extend to companies that sell a variety of brands, such as Tesco and Wal-Mart. These retailers must operate through franchises or a cash-and-carry wholesale model. Wal-Mart recently joined forces with Indian telecom giant, Bharati Enterprises Ltd., to participate in a franchise model. This strategy skirts the issue of not being able to sell directly to consumers and establishes a presence in the local market. The retail shops will be owned by Bharati Enterprises under the Wal-Mart franchise and Wal-Mart will operate the logistics, procurement and storage activities.

Still, controversy about how globalization will affect local retailers continues, and local conglomerates are moving quickly to ensure they don't lose out to international players. Reliance, a leading Indian conglomerate, announced that it will invest over $6 billion to become the country's largest modern retailer by establishing a chain of multi-format retail stores. Seasoned domestic business houses like the Reliance and Birla groups have started to lock up the upstream value chain (farms, logistics, storage) to set themselves up to compete in the long term.

India's government seems to be on a gradual, but definite, path toward allowing foreign retailers into the country. And when it takes the final steps, the peak time to enter will quickly pass—giving retailers that enter now a distinct edge.

China

Country Fact-sheet

- Population: 1.3 billion
- GDP size: $2.6 trillion
  - Rise in disposable income: 13% (5-yr CAGR)
- Retail Market Size/Growth
  - Supermarkets, Hypermarkets and Cash ‘n’ Carry
  - Share of organized retail: 20%
- Key retailers (market share): Lianhua (1.2%), China Resources Enterprise (0.9%), Carrefour (0.4%), Hualian Supermarket (0.4%) & Shanghai Nonggongshang (0.4%)

China continues to defy its critics with strong GDP growth - it remains one of the fastest growing economies in the world, with GDP growth equaling 10.7% in 2006 and estimated at 10% in 2007. Although GDP per capita remains low, given its large rural population, spending has more than doubled from the mid 1990s and continues to grow rapidly in the large southern and eastern cities. However, because international retailers are fuelling this growth, market saturation is also on the rise. More than 55 foreign retailers have now entered the China market.

In 2006, the retail market grew by 13% and is expected to grow at 14% in the next 4 years – it is expected to double by 2010. The expansion will be aided by consolidation in the industry, as fierce competition forces retailers to join forces to gain scale economies.

“Wave 1” retailers, such as grocers and convenience stores, entered the market on the east coast and have begun moving west. “Wave 2” companies—consumer electronics, do-it-yourself and apparel retailers—are a few years behind, but are following the same east-to-west path. Carrefour, which enjoyed approximately 25 percent growth in China last year, will expand into medium and small cities, particularly in northeast and northwest China. In the past year, Wal-Mart has also entered second tier markets by way of Yuxi, Weifan, Wuhu and Yueyang. Additionally, in a race to catch up to Carrefour’s aggressive expansion, Wal-Mart is gearing up to buy 100 Trustmart stores, which will expand its global footprint across 20 Chinese provinces.

Domestic retailers are now scrambling to launch into tier two cities or consolidate their positions before global retailers establish themselves in these areas. Home World, a Chinese retailer operating 58 hypermarkets, plans to expand by 30 percent each year in tier two cities. Gome and Suning, Chinese electronics retailers, have enjoyed massive store expansion and increased their presence in many 2nd tier coastal Chinese cities.

With Wal-Mart and Carrefour firmly entrenched and Tesco gaining ground, the retail market is poised for some interesting developments in the next few years.

Authors

Raman Mangalorkar, *VP, A.T. Kearney, India*

Raman Mangalorkar has over fourteen years of industry and consulting experience with international corporations in the Retail, Consumer Products and Sports & Entertainment industries. His areas of expertise include designing growth strategy, transforming supply chain and managing large scale programs in Retail and Consumer industries. Mangalorkar moved to A.T. Kearney India in December 2005 and currently heads A.T. Kearney's Consumer Industries and Retail Practice in India.

Ram Kuppuswamy, *Senior Manager – A.T. Kearney, New York*

Ram Kuppuswamy has eight years of consulting experience with Fortune 500 companies in the Consumer Goods & Retail industries. He has worked with retailers such as Wal-Mart stores, Home Depot, Williams Sonoma and Best Buy. Kuppuswamy's areas of expertise include merchandising and growth, supply chain strategy, sales and operations processes and inventory management. He has an MBA from IIM Ahmedabad, India.

Michael Groeber, *Senior Business Analyst – A.T. Kearney, Chicago*

Michael Groeber is a Senior Business Analyst in A.T. Kearney's Chicago office. Groeber has developed product segmentation, replenishment and forecasting strategies for one of the world's largest retailers and created detailed operations simulation and network models for retailers. Prior to joining A.T. Kearney, he has worked with Bain & Company, Zurich, Switzerland and Lufthansa Cargo, Frankfurt, Germany. Groeber received degrees from Reutlingen University, European School of Business (ESB), Germany, Indiana University, Kelley School of Business, Bloomington, Indiana and University of Texas, McCombs School of Business, Austin, Texas.