

RETAIL INDUSTRY IN INDIA

1. OVERVIEW

1.1 Background

The Indian retail industry is divided into organised and unorganised sectors. Organised retailing refers to trading activities undertaken by licensed retailers, that is, those who are registered for sales tax, income tax, etc. These include the corporate-backed hypermarkets and retail chains, and also the privately owned large retail businesses. Unorganised retailing, on the other hand, refers to the traditional formats of low-cost retailing, for example, the local *kirana* shops, owner manned general stores, *paan/beedi* shops, convenience stores, hand cart and pavement vendors, etc.

India's retail sector is wearing new clothes and with a three-year compounded annual growth rate of 46.64 per cent, retail is the fastest growing sector in the Indian economy. Traditional markets are making way for new formats such as departmental stores, hypermarkets, supermarkets and specialty stores. Western-style malls have begun appearing in metros and second-rung cities alike, introducing the Indian consumer to an unparalleled shopping experience.

The Indian retail sector is highly fragmented with 97 per cent of its business being run by the unorganized retailers like the traditional family run stores and corner stores. The organized retail however is at a very nascent stage though attempts are being made to increase its proportion to 9-10 per cent by the year 2010 bringing in a huge opportunity for prospective new players. The sector is the largest source of employment after agriculture, and has deep penetration into rural India generating more than 10 per cent of India's GDP.

Over the past few years, the retail sales in India are hovering around 33-35 per cent of GDP as compared to around 20 per cent in the US. The table gives the picture of India's retail trade as compared to the US and China.

Retail Trade – India, US and China				
	Trade (US\$ billion)	Employment (%)	Shops (million)	Organized sector share (%)
India	180-394	7	12	2-3
China	360	12	2.7	20
US	3800	12.6-16	15.3	80

Source: The Economist

The last few years witnessed immense growth by this sector, the key drivers being changing consumer profile and demographics, increase in the number of international brands available in the Indian market, economic implications of the Government increasing urbanization, credit availability, improvement in the infrastructure, increasing investments in technology and real estate building a world class shopping environment for the consumers. In order to keep pace with the increasing demand, there has been a hectic activity in terms of entry of international labels, expansion plans, and focus on technology, operations and processes.

This has led to more complex relationships involving suppliers, third party distributors and retailers, which can be dealt with the help of an efficient supply chain. A proper supply chain will help meet the competition head-on, manage stock availability; supplier relations, new value-added services, cost cutting and most importantly reduce the wastage levels in fresh produce.

Large Indian players like Reliance, Ambanis, K Rahejas, Bharti AirTel, ITC and many others are making significant investments in this sector leading to emergence of big retailers who can bargain with suppliers to reap economies of scale. Hence, discounting is becoming an accepted practice. Proper infrastructure is a pre-requisite in retailing, which would help to modernize India and facilitate rapid economic growth. This would help in efficient delivery of goods and value-added services to the consumer making a higher contribution to the GDP.

International retailers see India as the last retailing frontier left as the China's retail sector is becoming saturated. However, the Indian Government restrictions on the FDI are creating ripples among the international players like Walmart, Tesco and many other retail giants struggling to enter Indian markets. As of now the Government has allowed only 51 per cent FDI in the sector to 'one-brand' shops like Nike, Reebok etc. However, other international players are taking alternative routes to enter the Indian retail market indirectly via strategic licensing agreement, franchisee agreement and cash and carry wholesale trading (since 100 per cent FDI is allowed in wholesale trading).

1.2.1 Food and grocery retail

The food business in India is largely unorganized adding up to barely Rs.400 billion, with other large players adding another 50 per cent to that. The All India food consumption is close to Rs.9,000 billion, with the total urban consumption being around Rs.3,300 billion. This means that aggregate revenues of large food players is currently only 5 per cent of the total Indian market, and around 15-20 per cent of total urban food consumption. Most food is sold in the local 'wet' market, vendors, roadside push cart sellers or tiny kirana stores. According to McKinsey report, the share of an Indian household's spending on food is one of the highest in the world, with 48 per cent of income being spent on food and beverages.

1.2.2 Apparel retail

The ready-mades and western outfits are growing at 40-45 per cent annually, as the market teams up with international brands and new entrants entering this segment creating an Rs.5 billion market for the premium grooming segment. The past few years has seen the sector aligning itself with global trends with retailing companies like Shoppers' stop and Crossroads entering the fray to entice the middle class. However, it is estimated that this segment would grow to Rs. 3 billion in the next three years.

1.2.3 Gems and Jewellery retail

The gems and jewellery market is the key emerging area, accounting for a high proportion of retail spends. India is the largest consumer of gold in the world with an estimated annual consumption of 1000 tonnes, considering actual imports and recycled gold. The market for jewellery is estimated as upwards of Rs. 650 billion.

1.2.4 Pharmaceutical retail

The pharma retailing is estimated at about Rs. 300 billion, with 15 per cent of the 51 lakh retail stores in India being chemists. Pharma retailing will follow the trend of becoming more organised and corporatised as is seen in other retailing formats (food, apparel etc). A few corporates who have already forayed into this segment include Dr Morepen (with Lifespring and soon to be launched Tango), Medicine Shoppe, Apollo pharmacies, 98.4 from Global Healthline Pvt Ltd, and the recently launched CRS Health from SAK Industries. In the south, RPG group's Health & Glow is already in this category, though it is not a pure play pharma retailer but more in the health and beauty care business.

1.2.5 Music Retail

The size of the Indian music industry, as per this Images-KSA Study, is estimated at Rs.11 billion of which about 36 percent is consumed by the pirated market and organized music retailing constitutes about 14 percent, equivalent to Rs.1.5 billion.

1.2.6 Book retail

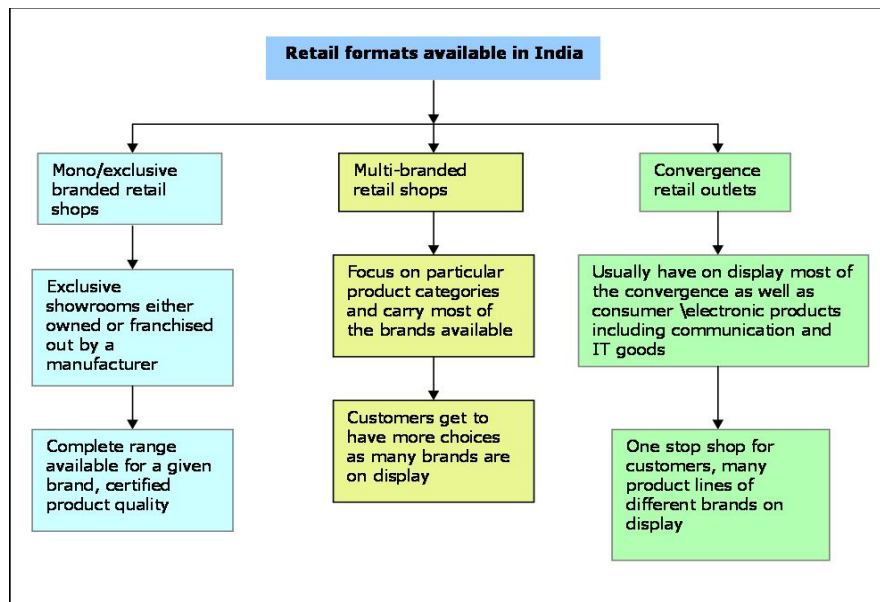
The book industry is estimated at over Rs. 30 billion out of which organized retail accounts for only 7 per cent (at Rs.2.10 billion). This segment is seen to be emerging with text and curriculum books accounting to about 50 per cent of the total sales. The gifting habit in India is catching on fast with books enjoying a significant share, thus expecting this sector to grow by 15 per cent annually.

1.2.7 Consumer durables retail

The consumer durables market can be stratified into consumer electronics comprising of TV sets, audio systems, VCD players and others; and appliances like washing machines, microwave ovens, air conditioners (A/Cs). The existing size of this sector stands at an estimated US\$ 4.5 Billion with organized retailing being at 5 per cent.

1.3 Retailing Formats

Modern retailing has entered India in form of sprawling malls and huge complexes offering shopping, entertainment, leisure to the consumer as the retailers experiment with a variety of formats, from discount stores to supermarkets to hypermarkets to specialty chains.



Source: *IT Retailing: Are You In The Loop?*

However, *kiranas* still continue to score over modern formats primarily due to the convenience factor. The organized segment typically comprises of a large number of retailers, greater enforcement of taxation mechanisms and better labour law monitoring system. It's no longer about just stocking and selling but about efficient supply chain management, developing vendor relationship quality customer service, efficient merchandising and timely promotional campaigns. The modern retail formats are encouraging development of well-established and efficient supply chains in each segment ensuring efficient movement of goods from farms to kitchens, which will result in huge savings for the farmers as well as for the nation. The Government also stands to gain through more efficient collection of tax revenues. Along with the modern retail formats, the non-store retailing channels are also witnessing action with HLL initiating Sangam Direct, a direct to home service. Network marketing has been growing quite fast and has a few large players today. Gas stations are seeing action in the form of convenience stores, ATMs, food courts and pharmacies appearing in many outlets.

In the coming years it can be said that the hypermarket route will emerge as the most preferred format for international retailers stepping into the country. At present, there are 50 hypermarkets operated by four to five large retailers spread across 67 cities catering to a population of half-a-million or more. Estimates indicate that this sector will have the potential to absorb many more hypermarkets in the next four to five years.

Retailer	Current Format	New Formats, Experimenting with
Shopper's Stop	Department Store	Quasi-mall
Ebony	Department Store	Quasi-mall, smaller outlets, adding food retail
Crossword	Large bookstore	Corner shops
Piramyd	Department Store	Quasi-mall, food retail
Pantaloon	Own brand store	Hypermarket
Subhiksha	Supermarket	Considering moving to self-service
Vitan	Supermarket	Suburban discount store
Foodworld	Food supermarket	Hyper market, Foodworld express
Globus	Department Store	Small fashion stores
Bombay Bazaar		Aggregation of Kiranas
Efoodmart		Aggregation of Kiranas
Metro		Cash and Carry
S Kumar's		Discount Store

Traditionally, the small store (*kirana*) retailing has been one of the easiest ways to generate self-employment, as it requires minimum investments in terms of land, labour and capital. These stores are not affected by the modern retailing as it is still considered very convenient to shop. In order to keep pace with the modern formats, *kiranas* have now started providing more value-added services like stocking ready to cook vegetables and other fresh produce. They also provide services like credit, phone service, home delivery etc.

The organized retailing has helped in promoting several niche categories such as packaged fruit juices, hair creams, fabric bleaches, shower gels, depilatory products and convenience and health foods, which are generally not found in the local *kirana* stores. Looking at the vast opportunity in this sector, big players like Reliance and K Rahejas has announced its plans to become the country's largest modern retainers by establishing a chain of stores across all major cities.

Apart from metro cities, several small towns like Nagpur, Nasik, Ahmedabad, Aurangabad, Sholapur, Kolhapur and Amravati as witnessing the expansion of modern retails. Small towns in Maharashtra are emerging as retail hubs for large chain stores like Pantaloon Retail because many small cities like Nagpur have a student population, lower real estate costs, fewer power cuts and lower levels of attrition. However, retailers need to adjust their product mix for smaller cities, as they tend to be more conservative than the metros.

In order for the market to grow in modern retail, it is necessary that steps are taken for rewriting laws, restructuring the tax regime, accessing and developing new skills and investing significantly in India.

1.5 Merger and acquisition activity

India witnessed a record number of M&A deals in the first half of 2006, which were collectively worth US\$ 25.6 billion. A significant number of deals have being carried out in the Indian retail sector in the past few months in order to acquire a larger share in the growing domestic market and to compete against the prospective global and domestic players. The table below shows some recent deals that have taken place in the Indian retail sector.

Year	Acquired/ JV Company/ Target	Acquirer	Nature of Business	Stake (%)	Consideration (US\$ million)
2005	Liberty Shoes	Future group	Retail (Footwear)	51	3
2005	Indus – League Clothing	Future group	Retail clothing	68	5
2005	Odyssey India	Deccan Chronicle Holdings	Leisure retail chain (books, music, toys)	100	14
2005	Landmark	Tata Trent	Books, music, accessories	74	24
2006	Bistro Hospitality	TGI Friday's (a subsidiary of Carison Restaurant worldwide)	Restaurant (Food retail)	25	N/A
2006	Indus League Clothing (Future group company)	Etam group, France	Lingerie and women's wear retailing	50 (JV)	8

Source: PricewaterhouseCoppers, Asia-Pacific M&A bulletin.

2. COMPETITION OVERVIEW

2.1 Profile of the Major Players

2.1.1 Pantaloon Retail

Pantaloon Retail (India) Limited, is India's leading retail company with presence across multiple lines of businesses. The company owns and manages multiple retail formats that cater to a wide cross-section of the Indian society and is able to capture almost the entire consumption basket of the Indian consumer. Headquartered in Mumbai (Bombay), the company operates through 4 million square feet of retail space, has over 140 stores across 32 cities in India and employs over 14,000 people.

Pantaloon Retail forayed into modern retail in 1997 with the launching of fashion retail chain, Pantaloons in Kolkata. In 2001, it launched Big Bazaar, a hypermarket chain that combines the look and feel of Indian bazaars, with aspects of modern retail, like choice, convenience and hygiene.

The group's subsidiary companies include, Home Solutions Retail India Ltd, Pantaloon Industries Ltd, Galaxy Entertainment and Indus League Clothing. The group also has joint venture companies with a number of partners including French retailer Etam group, Lee Cooper, Manipal Healthcare, Talwalkar's, Gini & Jony and Liberty Shoes. Planet Retail, a group company owns the franchisee of international brands like Marks & Spencer, Debenhams, Next and Guess in India.

2.1.2 Lifestyle International

Lifestyle International Holdings Ltd's principal activity is the operation of lifestyle department store and retail outlets. It focuses on high-end department store format. As of December 31, 2005, Lifestyle International operated its retailing business through two brand names, SOGO and Jiuguang. The SOGO Department Stores consists of the Company's flagship department store, SOGO CWB, in Causeway Bay, Hong Kong, and the Tsimshatsui store, which features a slightly different format that targets younger group of customers. The Jiuguang Department Store, which is located in Shanghai, has a similar business format as that of the SOGO store. During the year ended December 31, 2005, it launched SOGO CLUB, a lifestyle service center. Some of the Company's subsidiaries include Asia Kinetic Limited, Congenial Company Limited, Eastlord Development Limited, Everwin Worldwide Limited and Fine Shine Limited.

2.1.3 RPG Retail

RPG Enterprises is one of India's largest business conglomerates. Since its inception in 1979, RPG Enterprises has been one of the fastest growing groups in India with more than 20 companies operating successfully in 7 business sectors: Retail, IT & Communications, Entertainment, Power, Transmission, Tyres and Life Sciences.

Spencer's retail is the largest supermarket chain in India. Spencer's retail offers the complete gamut of products & durables ranging from bread to bed covers; from toothpaste to television. Spencer's today is operating across 80 stores spread across 20 cities in the country with a retail trading area of more than half a million square feet, and rapidly growing.

Spencer's Retail is located in various parts of India like Chennai, Hyderabad, Vizag, Bangalore, Mumbai, Aurangabad, Pune, Ghaziabad, Faridabad, Delhi, Cochin, Trivandrum and many more to come by this financial year.

2.1.4 Shopper's Stop

The foundation of Shoppers' Stop was laid on October 27, 1991 by the K. Raheja Corp. group of companies. From its inception, Shoppers' Stop has progressed from being a single brand shop to becoming a Fashion & Lifestyle store for the family.

Shoppers' Stop is the only retailer from India to become a member of the prestigious Intercontinental Group of Departmental Stores (IGDS). The IGDS consists of 29 experienced retailers from all over the world, which include established stores like Selfridges (England), Karstadt (Germany), Shanghai No. 1 (China), Matahari (Indonesia), Takashimaya (Japan), C K Tang (Singapore), Manor (Switzerland) and Lamcy Plaza (Dubai). This membership is restricted to one member organization per country/region.

2.1.5 Trent (Tata)

Trent (Tata) was established in 1998, Trent operates some of the nation's largest and fastest growing retail store chains. A beginning was made in 1998 with Westside, a lifestyle retail chain, which was followed up in 2004 with Star India Bazaar, a hypermarket with a large assortment of products at the lowest prices. In 2005, it acquired Landmark, India's largest book and music retailer.

2.1.6 Vivek Ltd

Vivek Limited, is the largest Consumer Electronics & Home Appliances retail chain in India, with 14 world class showrooms in Chennai, Bangalore and Salem; covering a retail space area of over 1,00,000 sq. Ft.

Vivek Ltd proposes to expand its operations in Karnataka and also open outlets in Andhra Pradesh. The company is working on a plan to open three retail outlets in Mysore, Hubli and Mangalore in Karnataka and in Hyderabad, Vijayawada and Visakhapatnam in Andhra Pradesh. Viveks currently has 22 showrooms in 5 cities.

3. INVESTMENT POLICY AND INITIATIVES

3.1 FDI Policy in the Retail Sector

India has kept the retail sector largely closed to outsiders to safeguard the livelihood of nearly 15 million small storeowners and only allows 51 per cent foreign investment in single-brand retail with prior Government permission. FDI is also allowed in the wholesale business. Single-brand retailers such as Louis Vuitton, Fendi, Lladro, Nike and Toyota can operate now on their own. Metro is already operating through the cash-and-carry wholesale mode.

The policy makers continue to explore areas where FDI can be invited without hurting the interest of local retail community. Government is considering opening up of the retail trading for select sectors such as electronic goods, stationery, sports goods, and building equipment.

Foreign direct investment (FDI) in retail space, specialized goods retailing like sports goods, electronics and stationery is also being contemplated. The Government has to walk a tightrope to ensure a 'level playing field' for everyone.

The policy of permitting 51 per cent FDI in single-brand product retailing has led to the entry of only a few global brands such as Nike (footwear), Louis Vuitton (shoes, travel accessories, watches, ties, textiles ready-to wear), Lladro (porcelain goods), Fendi (luxury products), Damro (knock-down furniture), Argenterie Greggio (silverware, cutlery, traditional home accessories and gift items) and Toyota (retail trading of cars), into retail trading. A 12-billion euro French luxury industry is also eyeing the domestic luxury segment to make a presence through retailing directly.

3.2 Business models for entry in Indian markets

Due to the FDI restrictions the international players are looking for alternative avenues to enter the Indian markets. However FDI restrictions in retailing have not deterred prominent international players from setting up shops in India.

In recent developments, the Australian retail giant Woolworth Ltd made an innovative entry in India's retail space, with India's Tata group. The Tata group has floated Infiniti Retail Ltd, in venture with which will sell consumer goods and electronics across the country. Infiniti Retail will be a 100 per cent subsidiary of Tata Sons and will receive an initial equity infusion of Rs 4 billion. This Tata retail venture joined hands with Australian retail giant Woolworths Ltd, which currently operates more than 2,000 stores in 12 different formats.

While Infiniti will own and run retail operations in India, Woolworths, which has attained notable success in selling electronics and consumer goods through its Dick Smith Electronics chain, will provide technical support and strategic sourcing facilities from its global network.

At present entry into India's retail sector can be done through three different routes. The chart below shows the current formats permitted by the Government of India for the international players.

Current entry options for foreign players	
Franchise agreements	<ul style="list-style-type: none"> • Most widely used entry route by multinational retailers • Fast food retailer Domino's entered India through master franchise route while Pizza Hut entered through regional franchisee
Cash and Carry wholesale trading	<ul style="list-style-type: none"> • 100% FDI is allowed in wholesale trading which involves building of a large distribution infrastructure to assist local manufacturers • The wholesaler deals only with smaller retailers and not consumers • Metro AG of Germany was the first significant global player to enter India through this route
Strategic licensing agreements	<ul style="list-style-type: none"> • Foreign company enters into a licensing agreement with a domestic retailer • Mango, the Spanish apparel brand has entered India through this route with an agreement with Piramyd, Mumbai • SPAR entered into a similar agreement with Radhakrishna Foodlands Pvt. Ltd

4. OPPORTUNITIES AND CHALLENGES

4.1 Investment Opportunities in the Retail Sector

AT Kearney's study on global retailing trends found that India is the least competitive as well as least saturated of all major global markets. This implies that there are significantly low entry barriers for players trying to setup base in India, in terms of the competitive landscape. The report further stated that global retailers such as Walmart, Carrefour, Tesco and Casino would take advantage of the more favourable FDI rules that are likely in India and enter the country through partnerships with local retailers. Other retailers such as Marks & Spencer and the Benetton Group, who operate through a franchisee model, would most likely switch to a hybrid ownership structure.

A good talent pool, unlimited opportunities, huge markets and availability of quality raw materials at cheaper costs is expected to make India overtake the world's best retail economies by 2042, according to industry players.

The retail industry in India, according to experts, will be a major employment generator in the future. Currently, the market share of organised modern retail is just over 4 per cent of the total retail industry, thereby leaving a huge untapped opportunity.

The sector is expected to see an investment of over \$30 billion within the next 4-5 years, catapulting modern retail in the country to \$175-200 billion by 2016, according to Technopak estimates.

On the total organised retail market of Rs 550 billion, the business of fashion accounts for Rs 300.80 billion, which translates in to nearly 55 per cent of the organised retail segment in the country.

Total fashion sector was estimated at Rs 1,914 billion and forms about 15 percent of the country's retail market of Rs 12,000 billion.

Commanding such a large chunk of the organised retail business in India, fashion retailing has indeed been responsible for single-handedly driving the business of retail in India.

4.2 Challenges in Retailing

The industry is facing a severe shortage of talented professionals, especially at the middle-management level.

Most Indian retail players are under serious pressure to make their supply chains more efficient in order to deliver the levels of quality and service that consumers are demanding. Long intermediation chains would increase the costs by 15 per cent.

Lack of adequate infrastructure with respect to roads, electricity, cold chains and ports has further led to the impediment of a pan-India network of suppliers. Due to these constraints, retail chains have to resort to multiple vendors for their requirements, thereby, raising costs and prices.

The available talent pool does not back retail sector as the sector has only recently emerged from its nascent phase. Further, retailing is yet to become a preferred career option for most of India's educated class that has chosen sectors like IT, BPO and financial services.

Even though the Government is attempting to implement a uniform value-added tax across states, the system is currently plagued with differential tax rates for various states leading to increased costs and complexities in establishing an effective distribution network.

Stringent labor laws govern the number of hours worked and minimum wages to be paid leading to limited flexibility of operations and employment of part-time employees. Further, multiple clearances are required by the same company for opening new outlets adding to the costs incurred and time taken to expand presence in the country.

The retail sector does not have 'industry' status yet making it difficult for retailers to raise finance from banks to fund their expansion plans.

Government restrictions on the FDI are leading to an absence of foreign players resulting into limited exposure to best practices.

Non-availability of Government land and zonal restrictions has made it difficult to find a good real estate in terms of location and size. Also lack of clear ownership titles and high stamp duty has resulted in disorganized nature of transactions.