Indian Retail:
Time to change lanes
The advent of New Year 2009 heralded interesting yet challenging times for the Global Retail industry. The Indian retail industry—one of the fastest growing industries in the country over the past couple of years—is no exception. While 2008 showed growth for the industry on the whole, the last quarter of 2008 was impacted by the economic slowdown and liquidity crunch, and this is expected to continue in the current year.

The year gone by was packed with several significant developments for the Indian retail industry, including the entry of many global players, growing acceptance of the modern formats, the success of many speciality retail formats, and the rising competition in the regional markets beyond the metros and Tier 1 cities.

On the other hand, the after effects of the global economic turmoil are being felt in India as well, and the economy is expected to grow at a significantly lower rate over the next 2 years (between 5 to 7 percent according to various estimates*). Consequently, overall consumption levels, particularly discretionary spend and impulse purchases have been affected, which, in turn, has resulted in a lower growth rate for the industry for the current year. Moreover, this trend is expected to continue in 2009.

Given the industry's changing landscape and emerging challenges, the focus of industry players too is changing; with a strong emphasis on profitable growth in the current scenario. Hence, retail companies are increasingly concentrating on strengthening existing operations and assessing options for growth through consolidation, while continuing to innovate.

Looking at the changing contours of the industry, there are certain drivers which are likely to have an impact across retail categories, and we have examined these drivers in detail in this report. Factors like renegotiating rentals, store rationalization, working capital management, regionalization, cost optimization and manpower resizing are some of the key Top of Mind (TOM) issues for retailers in the current context of the downturn. We have focused on how these drivers are affecting various players across the retail value chain and their strategies to help cope with the slowdown.

The analyses and point of view presented in the report have been validated through extensive discussions with industry players. We take this opportunity to thank the industry players for making this endeavor possible.

* IMF, Cushman and Wakefield Report, 2009
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The Indian Retail sector has caught the world’s imagination in the last few years. Topping the list of most attractive retail destination list for three years in a row, it had retail giants like Wal-Mart, Carrefour and Tesco sizing up potential partners and waiting to enter the fray.¹

India’s retail growth was largely driven by increasing disposable incomes, favorable demographics, changing lifestyles, growth of the middle class segment and a high potential for penetration into urban and rural markets. However, with the onset of the global financial crisis, Indian retailers have been suffering from the effects of rapid credit squeeze, high operating costs and low customer confidence.

The impact of current slowdown in Indian retail sector is summarized along key operating parameters as follows:

**Impact of slowdown on key parameters**

<table>
<thead>
<tr>
<th>Top Line/Sales Turnover</th>
<th>Bottom Line/Profitability</th>
<th>Cost Competitiveness</th>
<th>Cost of Finance</th>
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<td>Store Expansion</td>
<td>Footfalls</td>
<td>Tier II/III Expansion</td>
<td>Advertising Spends</td>
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<td>Attrition</td>
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Source: KPMG Retail Survey, March 2009

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¹ AT Kearney’s Global Retail Development Index (GRDI), 2008
In this report, we have suggested strategies for the retail sector to help cope with impact of slowdown and validated them through extensive discussions with key players in the industry.

## Strategies to help cope with the recession

<table>
<thead>
<tr>
<th>Strategy</th>
<th>Description</th>
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<tr>
<td>Manage Costs</td>
<td>• Optimize costs (Cut costs in a way that doesn’t harm the business) and optimize resources. Key amongst them are: - improve labor productivity - manage inventory efficiently, - renegotiate the rentals • Adopt a revenue share model against fixed share model</td>
</tr>
<tr>
<td>Optimize technology usage</td>
<td>• Implement technology – specially in areas of manpower training, real estate management, supply chain and logistics management and day-to-day store operations</td>
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<tr>
<td>Efficient store management</td>
<td>• Streamline store processes, increase store visibility, manage staff effectively and look into store layout and product range</td>
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<tr>
<td>Re-evaluate store viability and expansion plans</td>
<td>• Classify stores clearly into categories: profitable, high cost-high sale, low cost-high price and unviable and take action accordingly for each category</td>
</tr>
<tr>
<td>Decode consumer behavior</td>
<td>• Invest in consumer research, paying close attention to the diversity present in India’s geography, to be more sharper in delivery</td>
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<td>Enter into alliances and leverage expertise</td>
<td>• Forge alliances and partnerships to leverage on each other’s financial muscle and expertise</td>
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<tr>
<td>Develop private labels</td>
<td>• Offer competitive in-store labels to earn higher margins — a win-win situation for both customer and retailer (the key is to improve quality of in-store brand)</td>
</tr>
<tr>
<td>Build competent supply chain management</td>
<td>• Focus on logistics in terms of minimizing the costs and knowledge aggregation • Leverage on technology and expertise of foreign players</td>
</tr>
<tr>
<td>Tap under penetrated markets</td>
<td>• Think beyond the metropolitan cities, target the opportunity offered by the rapidly developing and largely under-penetrated Tier II, Tier III and rural markets</td>
</tr>
<tr>
<td>Innovate</td>
<td>• Stand out of the crowd and keep offering new ideas, services, experiences to the customers</td>
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Some of our thoughts on future outlook and how it may impact behavior in retail sector are as follows:

- It is widely believed that the current slowdown might last for 12 – 18 months - depending on government incentives in increasing spends on infrastructure, development initiatives and other activities to stimulate the economy

- We expect an increased focus on value retail in the coming months and a shift away from lifestyle goods, thanks to the impact of the current slowdown

- There is expected to be increasing action in food retailing and FMCG products as this segment is largely insulated from the slowdown, while sectors such as home furnishing are less favored

- Retailers are likely to start closing unprofitable stores and rationalize capital expenditure, as a part of cost optimization

- Churn in malls is likely to increase in the short term when some retailers opt for low-rent premises as a means of sustenance in the current economic situation

- As Tier I cities become saturated, retailers may move to Tier II, Tier III cities where profits are higher due to lower rentals and operating costs

- There are going to be increased investments in shortening of supply chain. This is mainly due to the incentives offered by the government and the potential for higher profit margins

- The frequency with which retailers liquidate slow-moving goods by offering discounts to reduce inventory is likely to increase.

The long term prospects for retail chain expansion are still very attractive and this period of uncertainty is seen by retailers as an important consolidation imperative for an industry that has been growing at 30-40 percent p.a.\(^2\) over the past decade.

\(^2\) Jones Lang Lasalle Meghraj Report on India Retail 2008
In the past few years, India’s retail journey seemed picture perfect with the most attractive ‘stops’ still unexploited and under-penetrated. Favorable demographics, steady economic growth, easy availability of credit, and large scale real estate developments were fuelling the growth of India’s approximately USD 25 billion\(^3\) organized retail market. The opportunity was there for all to see and India was the destination of choice for top global retailers. In this environment, India’s own blue chip companies like Reliance, Bharti and RPG diversified to add retail to their sector portfolio\(^4\). All things considered, it was a good time for Indian retail.

This was the scenario till a few months ago. Enter the global meltdown and India did not find itself completely insulated from its harsh effects. As per the Cartesian survey, almost all key industries in India have been negatively impacted by the slowdown and retail is no exception.

**Industry-wise Impact**

![Industry-wise Impact Chart]

Source: Cartesian Economic Meltdown Survey, Dec 2008

An impact score of 0-15 indicates low impact
An impact score of 16-50 indicates moderate impact
An impact score of > 50 indicates high impact

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3 IBEF
4 Reliance, Bharti and RPG group websites
With the Q3 growth numbers of FY2008-09 at 10-12 percent as against 35 percent of the previous year, the ‘happy grins’ are fast turning into ‘nervous smiles’. While the sector is still registering decent growth, the heavy investments made during the boom period may weigh the retailers down.

Organized retail penetration - Gap created by slowdown

Organized retail penetration, which was expected to touch 16 percent by 2012 from the current 5 percent, is likely to trace 10.4 percent only

Source: KPMG Analysis and Retailers Association of India
As per KPMG’s survey, even though almost all retailers believe that the current uncertainty is only near term and is likely to persist for 12-18 months, there exists certain degree of skepticism in achieving targets. This is clearly indicated by the Cartesian study where 53 percent of retailer’s confidence levels have been shaken.

Retailer’s Confidence level in achieving targets

Source: Cartesian Economic Meltdown Survey, Dec 2008
Disappointing Footfalls

A large number of retailers have experienced a drop in footfalls which is mirrored by slowing Same Store Sales (SSS) growth figures. This also adversely impacts the time taken to break-even for new stores. SSS at some of India’s biggest retail groups have become negative for the first time in six years.

Although retailers are trying their best to combat this slowdown through constant promotional offers and deep discounts, consumers are expected to cut down on their discretionary spending. With the global recession having no clear end in sight, consumers see sense in saving for a rainy day.

According to KPMG’s survey, 70 percent of the respondents stated that the slowdown has adversely affected their footfalls.

Year-on-Year Net Sales Growth

Source: KPMG Analysis, Prowess
**Liquidity under pressure**

The slowing sales are resulting in lower inventory turnover and increasing working capital requirements for retailers. This in turn has resulted in liquidity pressures for many retailers. To free the cash that has been locked, a large number of companies have been trying to reduce the inventory on their books and shorten working capital cycles.

**Working Capital on the rise**

![Graph showing working capital increase from 2005 to 2008.](source: KPMG Analysis, Capitaline)

**Decline in Inventory Turnover**

![Graph showing decline in inventory turnover from 2005 to 2008.](source: KPMG Analysis, Capitaline)

**Margin contraction- Interest burden adversely impacts profits**

On their part, retailers have been trying to compensate for falling sales by curtailing expenses. This has countered the effect of the topline on operating margins leaving it largely unaffected. However, with working capital requirements and expansion capital being financed through sizeable debt, interest costs have significantly dented the bottomline.

**Operating Profit Margin**

![Graph showing operating profit margin from 2007/12 to 2008/12.](source: KPMG Analysis, Prowess)

**Net Profit Margin**

![Graph showing net profit margin from 2007/12 to 2008/12.](source: KPMG Analysis, Prowess)

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Funding constraints

A large number of retailers are highly leveraged and rely on fresh equity funding for growth, which is difficult to come by in the current market. Banks are increasingly hesitant to finance retailers in the context of falling demand and low profitability. Working capital requirements have also been difficult to meet as 60 percent of KPMG’s survey respondents confirmed the drying up of credit.

Roll out delays to compound problems

The organized retail space was expected to receive investments to the tune of USD 25 billion over the next 4-5 years. However, significant delays in retail real estate development and opposition to organized retail has resulted in delays in investment. A large number of retailers have not been able to meet their stated expansion plans. Currently, with higher cost of funds and a slowdown in demand, developers are likely to delay more projects in the near future.

“The slowdown and delay in development of quality malls have hindered our expansion plans to a large extent.” -- Amit Kumar, Head, Retail, Fashion@bigbazaar

Pantaloons Retail: Delay in plans

Source: Edelweiss Research

5 www.ibef.org
Besides the weak economy and the feeble consumer sentiments, the disappointing retail growth is also attributed to…

**Poor supply chain management and weak support infrastructure**

- Poor infrastructure – Underdeveloped supply chains, lack of strong cold chains, poor warehousing facilities, bad roads, etc. have been contributing to increased logistic costs for the retailers. Globally, the logistics cost component to the total retail price is around 5 percent, while in India it is as high as 10 percent.

- Absence of a mature Third Party Logistics (3PL) industry – Poor infrastructure (roads, communication and power) makes logistics and transportation in India extremely difficult. Further, internal operations of retailers, such as warehouse processes and distribution, are usually fairly ad hoc and inefficient. Retailers are keen to outsource their logistics to 3PL. But there is an absence of a mature 3PL player providing high service levels at competitive prices.

- Fragmented supply base – The supply base is highly fragmented with a large number of intermediaries squeezing the margins of all involved, which also includes the retailer. This not only has an adverse affect on the margins but also results in cases of mishandling, theft and increased instances of shrinkage.

**Rentals – skyrocketing to all time high**

As real estate prices skyrocketed, retail rentals also touched unsustainable levels eating directly into the profit margins of retailers. Until a few months back, store rentals were 300 to 400 basis points higher than even international levels. Retail rentals in Linking Road in Mumbai, South Extension in Delhi and Brigade Road in Bangalore have risen about 50 percent in the past 3 years.

**Rentals eating into profit margin of retailers**

- **2008**: 80% rentals, 20% profit margin
- **2005**: 68% rentals, 32% profit margin
- **2003**: 52% rentals, 48% profit margin

Source: Jones Lang Lasalle Meghraj Report on India Retail 2008, KPMG Analysis

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Mistakes by retailers have also added to external troubles

Crowding in unattractive locations

Another reason for slow growth in organized retail is poor choice of locations. Clustering is a common theme in retail in India and retail malls appear wherever real estate is available rather than where they are actually needed. This has resulted in attractive city centers being devoid of malls and newly developed areas having too many.

Inability to compete with traditional retail

Organized retailers have not been successful to provide services that match those of kirana stores. The true reason of their troubles is that the business capacity of the kirana shop owners and buyers is high in India. Mom and Pop stores already have a model that is preferred by consumers and is also cost efficient. The big stores are still trying to get their model right in providing an alternative to neighborhood retailers who offer convenience, credit and personalized service.

Over reliance on debt funding

The rapid expansion in retail space in recent years was largely debt funded. This has resulted in substantial leverage, which has added to retailers financing risks in the recent scenario. The declining interest coverage clearly indicated that a large number of retailers are highly leveraged and are battling high interest payments.

Interest coverage declining across players

Whatever be the reason, we believe that players who take immediate strategic measures are likely to be the dark horses. Be it store rationalization, change of supply chain, consolidation of operations, improvement in IT infrastructure, retailers need to think quick to protect their margins and toughen up for more challenging times.
“Consumers are currently sitting on the fence and the challenge for retailers will be to offer the right baits to get them back to stores. Retailers have to focus on growing profits through sales growth and not mere cost-cutting strategies. There will be a sharp cut in overall sales growth this year, but a marked improvement in bottomlines with players focusing on efficiencies” - Kishore Biyani, Chief Executive Officer, Future Group

Source: The Economic Times, 30 January 2009
Toughen internal efficiencies

Managing Costs:

Subdued quarterly results, staffing cuts and frozen budgets have increased the scrutiny on each rupee spent. When KPMG asked its respondents to name the most important focus area in the current times, about 90 percent of the retailers highlighted costs as their focal point and the remaining 10 percent mentioned evaluating store viability and revision of expansion plans as their main concern.

- **Cost Cutting:** Cost cutting is inevitable in a downturn, but strategic decisions with a long term view should be the key focus while making cost containment choices. Many retailers have made the mistake of cutting those costs that are easiest and fastest. An effective strategy should be one that identifies the costs least important to delivering what customers value. This requires a deep understanding of customers’ needs and re-evaluating the business activities that actually deliver what customers value and the ones that do not. This ensures that the costs cut now do not harm the future potential of the business.

In mid 2008, Kishore Biyani announced a new strategy for his group: “Garv se bolo hum kanjoos hain”
- Translated “Say ‘Yes, I am stingy’ with pride”

With this campaign, the company aimed to save USD 36.5 million in a period of one year. The idea was to openly accept that cost-cutting needs to be implemented and then aggressively eliminate inefficiencies. The move ensured that internal overlapping of functions was avoided within various departments. At the back-end, human resources and information technology were integrated in an organized manner.

Source: Mumbai Mirror, Sep 2008
• **Resource optimization:** A retailer wants to better manage its back-end centers, supply chain and stores while improving its profitability. Each customer amongst his millions is defined by a different buying history, a different buying propensity, and a distinct servicing cost. This raises several questions.

• Given the capacity and costs for each channel, which of the customers, should receive what kind of offers, through which of the channels?

• What will happen if some parts of the business are outsourced as against building in-house capabilities?

• Would it be viable to initiate a new model?

In each case the answer is “it depends.” The best way to allocate resources depends on the nature of the resources and the constraints at hand:

For example, in order to conserve resources, Vishal Retail too has decided to look at centralizing some of its operations. It has already closed its large distribution centers in Mumbai and Kolkata and opened a centralized warehouse in Gurgaon, near Delhi.*

Future Group has merged the back-office operations of its different stores to lower costs amid the global economic slowdown. “Our back-end operations have been converged to cater to multiple formats as a part of our cost-cutting and efficiency enhancing exercise,” Rajan Malhotra, Chief Executive, Big Bazaar. The group is also considering reducing the size of some Big Bazaar stores, and closing the worst performing ones.**

Companies need to review their optimization strategies in the changing environment, as with effective optimization they are likely to be able to bring about savings leading to improved competencies even in an unfavorable climate.

• **Improving labor productivity:** Retailers are turning their attention towards employee productivity to boost sales. Many retailers are going slow on hiring in back-end operations with training staff high on their agenda.

Koutons Retail has increased the performance target for its employees to deliver more. “We have motivated our employees to give that extra 25 percent in the quality and quantity of work they do,” --D P S Kohli, Chairman, Koutons Retail India.

Source: Business Standard, November 2008

* www.india retailbiz.com, March 2009
** Live Mint, Jan 2009
Manpower retention and training: Inspite of a downturn, the requirement for skilled manpower still persists. Companies need to understand how to retain their most desirable staff while ensuring their future development. This becomes a bigger concern particularly when management development costs are under pressure, as this is a leadership challenge.

One of the common problems with retail firms is that they hire fresh graduates without any experience in the retail sector. This has led to over-ambitious expansion plans which has left the firms struggling. The current downturn has highlighted this issue and made firms realize that to succeed they need experienced talent with an understanding of the ground realities faced by the Indian retail sector.

With scarcity of an experienced talent pool, talent development has to be brought in-house. The need is to focus on selected senior managers, to develop their capabilities to coach and mentor others. Indian players have already started to take steps to curb this problem and are opening academies to meet their manpower needs.

In 2008, two companies — Bharti Retail and Vishal Retail — announced the launch of retail training academies in Ludhiana and Delhi respectively. The 2 facilities are expected to churn around 5,000 trained persons every year. The new schools are in addition to the existing academies including Spencer’s Pragati, Subhiksha Retail Institutes in Mumbai, Delhi, Bangalore and Hyderabad, and Future Learning and Development Academies in Ahmedabad, Bangalore and Kolkata.  

Inventory Management: In any retail operation, restraining inventory cost is of utmost importance. Improper inventory may result in stock-outs for some of the categories whereas excess stock for others. Lower inventory turns are likely to have negative impact on ROI and more so for categories where gross margin is quite low like fruits and vegetables, milk, staples, mobiles, etc. In addition, higher inventory may result in obsolete stock, margin leakages, damages and high carrying cost (interest, space, handling costs, etc.).
Retailers should aim to:

- **Reduce stock-outs**: When an item is not available it reduces direct sales and can lead to customers shopping elsewhere.

- **Avoid bargain hunting**: Buying huge quantities of goods at low prices but then being unable to sell the stock may lead to increased cost of inventory.

- **Increase Inventory turnover**: Increase inventory turnover and, in turn, reduce excess inventory stock. This is both important and difficult as it may require a change in retailer mindset and tough decisions in terms of write-downs.

- **Control shrinkage**: In India shrinkage is equivalent to 2.9 percent of retail sales and is the highest in the world. Reducing shrinkage through well-defined processes for physical counting of inventory, digital surveillance, Electric tags, etc might effectively save costs and improve

Source: KPMG Analysis, Technopak’s Retail Summit 2008
• **Bringing down Real estate costs:** Real estate rentals constitute the biggest cost item for retailers at about 10-15 percent of sales. Quite frequently, it has been observed that one of the major costs for retail stores i.e. rental cost is ignored by retailers.

**Renegotiating Real estate costs:** The current environment is conducive for retailers to re-negotiate the rentals and bring down this cost. Large retailers like the Future group, Reliance Retail and Aditya Birla Retail are in the midst of furiously renegotiating rentals to bring down costs. Some players have managed a 40 to 50 percent reduction in store rentals.

**Entering into revenue sharing model as against fixed rental model:** Although previously developers and landlords were unwilling to enter into revenue sharing model, they are now ready to lease out their empty spaces. The model, under which retailers share a percentage of their sales with real estate companies, is seen as a fair way of sharing risks between the two stakeholders. Revenue-sharing model increases the responsibility of the developer to bring in footfalls in the mall by providing good upkeep of the infrastructure. The model is sustainable during the downturn as the retailers do not have to take the hit alone. Players can leverage this opportunity by collaborating with developers to work out a win-win model and a revenue sharing deal.

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“The rentals have fallen dramatically in the past few months, bringing retailers and the developers on equal footing. Now, the developers are ready for flexible revenues instead of fixed rentals,” - Samar Shekhawat, Vice-President, Spencer’s Retail.

Source: Business Standard, November 2008

“We believe this is the way forward for all the retailers as it is beneficial for both the developer and the retailer,” - Kishore Biyani, Chief Executive Officer, Future Group.

Source: Business Standard, November 2008

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9 Hindu Business Line, February 2009, Company websites, KPMG Analysis
Leveraging Information Technology

Organized retail in India faces many hurdles in the absence of proper supply-chain infrastructure and development of effective electronic payment and delivery channels.

The technologies that retailers have deployed over the years, to serve their distributed networks, are without standards. Going forward, technology is likely to be a key differentiator to bring about efficiencies, save on costs and offer better services to customers. The problem with old technology is that there are no standards and in many instances, one does not integrate with another.

All the elements within the retail industry right from data warehouses, logistics, supply chain, store management, point of sale, etc. are likely to get impacted positively with the usage of technology be it RFID, GPS, intelligent video analytics, point-of-sales terminals or sensor-based shop carts, etc.

Although Indian retail chains have started deploying these technologies, there still exists a challenge to implement them simultaneously and make the process more efficient.

The advantages of implementation of technology could be scaled manifold by carefully choosing solutions in context of the said business and by use of technology in following domains:

• **Manpower training:** Retailers need to gear up with good people management programs. One way this can be done is through certification programmes. Such programmes are likely to enable employees to upgrade their basic skills in retail operations and result better utilization of the available resources.

• **Real Estate Management:** Information technology can be leveraged to provide project management capabilities to monitor the progress of store launches. Timely launch of retail outlets can provide a good head-start for retailers and save significant funds as well.

• **Supply chain visibility:** IT can help retailers set up basic forecasting, replenishment and supplier management solutions to improve supply chain management. Starting from sensor based inventory management to RFID based control over the inventory coupled with GPS based tracking; IT can help in maintaining the optimally minimal inventory enabling reduced input costs.
• **Store operations:** Innovative use of Intelligent Video Analytics, point-of-sales terminals and sensor-based shop carts can help retailers enhance customer experience and simultaneously reduce costs by controlling shrinkage.

• **Logistics management:** Retailers can leverage IT for back-end support and 3PL companies for physical infrastructure such as warehouse space and a transportation fleet. GPS technology is extremely useful in real time tracking of the goods moment.

**Case Example**

**Shopper's Stop:** Fifteen percent of Shopper’s Stop’s net worth is invested in IT. The company has reaped its benefits through reduction in shrinkage levels and enhancing customer’s experience. Shopper’s Stop has one of the lowest shrinkage levels in the industry (0.4 percent)

“We have found that 50 to 55 percent of a customer’s experience revolves around two components: The availability of merchandise, and the ease and speed of a billing process. Out of the two, the availability of merchandise is more important. Here, I see IT playing a much more important role.” – B.S. Nagesh, Managing Director, Shopper’s Stop

Future Plans: Since the base of Shopper’s Stop IT structure is more or less in place, progressively a large part of their investments is expected to be inclined towards user education. The company plans to invest in understanding its customers using CRM technologies by building data warehousing, data-mining, and CRM capabilities. There is also likely to be further investments in enhancing corporate governance, information insight, scaling and managing SKUs, network and infrastructure management, and disaster recovery.

Source: CIO India
Reevaluating store viability and expansion plans

With catchments turning unviable, rampant store closures and format rationalization is on the cards. Rationalization is likely to intensify in coming quarters. Retailers may need to shut down unviable stores to conserve cash and inventory.

Given high debt levels and dormant equity market, capital for growth has become scarce. Expansion plans need to be re-looked because of capital scarcity and catchment reassessment.

Efficient store management

Even after setting up stores, retailers may face issues in running stores efficiently. There are currently no streamlined and defined processes for allocation of products/categories, inventory management (both on shelf and in back room), workforce management and store infrastructure management.

Issues facing retailers

| New Customers | Marketing inadequate: Insufficient hype during store launch, lack of regular in store events  
| Store visibility: Store not distinctly visible within mall or on street outside |
| Loyalty and Spend | Staff knowledge and motivation: High attrition rates, low product knowledge, poor customer interaction skills, inadequate competition and incentives  
| Product range: Wide range of certain categories  
| Price Perception: Price communication not strongly brought out through VM and product adjacencies  
| Layout and VM: Reduced shoppability due to layout and VM not being optimal  
| GC management not aggressive: Inadequate monitoring and incentives on GC recruitment targets |
| Costs | Rent: Very high rentals, poor retail to carpet and carpet to chargeable ratios. Low packing density of options  
| Power: Absence of monitoring mechanisms and metrics for power control  
| Personnel: Large number of idle personnel leading to high costs |
Players need to take multiple initiatives to fix retail basics and ensure growth to meet the targets.

**Decode consumer behavior**

India is a diverse nation with multi-lingual, cross cultural population spread across different geographical regions. Retailers have to recognize the fact that a strategy that holds true for a particular region and set of people may not hold true for others.

While India has a great market potential, most retailers tend to ignore the basic fact about the diversity of its customer base. Any retailer who does not do his ground work in terms of understanding his customer needs stands a great risk of failing even with one of the best models at hand.

A case in point is discount shopping in India. Indian discount shopping is still fragmented because of diverse culture while western retailers are able to treat the entire customer base as one. This helps them gain benefits of large scale promotions and offers. The opportunity lies with the Indian retailers to customize discount seasons based on festivals of different regions. However, annual planning of sales based on geography and festivals is still at a nascent stage in India.
Retailers should recognize that consumer is the king and cannot be ignored. The true metric of success may not be in terms of number of new stores added by a company, rather, increase in same store sales through a thorough understanding of consumer requirements.

According to KPMG’s survey, while attracting the customers was one of the top concerns of the retailers, investment in consumer research was not amongst their top priorities. Retailers have started espousing different approaches to seize a share in consumers’ wallet. Some of the strategies adopted by retailers:

- **Offering Discounts**: Most retailers have advanced off-season sales plans and some have extended discount sales periods from 15 days to a month. The discounts on offer have gone up from 25-30 percent to 40 percent, even higher for certain lifestyle products.

- **Lowering Prices**: Certain retailers are moving towards adopting “First Price Right” approach. Under this the retailer does not offer discounts, rather directly competes on the selling price by offering best price without any mark downs.

- **Offering Value Added Services**: Companies are offering innovative value added services like happy hours on shopping deals, offers for senior citizens, contests for students, lottery gains, etc.

- **Leveraging partnerships**: With an aim to keep customers longer on the shop floor and increase conversions, retailers are now pitching to partner with manufacturers, service providers, financial companies, etc. to create a buzz around certain product categories.

KPMG believes that companies that invest in CRM and consumer research analytics may stand to gain against those who take customers for granted. Big Bazaar has set up Customer Advisory Boards (CABs) as a measure for receiving valuable customer feedback. Through CABs the management aims to get closer to customers and give them a platform to voice their opinions about the stores. CABs consist of 8-10 influential people of the community like local doctors and lawyers who hold meeting and collect feedback from consumers. The feedback is then assessed and implemented by management to develop better customer relationships.

10 www.ibef.org
Entering into alliances and leveraging expertise

In the current scenario retailers should be on lookout for opportunities to partner with foreign retailers as it could possibly bring in the much-needed capital and expertise. The relationship could involve joint contribution by parties with shared control/ownership and has some degree of exclusivity attached to it.

Retailers can also consider entering into an alliance with:

- A retailer from the same channel
- A retailer from a different channel
- Vendors
- Back-end service providers like third party logistics players and IT service providers

Alliances enable retailers in entering new markets, categories, expanding value proposition and capturing new consumer segments. While globally, it’s a common trend, Indian retailers are slowly recognizing the importance of such partnerships and therefore actively seeking for opportunities to unlock value.

<table>
<thead>
<tr>
<th>Tap new consumer segments</th>
<th>Extend into new categories</th>
<th>Enter into new geographies</th>
<th>Enhance value proposition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reliance retail has tied up with Pearle Europe to launch a chain of optical stores in India</td>
<td>Future Group is leveraging Blue Foods expertise in food and beverages (F&amp;B)</td>
<td>Fabindia has acquired a 25 percent stake in UK’s bohemian women’s wear retailer EAST, to help FabIndia sell its garments in UK</td>
<td>Shoppers’ Stop has entered into an alliance with Mothercare UK to expand its value proposition in mother care and kids wear section</td>
</tr>
<tr>
<td>For tapping the kids segment in India, Spencer retail has tied up with Woolworths for marketing its Chad Valley range of toys</td>
<td>Spencer’s entered into partnership with specialists like Sankalp, Rajdhani, Yo China and Singapore based Bread Talk to open chain of food outlets in its stores</td>
<td>AB Retail acquired 90 percent stake in Trinethra from India Value Funds to gain a strong retail footprint in South India</td>
<td>Trent, has entered into a joint venture with Inditex Group to develop and promote Zara stores in India and thus leverage on Zara’s international experience</td>
</tr>
</tbody>
</table>

It’s the time of Private Labeling

Private labels enable retailers to offer quality products and earn higher margins. The retailer also derives many advantages of using private labels. In-store labels are at least 5-20 percent cheaper across various categories\(^\text{11}\). This is because they cut out middlemen costs and pass on the benefit to the consumer. Private labels enhance the bargaining power of the retailer while negotiating with manufacturer (national/ international) brands. In the long run, the retailer can use the Private Labels to attract customers to his outlet. Thus, many retailers are considering increasing their private label offerings significantly.

Aditya Birla Retail is aggressively pursuing the strategy of promoting sales of private labels. Currently, the segment accounts for around 3 percent of its total sales. A B Retail, which operates supermarket and hypermarket formats, under ‘More for You’ food and grocery chain, is targeting to increase private label sales to 10-15 percent in the next 2-3 years.\(^\text{12}\)

When we asked Mr. Amit Kumar, Retail head, Fashion@bigbazaar on private labeling, he said that he plans to increase his private labels from 60 percent to 90 percent in the next three years. According to him private labels provide four key merits:

- Gives the opportunities to stand out from the crowd
- Helps maintain consistency in stocks. Outside brands may or may not be available in the future leading to a potential loss of customers.
- Enables retailers to control margins by improving their bargaining power
- Facilitates movement into a planned environment. Since private labeling requires long term planning, it enables the retailers to understand all the nuances of its products as against an opportunity stock which could turn into an opportunity cost in the long run

Globally, own label brands contribute to 17 percent of Retail Sales with a growth of 5 percent per annum. International Retailers like Wal-Mart of USA and Tesco of UK have 40 percent and 55 percent own label brands representation in their stores, respectively. In India there is an increasing trend towards acceptance of Private Label brands and thus their

\(^{11}\) Images Retail Report, 2009
\(^{12}\) India Retailing, February 2009
penetration is on the rise especially in the Apparel, Consumer Durables, Home Care and FMCG segments. Overall, in India, Private Labels constitute 10-12 percent of the organized retail product mix.13

**Private label penetration (%)**

<table>
<thead>
<tr>
<th>Region</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Emerging Markets</td>
<td>6</td>
</tr>
<tr>
<td>North America</td>
<td>16</td>
</tr>
<tr>
<td>Latin America</td>
<td>2</td>
</tr>
<tr>
<td>Asia Pacific</td>
<td>4</td>
</tr>
<tr>
<td>Europe</td>
<td>23</td>
</tr>
<tr>
<td>World</td>
<td>17</td>
</tr>
</tbody>
</table>

Source: Images Retail Report 2009

Players like Shoppers Stop, Tata Trent, Pantaloon, Reliance, Spencers, Subhiksha, and Vishal have moved towards adopting private labels to address consumer needs and to increase profitability of their retail businesses.14

In India, very few players are into own manufacturing of private labels and are dependent on third parties – For example, Vishal Retail is increasingly shifting from manufacturing to third party sourcing primarily because of increase in categories for private labeling and volumes.

13 Images Retail Report, 2009
14 Images Retail Report, 2009
Recession spurs private label appeal

Private labels are likely to continue to grow in the current financial environment as cash-strapped consumers’ perception of the products as a ‘cheaper option’ changes. Part of private label growth in a recession is permanently sustainable. As consumers learn about the improved quality of private labels in recessions, a significant proportion of them are likely to remain loyal to private labels, even after the necessity to economize on purchases is no longer required.

Higher profile, quality-focused private label brands are likely to prosper as consumers begin to reassess their views of own-brand goods. Also, with increase in competition and rising pressure on margins, private label are increasingly getting attention due to the aggressive marketing of retailers at par with branded goods.

“Today with the margins that the FMCG companies offer, no one can survive. Even global retailers such as Wal-Mart, Carrefour and others are successful because of their strong focus on private labels. No retailer can survive on high rentals and low margins, adding that margins on private labels are higher, as much as 35-40 percent” - Thomas Varghese, Chief Executive Officer, Aditya Birla Retail

Source: Images Retail Report 2009
Build a competent supply chain management system

Strengthen support infrastructure

With the large players like Reliance, Bharti - Wal-Mart, Tata’s entering into retail market, there is likely to be enhanced focus on improvements in logistics and supply chain infrastructure. Retailers as well as third party logistics providers may increase their investment in logistics infrastructure. To gain cost leadership in the market, big players may have to minimize costs by developing supply chain infrastructure. Warehouses, distribution centers and transportation are likely to see modernization.

Warehouses

A large number of players in this industry are small / medium entrepreneurs running the warehouse for one or more companies. The scale of these warehouses is not large enough to tap large scale economies or justify investments in higher standards. However, going forward, the implementation of VAT regime is expected to drive consolidation and hence larger scale warehouses. Also the rapid growth of organized retail is expected to drive sophistication and efficiency in warehousing practices.

Cold Chain

There is an untapped potential of USD 2.6 billion for providing efficient cold storage facilities. Driven by a growing demand for convenience foods, we expect retailers to partner with logistics specialists to meet their cold chain infrastructure needs.

Third Party Logistics (3PL)

3PL market in India is still in a relatively nascent stage. However, realizing the cost benefits that these companies bring, retailers are gearing up to use 3PL services for their logistics function. As the sizes of retailers grow with a potential for scale economies, we foresee them to move to 3PL service providers.

15 Inhouse magazine of group TCI 2008, KPMG Analysis
Backward integration

There is a need to reduce the number of intermediaries so as to increase the efficiency and profitability of retailers. One of the ways to do that is to integrate the functions in the supply chain. There have been initiatives in this regard in rural India following the government’s approval of contract farming and land leasing. This is likely to allow accelerated technological transfer, capital inflows and assured market for crop production. This is likely to eliminate the intermediaries sucking away a large chunk of the margins. Pepsico’s contract farming in Punjab, ITC’s e-chaupal and Mahindra Shubhlabh services are examples of this vertical co-ordination leading to an increasingly efficient supply chain.16

Optimize Processes

IT can help retailers optimize their processes in a lot of ways including improving forecasting accuracy, reducing stock-outs, increasing sourcing efficiency, increasing product movement visibility, reducing lead time and optimizing transportation. Starting from sensor based inventory management to RFID based control over inventory, IT can help in maintaining optimal inventory resulting in reduced input costs.

Venture into under penetrated markets: Rural Retailing

India has witnessed a rapid increase in incomes with per capita incomes soaring to USD 1000 in 2008 from miniscule USD 418 in 1998. The growth has not been restricted to urban India, as the per capita income in rural India has grown by 50 percent in past 10 years.17

Among key reasons for the latter are rising commodity prices, improving productivity and higher production. The increasing availability of basic infrastructure, improving access to funding, employment guarantee schemes, better information systems and growing literacy are together

16 New Farm Supply Chain Initiatives in Indian Agriculture, Article by Dr. Rakesh Singh, Professor of Economics, Great Lakes Institute of Management
17 Business Standard
helping bring prosperity to rural households. With additional fiscal incentives provided by the government, rural India is set to witness further boost in overall farm incomes.

Overall, there is a huge market which is waiting to be served, ready to splurge, willing to explore new products and services. Retailers can tap on their wallets given they do their homework well.

According to India Retail Report 2009 by Images, "India’s rural markets offer a sea of opportunity for the retail sector. The urban-retail split in consumer spending stands at 9:11, with rural India accounting for 55 percent of private retail consumption."

As per IBEF, rural India accounted for almost half of the Indian retail market, which was worth about USD 300 billion. With most of the retail markets getting saturated in Tier I and Tier II cities, the next phase of growth is likely to be seen in the rural markets.
Major domestic retailers have started setting up farm linkages. Few examples include, DCM's Hariyali Kisan Bazaars, Pantaloon Godrej’s joint venture Aadhars, ITC’s Choupal Sagars, Tata’s Kisan Sansars and Reliance Fresh are some of the established rural retail chains.¹⁸

Many retail players are capitalizing on rural India’s potential by partnering with farmers

**Triveni (Khushali bazaar)**
- Triveni aims at increasing the association of rural communities. Currently the company has 2 owned and 4 franchises stores. Each store provides to farmers agri inputs, agri equipment for sale and rental, irrigation equipment, cattle feeds, FMCG, petrol, diesel, two wheelers and tractors, and other goods to complete the farmer’s basket of goods.

**ITC (e chaupal)**
- IITC procures all materials directly from the producers, thereby cutting down the middlemen all together.
- It pays upfront to the producers, meaning there is no credit system.

**HUL (Shakti)**
- Access to the remote rural areas and market potential.
- Sell its products through women self-help groups who operate like a direct-to-home team of sales women in inaccessible areas where HLL’s conventional sales system does not reach.

**DCM (Hariyali Kissan Bazaar)**
- Caters for about 15-20,000 farming households and at least 70,000 acres of agricultural land.

**Godrej Agrovet (Aadhar)**
- Complete solution provider to the farmers rendering farm advisory services, credit facility to farmers, providing up to date information on weather, price, soil & water testing facility, FMCG / consumer durables, etc. to farmers.

**Reliance Retail (Fresh & Fresh plus)**
- Focusing on sourcing directly from farm gate for Fresh & Fresh Plus.
- Aimed at connecting farms & unorganized retail by setting up 1600 farm-supply hubs across the country.

**Tata (Tata Kisan Sansar)**
- Provide end-to-end solutions, right from what crops to grow to how to sell them for the maximum returns.

**M&M (Shublabh)**
- Shublabh interfaces with bank for the financing w.r.t the fertilizer and seeds firm as well as for the delivery of produce to the end buyer and payment to farmer.

Source: Company websites, www.ibnlive.in.com, KPMG Analysis

¹⁸ Company Websites and IBEF
In today’s world of internet technology, globalization when everyone is connected and well informed; retailers have to ensure that they continuously understand the pulse of their customers and design their offerings accordingly. This requires not only in-depth understanding customer requirements but also thinking laterally to come up with innovative solutions which would make the retailers stand out of the crowd.

With rapid globalization, increased connectivity and heightened awareness the consumer is much more conscious about his needs and requirements. He not only seeks to purchase a product but also the entire shopping experience. KPMG believes that players, who can customize their offerings according to the specific needs of the Indian consumer, are likely to emerge as leaders. Retailers have to start appreciating this fact and take out their thinking hats to plan innovative solutions for their customers.

The current environment is a good time for generating trials; the consumers are actively looking for the best value and may therefore be more than willing to experiment. Internationally, with consumers currently debating over whether or not to spend their hard-earned money on that next cup at Starbucks, McDonald’s has a perfect opportunity to prove that their Premium Roast coffee—a step up in price for McDonald’s, but still cheaper than Starbucks—is a pretty tasty brew.  

“Innovation and newness should be the name of the retail game in India. As an industry we have to be radically different in our approach towards consumers, product offering, market segmentation and competition. This would create demand within the target segment and in turn help attain viability for the business model. Instant gratification as envisaged by the promoters in the past actually reduced the share of the pie resulting in the repelling impact as witnessed today.” — Anurag Rajpal, Vice President (Apparel), Spencer’s Retail

Source: www.indiafashionforum.co.in

19 www.chiefmarketer.com
Big Bazaar’s Chaos Theory evolved to cater to the Indian Mindset

<table>
<thead>
<tr>
<th>Concept</th>
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<tbody>
<tr>
<td>A value for money hypermarket that subscribes to the notion that chaos in stores increases sales.</td>
</tr>
<tr>
<td>Mr. Kishore Biyani realized that in abroad hypermarkets have long, narrow aisles, suitable for individuals shopping around carts which won’t work in India, so in big bazaar he created multiple clusters within every store.</td>
</tr>
<tr>
<td>The stores are designed as an agglomeration of bazaars with different section selling different categories.</td>
</tr>
<tr>
<td>The U-shaped section and islands have proved to be more appropriate for the Indian context than long aisles.</td>
</tr>
<tr>
<td>Brought in the innovative concept of ‘sabse saste 3 din’ which offers, deals and discounts, helping ensure that there is something for everyone in the family to shop for, and customers get ‘value-for-money’.</td>
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<thead>
<tr>
<th>Impact</th>
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<tbody>
<tr>
<td>Big Bazaar and Food Bazaar to be hived off into independent companies.</td>
</tr>
<tr>
<td>Big Bazaar is eyeing a turnover of USD 1700 million by the next financial year.</td>
</tr>
<tr>
<td>In 2007-08, Big bazaar clocked 110 million footfalls.</td>
</tr>
<tr>
<td>Kishore Biyani awarded the ‘Retail Face of the Year’ at Images Retail Awards 2007.</td>
</tr>
</tbody>
</table>

Sources: www.retailigence.wordpress.com , September 2008; Economic Times, January 2008; Book on Kishore Biyani’s autobiography – ‘It happened in India’; company website; KPMG Analysis

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Mom & Me Stores: A Unique Specialty Retail Model

<table>
<thead>
<tr>
<th>Business Model</th>
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<tbody>
<tr>
<td>A speciality concept started by Mahindra &amp; Mahindra’s in January 2009</td>
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<tr>
<td>Store size: Range between 5,000 and 10,000 sq.ft</td>
</tr>
<tr>
<td>Stores to be located in Metros, major cities at high street or mall locations</td>
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<tr>
<td>The concept provides various functionally important products that offer safety and quality products that are currently lacking in India</td>
</tr>
</tbody>
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<thead>
<tr>
<th>Target Audience</th>
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<tbody>
<tr>
<td>The primary target for company includes ‘9 to 9’ which means women who are expecting, to mothers who have kids up to the age of 9 years, and kids from 0-9 years.</td>
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<table>
<thead>
<tr>
<th>Product Offerings</th>
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<tbody>
<tr>
<td>Product basket would comprise of maternity wear, fashion apparel for babies, toddlers &amp; young kids, toys &amp; games, wellness products for mothers and babies, nursery and furnishings, travel &amp; safety products, personal products, foods, etc.</td>
</tr>
<tr>
<td>Partnership with international brands: Startrit, Brainy Baby, Mary Meyer, CAM, Bugaboo, Evenflo, and Avado</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Add on’s</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value added services like feeding area, play area for kids, nappy change area, and other facilities like a stroller to use at the store, reading lounge, etc.</td>
</tr>
<tr>
<td>M&amp;M will conduct morning coffee meetings, consultations with experts and many such more events to be a source of knowledge and expertise for customers</td>
</tr>
<tr>
<td>The website will also serve as a forum for customers to share information</td>
</tr>
</tbody>
</table>

Source: Images Retail, 2009
“We predict an increase in ‘value for money’ category and a decline in lifestyle category. Also we might see lesser aggression in stores expansion and focus on store productivity, shrinkage and loss reduction”- Narayanan Ramaswamy, Executive Director, KPMG.

Shift from lifestyle to ‘value for money’

<table>
<thead>
<tr>
<th>Retail</th>
<th>Everyday usage</th>
<th>High ticket retail</th>
<th>Impulse purchase</th>
<th>High end luxury</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>• Value format</td>
<td>• Home Furnishings/ Electronics</td>
<td>• Books/ Music/ Stationery/ Travel</td>
<td>• Apparel/ Fashion wear</td>
</tr>
<tr>
<td></td>
<td>• Groceries/ FMCG/ Beverages</td>
<td>• People are buying products which gives value in the long term</td>
<td>• Retailers are giving discounts to increase sales</td>
<td>• Retailers are offering discounts</td>
</tr>
</tbody>
</table>

Not effected  Not effected  Adversely effected  Adversely effected

The past six months have been difficult for the retail industry. Retail has been one of the seven industries in the country that have been severely impacted by the downturn in economic conditions. The sector has entered into a mode of correction removing some of the flab that had accumulated over the past 5 years of rapid expansion. Almost all retailers that we met with were redrawing their expansion plans and seriously evaluating options to close out poor performing stores. These efforts are expected to intensify over the next few months. There could be some Merger and Acquisition (M&A) activity that has been missing of late with the long-term players likely to consolidate and move ahead strongly.
There is a consensus however within the sector that this restructuring exercise may continue for the next 12-18 months before retailers begin another serious round of expansion.

The long term prospects for retail chain expansion are still very attractive and this period of uncertainty is seen by retailers as an important consolidation imperative for an industry that has been growing at 30-40 percent p.a. over the past decade. The relatively low rates of penetration of organized retail in most categories coupled with the sheer attractiveness of India’s demographic and economic environment is expected to continue to add momentum to overall prospects of this sector in the long term.

**Short term outlook**

- The current slowdown is expected to last 12–18 months conditional on government incentives in increasing spends on infrastructure, development initiatives and other activities to stimulate the economy.
- In light of the effects of the slowdown, we expect an increased focus on value retail in the coming months and a shift away from lifestyle goods.
- The focus is likely to shift towards food retailing and FMCG products as this segment is largely insulated from the slowdown.
- Retailers may start focusing on cost reduction by closing the unprofitable stores and rationalization of capital expenditure.
- Churn in malls is likely to increase in the short term when some retailers may find it difficult to sustain in the current economic situation, instead opting for low rent premises.
- As Tier I cities become saturated, retailers are likely to move to Tier II, Tier III cities where profits are higher due to lower rentals and operating costs.
- There are going to be increased investments in shortening of supply chain. This is mainly due to the incentives offered by the government and the potential for higher profit margins.
- The frequency with which retailers liquidate slow moving goods by offering discounts to reduce inventory are expected to increase
The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.