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Indian retail market: Changing with the changing times

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We need greater competition and therefore, need to take a firm view on opening up of the retail trade.

– Manmohan Singh, Prime Minister of India

The Indian retail landscape

Modern Retail has seen a significant growth in the past few years with large scale investments made by Indian corporate houses primarily in Food and Grocery retailing in a bid to capture the large potential of the USD 300 Billion market. Foreign apparel brands including luxury brands have set up shop in India through Franchisee/ Joint Venture route and have expanded rapidly in the last few years. Multi-brand retailing has currently been banned for foreign investment. For global retailers who have not been seeing large organic growth, India provides a lucrative market for them to grow their top line and profitability. Some global retailers are currently operating in India in the cash and carry (wholesale) format. Few retailers have been designing plans to start their Cash & Carry business to have a market presence and create brand awareness.

The Indian retail sector is poised to witness a sea change. The recent times have seen a significant discussion emanating towards allowing 100% FDI in multi brand retailing. This, if translated to reality, will have a game changing impact on the modern retail sector in India.

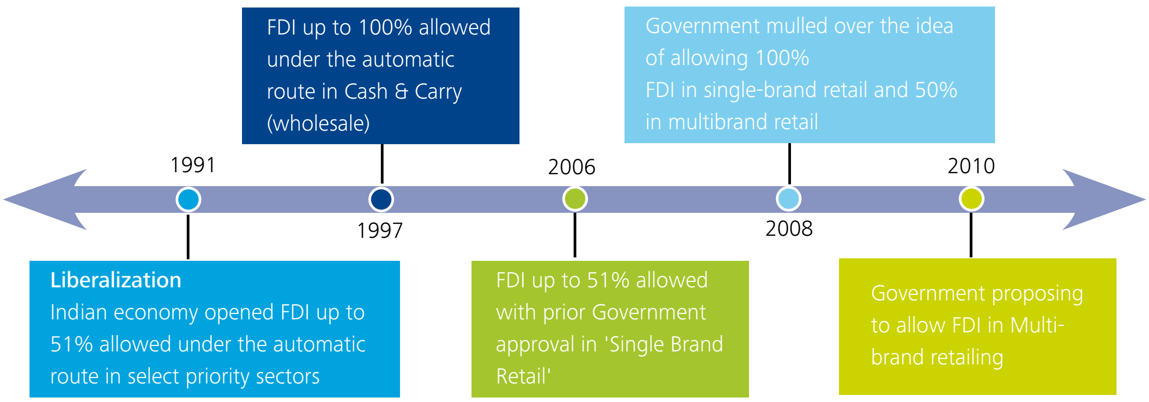
To put the large-scale policy change into motion and bring it to actual implementation, it is imperative for the ruling party to obtain buy-in from the opposition, including the Left parties and the BJP. Since the retail sector is the second largest employer after agriculture in India, both these parties have a reservation against opening up of the retail sector to foreign investment.

Looking back

Evolution of Foreign Direct Investment (FDI) policy

The last two decades, have seen India open up its economy in a slow but steady fashion to private as well as foreign investment. The foreign investment is governed through the FDI policy which regulates industries open to foreign investment, and also the percentage that can be held by the foreign companies. Globalisation and liberalisation have immensely influenced the Indian economy and have gone a long way in making it a lucrative consumer market.

FDI Policy – Milestone



The government in a series of moves has opened up the retail sector slowly to FDI. There were initial reservations towards opening up of retail sector arising from fear of job losses, procurement from international market, competition and loss of entrepreneurial opportunities. To evaluate the impact of international players on domestic markets, in 1997 FDI in cash and carry (wholesale) with 100 percent ownership was allowed. In 2006, 51 percent investment in a single brand retail outlet was permitted. Since then retailing through franchisee route has been explored by several global brands.

Discussions were carried out by the government in 2008 to allow 100 percent FDI in single brand and 51 percent in multi brand retailing, but did not succeed due to fierce opposition from its then allies and Left (Communist) party and also from the local trade associations.

The debate around opening up of the sector is expected to include among other the key points around:

- Entry in cities with population above one million
- Local sourcing requirements
- Mandatory investment in back-end operations
- Cash and carry model to support the local retailers to benefit from large scale sourcing
- Employment to rural youth to help spur employment growth for people who may be affected by this move.

The push for proposed investment seems to be around creating an supply-chain infrastructure for agriculture to help alleviate the income levels of farmers and reduce wastage of crops which are currently pegged at about 30-40% of total produce.

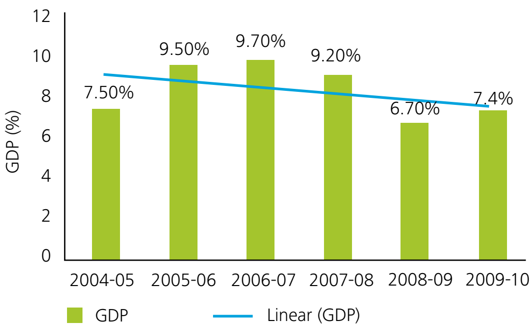
The ministry of industry and commerce has initiated a discussion in July on allowing FDI in multi brand retail to open up the retail sector

Continuing momentum

Opportunity in India

India's economy witnessed a GDP growth rate of 7.4% during the fiscal year 2009-10 and is further expected to grow at c. 8.5% in 2010-11.

Growth in Real GDP



With the boom of the service sector and increased industrial output, the growth pace has spiralled in the last decade. This has set a sustainable platform for consumerism and rising per capita spend leading to an inclusive growth.

Growing disposable income has led to increasing consumer aspiration, with easy access to consumer finance lending a source to achieve these aspirations and desires.

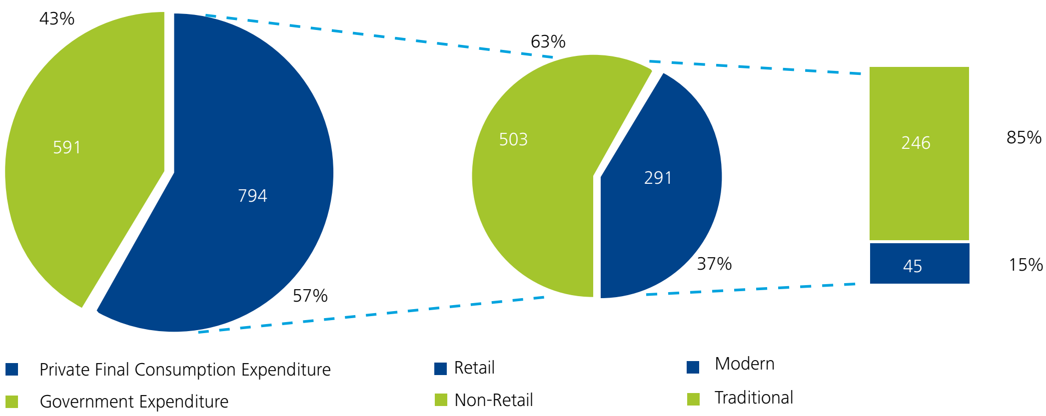
The middle class today accounts for c. 47 percent of the total households in the country, which has rapidly grown over the last decade and is expected to have a similar trend over the coming years. The Indian consumer today is exposed to a large variety of products from where they pick and choose till they get the right product at the right price.

Retail sector

Private Final Consumption Expenditure (PFCE) accounts for c. 57 percent of the Indian GDP. Retail contributes c. US$ 291 billion to the PFCE of which organised retail accounts for c. 15 percent.

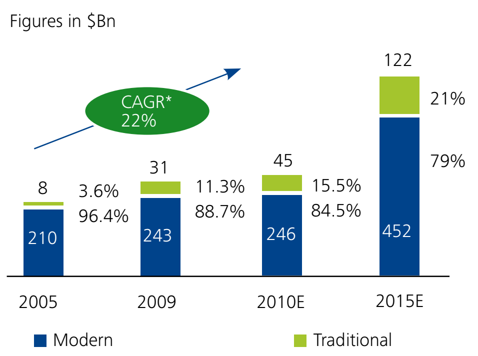
The total retail spend is estimated to double in the next five years, of which organised retail growing at a CAGR of 22 percent is estimated to be c. 21 percent

2009-10* – Gross Domestic Product c. $1385 Bn



Source: CSO and Indian Retail Report 2009
*GDP at market price

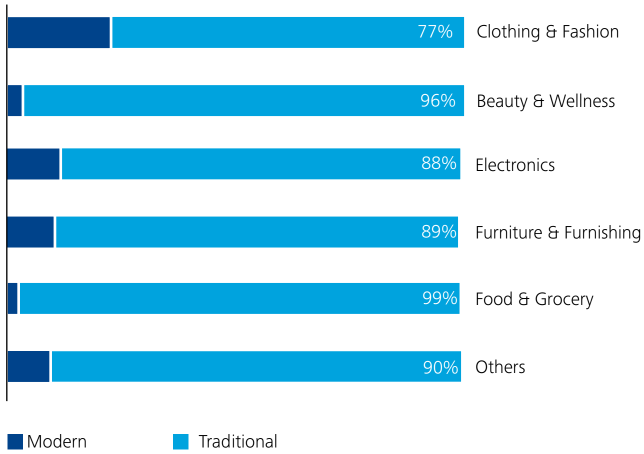
Roots of modern trade can be traced back to the 60s with the formation of co-operative stores; this was the time when Indians experienced their first self service format. Early 90s witnessed the family managed stores modernising their operation and gaining scale over a period of time. Late 90s and the beginning of the new century (year 2000) saw some of the key players scale up operations, introduce multiple formats and roll out larger stores.



* CAGR: Organized Retail from 2009 – 2015
Source: India Retail Report, 2009

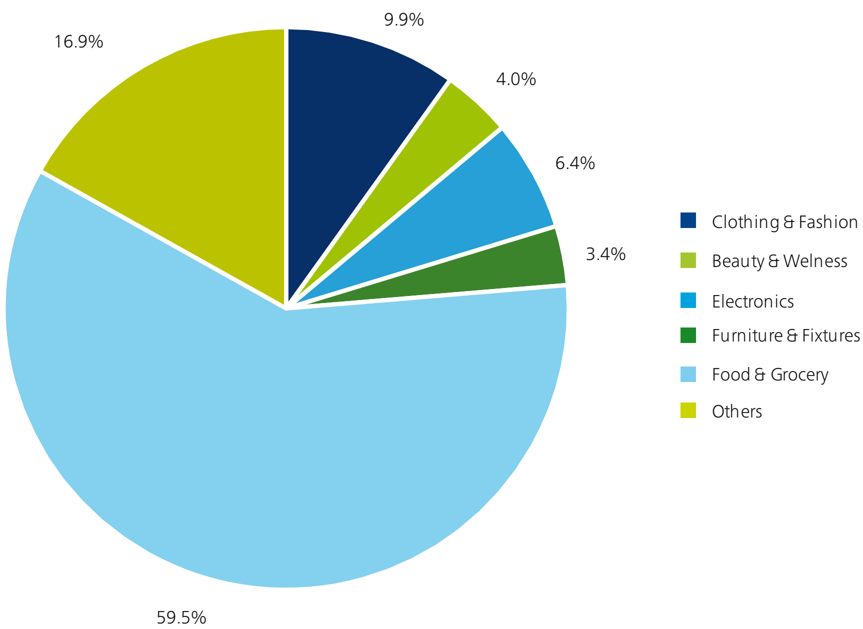
Food and grocery with c. 60 percent forms a lion's share of Indian household consumption, followed by clothing and fashion, which is c. 20 percent of the total spends. Penetration of modern retail varies widely across categories for e.g. clothing and fashion has c. 23 percent share while sectors like food and grocery make up only 1 percent of their total market size respectively.

Share of Modern & Traditional retail



Source: India retail report 2009

India Spends On



Source: India retail report 2009

Food and grocery

Several players operating in this category have experimented with their offerings, formats but have had limited success till date. With growing urbanisation, consumerism and acceptance of modern retail, this sector exhibits huge untapped potential.

The ready-to-eat market has grown over the past few years and with further investment expected in the food processing sector, the ready-to-eat market may prove to be the catalyst for modern retail food and grocery category.

This sector requires the most amount of effort in terms of getting appropriate store location well trained staff, right merchandise mix; value added services and efficient/effective supply chain consistently delivering Every Day Low Pricing (EDLP).

Apparel

Rising fashion awareness and the desire to be perceived as 'in vogue' has led to the rapid growth of apparel category. Brand conscious behaviour; initially restricted to men's apparel with rapid urbanisation has now caught on in the women's apparel line as well. Gradual shift from the traditional 'buy and stitch' to readymade wear, for convenience and larger choice prompted the increase in purchase through departmental stores.

This category is considered to be the pioneer of modern/ departmental retailing and in its early days witnessed many manufacturers venture into front-end retailing. Over the years, these players have not only realigned their product offerings but have also moved towards providing other value added services. With the 2006 FDI policy allowing 51 percent investment in single brand retailing, exclusive brand outlets have witnessed a rapid growth.

Critical success factors would be to deliver affordable and accessible fashion, provide value added service to keep the consumer coming back for more.

Electronics

Historically, this market was largely dominated by branded stores which primarily sold high ticket value items (television, refrigerators etc.), which over the years has broadened to include lower ticket value products (hand blenders, water purifiers etc.)
There also exists a parallel second hand market for these goods (exchange offer items) creating a need for retailer reverse logistics.

Easy availability of consumer finance, high technology acceptance, newer product categories and technologies, desire to emulate the developed world has led to an increase in the overall spend within this category. Critical success factors include store branding and layout, developing a concept of 'one point solution,' training the sales/ procurement staff with product and technology knowledge, being able to match competitor discounts and tie-up for consumer finance.

Furniture and furnishing

In the past, modern retail market within this category was predominantly driven by furniture makers who would import and market their products. This category, of late, has witnessed modern retailers setting up home furnishing sections in their hypermarkets or starting speciality stores. This category faces stiff competition from small time traditional retailers as well as individual carpenters/ furnishers.

Critical success factors would include store layout, experience selling, providing a 'one stop solution for home and office requirement', introducing new/ innovative concepts and designs, tie-up/ alliances for consumer finance and competitive pricing.

Beauty, wellness and pharmacy

Beauty and wellness category has been growing rapidly over the past few years which can be attributed to consumer product companies venturing in the front end. This category in India is primarily targeted at female audience, leaving a huge untapped potential for men's products and services.

Pharmacy retailing in India is largely dominated by traditional/ local chemists. Over the years, this category has attracted a number of pharmaceutical companies venturing into retailing. These new entrants are offering attractive discounts along with value added services (e.g. diagnostics and lab facilities, home delivery etc) being their unique selling proposition.

Critical success factors include relationship building and meeting customer aspirations, talent management, service innovation, providing value-added services, creating strong brand awareness as well as offering value for money proposition.

Learning's in industry

Rapid expansion

Retailers with an aim of having pan-India presence ramped up property at high rentals with low focus on demographic and consumer research and lack of sufficient back-end support.

Economic slowdown/ tight liquidity position in the market impacted retailers ability to grow and expand. Retailers evaluated their store network and expansion strategy to adopt a more conservative approach and negotiated rents with property owners.

Mall mania

With the advent of modern retail, property developers and land owners in metro and tier- I cities started developing malls. As rentals increased, more malls were being built without much consideration given to customer catchment/ other malls in the vicinity. Retailers grabbed available stores in the boom period, but this has reversed with the slowdown in 2008 when mall mania started fading away. Property developers have since realised that success of a mall is not just in developing a property but also in being able to attract footfalls necessary to facilitate tenants' business.

Formats and sizes

In the early years, retailers experimented with multiple store formats and sizes followed by global peers. This has, however, not yielded the desired results leading to retailers streamlining their offerings, store formats, reduced store sizes, maintaining lesser SKU's and categories for better working capital management and improved profitability.

Managing shrinkage

Globally, retail dump and shrink is estimated to be around c. 1 percent of the turnover. In India, this is estimated to be about c. 3 to 4 percent of the turnover. Lot of efforts and time have been channelized by retailers and their associates to streamline their processes and reduce wastage, especially for perishable products, but a significant breakthrough is yet to be achieved.

Talent management

Modern retailers are facing challenges to attract, recruit and retain skilled employees. Players face stiff competition not just from the other retailers but also from other service industries due to a huge gap between the demand and supply for skilled employees. Steps have been initiated by few large retailers for creating a skilled pool of resources by forming an alliance with educational institutes and designing courses for retail sector.

Managing consumer expectation

Retailers have been expending a lot of their efforts towards generating footfalls with limited efforts to improve consumer conversion rate. With the global slowdown translating into declining footfalls, players started revisiting their strategies. Although, they have spent time and energy in creating an overall shopping experience for their consumer, there still exists a mismatch between expectancy and delivery.

Structure of Retailers currently operating in Indian Global retailers can operate in India through a Cash and Carry (Wholesale) model where the retailer can sell to tax registered businesses. Some of the Cash and Carry operators were working in a JV arrangement with local businesses having a front end retailing. In view of the above the government has come out with a rule that Cash and Carry companies cannot have more than 25% of their turnover coming from group companies.

Challenges faced by retail sector

Supply chain

Finance Minister Pranab Mukherjee had in his 2010-11 budget speech said "... the second element of the strategy relates to reduction of significant wastages in storage as well as in the operations of the existing food supply chains in the country. This needs to be addressed."

India is the seventh largest country (land mass: 3.2 million sq. Kms.) with varying climatic conditions over the country. Taste and preferences of people vary strongly all across the country. Catering to people in 35 states and union territories is equivalent to catering to people in 35 countries, leading to complexities in merchandise/ inventory management.

Infrastructure has been developing at a rapid pace over the past decade but has still a significant ground to cover, the planned expenditure of c. US$ 1 trillion in the 12th five year plan will help bridging this gap. There exists a need for retail to concentrate on developing a strong back-end support especially for perishable products to help reduce wastages which is estimated to be at 40 percent of national produce.

Channel conflicts

Globally, retailers maintain a direct relationship with their suppliers. Due to the complex taxation structure and geographic spread of the country, most FMCG companies have developed regional distribution and re-distribution network. Cutting out the distribution network will hurt operating structures of distributors, who as an industry body in the past have opposed FMCG companies selling directly to retailers.

There exists a need for a retailer to work closely with the suppliers in an attempt to shorten the supply chain network resulting in saving time and money.
Private labels

Location and rental

Finding the right location with the right rental for stores has been a challenge for all retailers. Rent forms a large portion of the total expenditure (c. 6 to 11 percent of the revenue) in retailer's income statement and can more often than not convert a profitable store into loss making.

The challenge for a retailer would be to find the right location for their stores either in malls or as a standalone store to be able to generate enough footfalls. A retailer could evaluate option of setting up a property development/ management arm that would be able to source/ develop stores at lower rentals.

Unique Indian customer

The Indian consumer experiencing modern retail has now warmed up to this idea. Buying habits have still not changed, where people prefer to buy most of the fruits and vegetables on a daily basis. The Indian consumers have a strong preference for freshly cooked food over packaged food mainly attributed to dietary patterns, poor electricity supply, low penetration of refrigerators and a family structure where one of the primary roles of the housewife is feeding the family.

There is also an impact on the basket size because of non-availability of personal transport facilities, due to which the consumers prefer to buy smaller quantities from stores conveniently located near their homes.

Regulatory

Currently, indirect taxation structure is complex in India with varying tax rates, multiplicity of taxes and multiple tax enforcement authorities. Goods and Service Tax likely to be implemented in 2011 will replace a host of levies like excise, sales tax, value-added tax, entertainment tax and luxury tax. This is likely to have an impact on the supply chain model and cost structure of distributive trade, followed by consumer packaged goods companies.

Opening a new store requires a lot of licences, which have to be obtained from different government departments leading to considerable lead time in opening up of the stores. A push has been made by existing retailers to get the government to have a single window clearance for getting all the licences at one place to speed up the process.

Private Labels

Private labels enable retailers to offer products at a better price point attracting footfalls to the store. This in turn not only translates to better margins by cutting out middlemen but also enhances retailers bargaining power with supplier. Penetration of private labels in emerging markets is expected to be about 6% of retail sales (Source: India Retail Report) which in India is estimated to be about 10 – 12%. The concept is still at a very nascent stage in India given the age of modern retail in India. Few players have introduced private labels in the category of Food & Grocery, Apparels, Consumer Durables etc. but reservations still exists towards acceptance of these products with the Indian consumer. Private labels offering competitive pricing proposition has helped to generate interest and a slow but steady acceptance from the Indian consumer.

Catering to people in 35 states and union territories is equivalent to catering to people in 35 countries, leading to complexities in merchandise/ inventory management

The road ahead

The proposed FDI norms will open up strategic investment opportunity for global retailers, who have been waiting to invest in India

Retail: 100% FDI – a reality? The implications…
The sentiment towards 100 percent FDI in retail sector is gathering pace. Currently, the UPA has a majority in the house and it seems quite possible that they will be able to pass the bill, making FDI in multi-brand retailing, a reality. Moreover, with state governments like Punjab working with modern retailers in furthering improvement of trade, there is a possibility that support will flow in from other state governments as well. However, the opposition led by the BJP is not in favour of this move and has presented a report recently to the Parliament recommending a complete ban on FDI in retail.

The proposed FDI norms will open up strategic investment opportunity for global retailers, who have been waiting to invest in India. This may have a significant impact on the current arrangement of foreign players.

This policy will require investment from retailers in areas of supply chain, especially for perishable products, thus helping farmers to get better income leading to an inclusive growth in the country.

Given the large number of SKU's that retailers stock Small and Medium Enterprises (SME) sector is also set to gain from this move due to preference given by retailers to private label brands. The move will also encourage smaller suppliers to take their products to a national platform that they could not previously manage due to lack of an organised supply chain of their own.

This policy will also open up avenues for attracting, developing and retaining talent. Contract manufacturers would also benefit from these policy changes.

With the global economy still recovering, investment in India is lucrative to a retailer attributable to strong consumerism, rising disposable income, growing middle class population, favorable macro and micro economic indicators supplemented by a stable government.

Retailers entering the Indian market need to ensure that they have considered the opportunity along with the challenges to maximise their returns. Retailers will need to bank on the local knowledge brought in by their partners/employees/ service providers to be able to reduce the lead time required by them to set-up operations and get a foothold in the Indian market.

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