INDIAN RETAILING: PERCEPTIONS OF FOREIGN RETAILERS

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ABSTRACT

Retailing is the largest private industry in India and second largest employer after agriculture. The sector contributes to around 10 per cent of GDP and 6-7 percent of employment. With over 15 million retail outlets, India has the highest retail outlet density in the world. This sector witnessed significant development in the past 10 years from small unorganized family-owned retail formats to organized retailing. Liberalization of the economy, rise in per capita income and growing consumerism have encouraged large business houses and manufacturers to set up retail formats; real estate companies and venture capitalist are investing in retail infrastructure. Many foreign retailers have also entered the market through different routes such as wholesale cash-and-carry, local manufacturing, franchising, test marketing, etc. With the growth in organized retailing, unorganized retailers are fast changing their business models and implementing new technologies and modern accounting practices to face competition.The present paper analyses the perceptions of foreign Retailers regarding Indian Retail market and emerging sceniario in retail sector.

1.1. INTRODUCTION

Retailing is the largest private industry in India and second largest employer after agriculture. The sector contributes to around 10 per cent of GDP and 6-7 percent of employment. With over 15 million retail outlets, India has the highest retail outlet density in the world. This sector witnessed significant development in the past 10 years from small unorganized family-owned retail formats to organized retailing. Liberalization of the economy, rise in per capita income and growing consumerism have encouraged large business houses and manufacturers to set up retail formats; real estate companies and venture capitalist are investing in retail infrastructure. Many foreign retailers have also entered the market through different routes such as wholesale cash-and-carry, local manufacturing, franchising, test marketing, etc. With the growth in organized retailing, unorganized retailers are fast changing their business models and implementing new technologies and modern accounting practices to face competition.

In spite of the recent developments in retailing and its immense contribution to the economy, retailing continues to be one of the least evolved industries and the growth of organized

retailing in India has been much slower as compared to the rest of the world. Over a period of 10 years, the share of organized retailing in total retailing has grown from 10 percent to 40 percent in Brazil and 20 percent in China, while in India it is only 4 percent. One important reason for this is that retailing is one of the few sectors where foreign direct, investment is not allowed within the country, there have been protests by trading associations and other stakeholders against allowing FDI in retailing. On the other hand, the growing market has attracted foreign investors and India has been portrayed as an important investment destination for the global retail chains. This is evident from the fact that India has received requests from many important trading partners (such as US, Japan, China, EU, Singapore, Brazil and Korea) in the Doha round of WTO negotiations to allow FDI in retailing.

It is now widely debated whether allowing FDI in retailing would bring in more foreign investment in India. Existing research has shown that the actual inflow of foreign investment would depend on several factors such as size of the market, per capita income growth, macroeconomic stability, conductive legislation, access to real estate and availability of retail infrastructure. In the present paper an attempt has been made to analyze the perceptions of foreign retailers about Indian retail market particularly with regard to;

- ✓ Nature & behavior of Indian consumer;
- ✓ Potentiality of Market
- ✓ Trends of prices ,
- ✓ Government regulations;
- ✓ Tax and labour laws and
- ✓ Logistic facilities etc.

1.2 NATURE AND BEHAVIOR OF CONSUMER[1]

The historical pattern in India and in most developing economies shows that, as incomes rise, consumers tend to spend proportionally less on basic necessities and more on discretionary items. Foreign Retailers foresee a similar change in India. As millions of deprived households move into the aspirer segment[2], they will begin to be able to afford products and services beyond their immediate needs for food and clothing. For example, they may start seeing a local doctor instead of relying on home remedies for health care, or invest in jewelry (a

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1 "The 'Bird of Gold': The Rise of India's Consumer Market" McKinsey Global Institute,p32

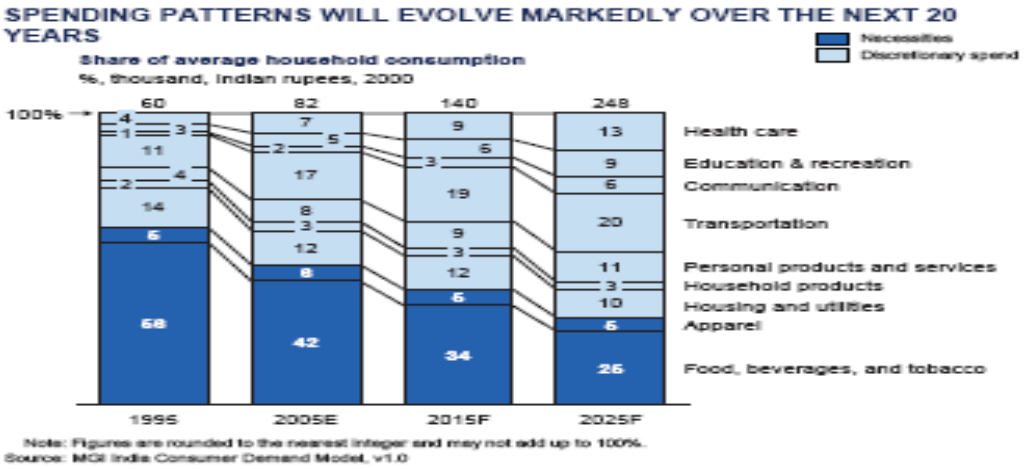
2 Five categories of Household Income brackets namely Global,Strivers,Seekers Aspirers and Deprived (Mckinsey Report "The 'Bird of Gold': The Rise of India's Consumer Market") discussed in Chapter II

common form of savings in India) or buy a secondhand motor bike. For families transitioning from aspirer to seeker, aspirations might include a cell phone, a television, or private schooling for their children.Discretionary spending has already risen from 35 percent of average household consumption in 1985 to 52 percent in 2009. Foreign retailer sees this trend continuing, with discretionary spending reaching 70 percent of average household consumption over the next 20 years.

Of the various changes in household spending across the nine consumption categories, the most significant will be the drop in relative share of food, beverages and tobacco. According to McKinsey report[1] The average Indian household currently spends 42 percent of its consumption budget on this category, but this is set to decline to 25 percent by 2025(Fig: 1.1). While the angle of decline may appear steep, it is largely driven by a dramatic growth in overall consumption rather than a slowdown in food demand.

FIG:1.1

CHANGING SPENDING PATTERNS

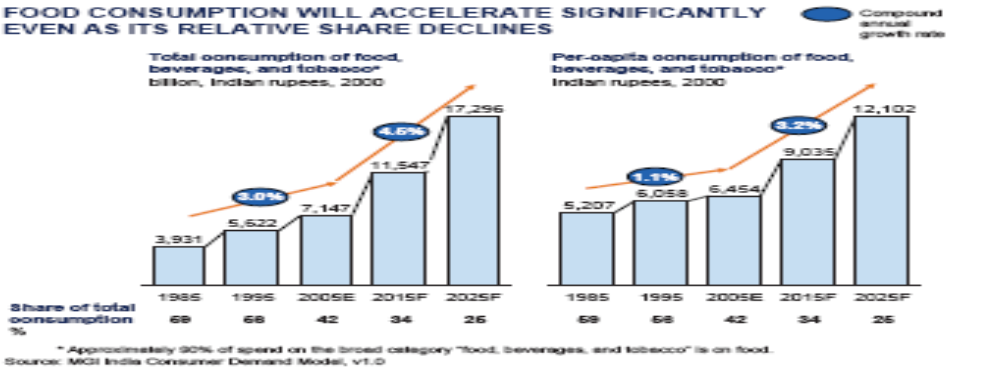


Source: The 'Bird of Gold': The Rise of India's Consumer Market" McKinsey Global Institute,p32

In fact, Foreign Retailer expect per-capita consumption of food to grow almost three times as fast as it has in the past (Fig: 1.2). Furthermore, the fall in the share-of-wallet for food is closely linked to the upward mobility of households. Already households in upper-income brackets such as the urban striver class spend only about 20 percent on food (Fig: 1.3). As more Indian households move up the income scale, the reduction in the share-of-wallet for food is natural.

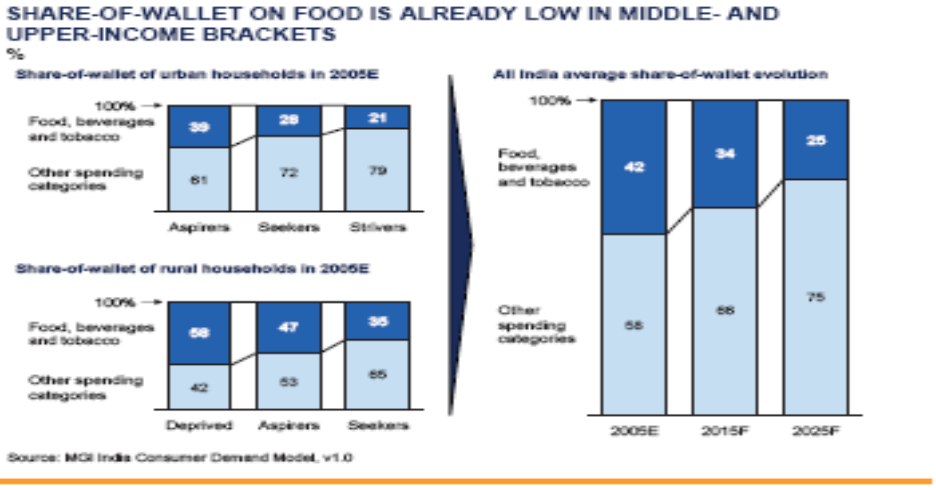
[1] "The 'Bird of Gold': The Rise of India's Consumer Market" McKinsey Global Institute,p32

FIG:1.2
EXPECTED DECLINING SHARE OF FOOD IN TOTAL SPENDING



Significant shifts in consumer spending will be seen in other consumption categories too, as the values and preferences of India's consumers change. Most interesting are the categories upon which Indian consumers have historically shown a greater propensity to spend as income rises, and substantial increases in share-of-wallet. Unsurprisingly, high priorities are the "economically enabling" categories that either boost current productivity or facilitate future participation in economic activity—namely health, education, transportation, and communication.

Not only will these the categories see the most substantial increases in share-of wallet, but they will also be the ones where Indian consumers will spend a greater share compared with their counterparts elsewhere. For example, Mckinsey report forecast the share of spending on health care will nearly double from 7 percent in 2005 to 13 percent in 2025.



Source:The 'Bird of Gold': The Rise of India's Consumer Market" McKinsey Global Institute,p35

1.3.1 POTENTIALITY OF MARKET[1]

PricewaterhouseCoopers estimates that the Indian retail sector is worth USD 350 billion and is growing at 15 to 20 percent per annum. Organised retail penetration accounts for between 5 to 8 percent. The unorganised market comprises 12 million mom-and-pop stores, also called 'kiranas'.

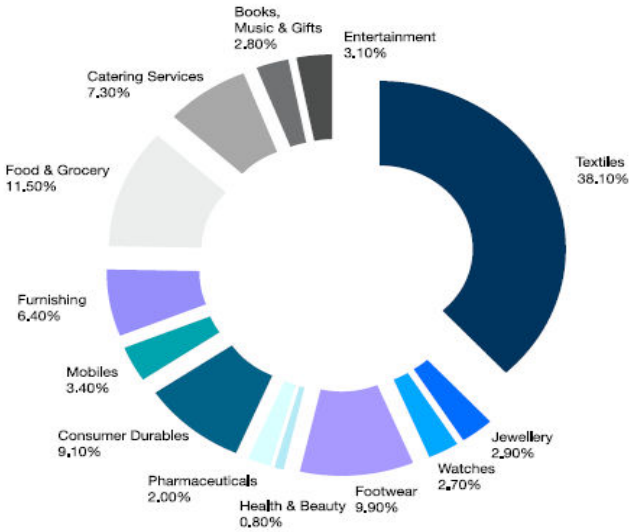
The retail and wholesale sector in India accounts for approximately 14 percent of GDP and over a quarter of the value added in all services sectors. In terms of employment, the sector is the second largest employer (after agriculture) providing over 10 percent of all formal jobs in India. Strong demand and supply features are responsible for growing the retail sector. These include –

Selected Demand Drivers	Selected Supply Drivers
Demanding consumers who want access to the latest and best products	Growth of modern trade formats are making it easier for consumers to access established and new products/brands
Increased access to credit	New entrants are launching a range of products and services for consumers
New customer segments e.g., children, men, working women, etc.) clamoring for products catering to their needs	Modern trade participants have long-term expansion plans for the Indian market
Increasing incomes are driving the purchase of both essential and non-essential products	Growth of niche areas such as health and wellness, organic products, skincare, etc.

[1] Strategic Issues for Retail CEOs " Perspectives on Operating in India's Retail Sector"Pricewater house Coopers Report 2010

Fig:1.4

India's retail penetration—growth opportunities in most categories



Indian retail sector—quick facts	
Market size	USD 350 billion
Organised retail penetration	5 – 8 %
Unorganised retail market	12 million kiranas
Growth rate	15 – 20%
Estimated investment by 2011	USD 412 billion
Retail density	6%

1.3.2 INDIA—AN IMPORTANT MARKET FOR BOTH GLOBAL AND DOMESTIC RETAILERS

The PricewaterhouseCoopers thought leadership study[1] indicates that growth prospects remain favourable in Asia, buoyed by the strong showing of China and India in recent years. India, as compared to other countries, has been relatively insulated from the global economic slowdown. This is apparent when looking at India's consumer confidence levels, its GDP projections for the new fiscal year, investor confidence in response to election results, etc. India's retail sector is perhaps one of the most challenging, dynamic and exciting markets to operate in, as indicated below:

✓ **Serving a heterogeneous market (CUSTOMERS)—** India's 28 states have unique languages, cuisine, geography, etc. and many retailers believe that consumers' tastes and preferences vary by state, city, catchment area and even street! Brand loyalty is an important aspect in serving customers. Some retailers indicated that Indian consumers are brand loyal; that said, if retailers do not listen to consumers and use their feedback, buyers are quick to frequent other retail establishments. Consumers are increasingly demanding value for money, are not willing to compromise on product choice or quality and are willing to visit other retailers if their needs are not met

[1] "Building to Win:How multinationals are structuring to compete in emerging markets" Pricewater house Coopers Report 2010.

✓ **Developing a long-term investment horizon (INVESTMENT)**— Both domestic and global retailers view India as a long-term investment proposition, and suggest that patience, deep pockets and customisation of products and services are required for success.

✓ **Focusing on innovation, customisation and new product development (PRODUCTS)**— Global retailers who have long-term plans for India are, through the launch of India-inspired/customised products, positioning themselves as international retailers who understand the nuances of serving Indian customers in terms of offering the right product, at the right price and through the right distribution channel.

✓ **Operating within the current regulatory framework (BUSINESS ENVIRONMENT)**— Currently, the Indian retail sector is not fully liberalised. Global retailers looking to enter India can do so through the cash and carry route, single brand retail (i.e., a joint venture agreement with an Indian party where the foreign retailer holds a maximum of 51 percent equity), franchising, distribution and strategic licensing agreements. Global retailers wanting to enter India need to find a structuring solution that meets their overall needs and strategic goals. Selecting "the right" Indian partners for single-brand entry, licensing, franchising and distribution is a critical success factor.

The global economic downturn has depressed worldwide consumer spending, sentiments and investor confidence and the retail industry, as with other industries, has been adversely impacted. That said, the PricewaterhouseCoopers thought leadership study[1] entitled '**Glimmers amid the gloom"** The outlook for the retail and consumer products sector in emerging markets especially India suggests that there some sub-sectors within the Retail Consumer industry that are performing robustly, globally, despite market conditions and India will continue to attract more & more global retailers.

1.4: TRENDS OF PRICES

Maximum Retail Price or MRP governs the Indian retail market. Any product prepacked if sold in the Indian market needs to be marked up with a maximum price that retailers can charge from the consumers. Manufacturers are required to mention the MRP on packaging of their goods. MRP was made mandatory to protect consumers against overcharging by retailers. While determining the MRP, manufacturers keep a sufficient margin above the cost of production. Over the years, the market determined price has taken aback seat and MRP is ruling the Indian market. This is because the retailers do not compete with each other but make a local cartel in each pocket across the country. They sell their products at the MRP

[1] "Glimmers amid the gloom" PricewaterhouseCoopers thought leadership study,2010

irrespective of the price that they buy the product for. In addition, the smaller trader/shopkeepers unions across market places in the country maintain intangible relationships and understandings among themselves to keep the price at MRP level and thereby, avoid any competition that would lead to a market determined pricing structure. Customers are forced to pay the maximum price for the products, which is higher then cost of production. Hence, to sum up, the mechanism to safe guard the customers against black marketers and uneven pricing is actually forcing the consumers to pay the highest price and not the market determined price. The foreign retailers are against this concept of MRP and prefer market determined price which in their view is beneficial to both consumers as well as buyers.

1.5:TAXATION HURDLES[1]

The tax structure in India is still complex and evolving, creating challenges for retailers. Even though there is a drive to standardize tax structures, currently there is inconsistency among states. So while most states have abolished octroi and entry tax, few states like Karnataka, Maharashtra and Gujarat still have them. These create delays in transportation due to long queues at check posts, which is especially harmful in case of perishable goods. There are other taxation issues as well. Sales tax issues drive warehousing location choice - many companies have one company-owned distribution centre in every state to avoid paying central sales tax.

Similarly, there are issues linked to multiple points of taxation in India. For example, sales tax is levied at both central and state level. These prevent optimal supply chain models being developed and act as deterrents for organized retailing in India. Similarly non-uniform VAT regimes across states lead to differential pricing of goods and multiple taxation formats for the same goods in different states.

1.6: LOGISTIC FACILITIES[2]

India is a large and highly fragmented country, with 29 states and 18 official languages.A bulk of its population, 66.1 %, lives in rural areas. The lack of adequate infrastructure makes it virtually impossible to reach this virtually untapped market. Distribution, or the lack of it, is a major hindrance for retailers in India. The lack of quality infrastructure across the country

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1 Bajpai, N. and N. Dasgupta (2004), "Multinational Companies and Foreign Direct Investment in China and India, " CGSD Working Paper No. 2.,January 2009. The Earth Institute at Columbia University, Website : www.earth.columbia.edu

2 Atkearney, “Emerging Market priorities for Global Retailers,” 2009 Global Retail Development Index,p.39

and a non-existent distribution sector results in inefficient logistics systems. Infrastructure is the weakest link in India's path to progress and there is an urgent need to address issues plaguing this area. Foreign retailers foresee following drawbacks in Indian supply chain System:

a) Presence of multiple intermediaries: Supply chains in India involve multiple intermediaries.

- ✓ The agri-produce supply chain in India typically has five players compared to three in mature markets; this leads to higher lead times, costs and wastage.
- ✓ Intermediaries hoard margins and reduce both the price paid to producers and the margins for retailers. Indian farmers typically receive approximately 30 percent of the retail price compared to average 50 percent globally.

Some of the major foreign players in the Indian retail sector are addressing this issue through disintermediation and approaching wholesale markets directly.

b) Lack of Suitable infrastructure :Despite increased investments in infrastructure development, the availability of infrastructure in terms of good roads, cold chains, etc. remains limited

- ✓ Infrastructure is a point of concern since the quality of roads requires major improvement.
- ✓ Logistics costs, as a component of total costs, are very high.
- ✓ Quality transportation partners are rare, given the fragmented truckers market.
- ✓ The third-party logistics industry is at a nascent stage with limited capabilities leading to only 30percent of retailers outsourcing logistics completely compared to more than 50 percent globally.
- ✓ The absence of a suitable cold chain infrastructure leads to wastage levels of around 20 to 40 percent of agricultural produce and perishables.

Foreign retailers believe that lack of adequate infrastructure and elements will leads to: High logistics costs, High lead times and High wastage.

c) Lack of Integration with suppliers: Operations of retailers and their suppliers are not adequately integrated in India.

- ✓ Best practices like vendor-managed inventory and cross docking are in the early stages of being adopted.
- ✓ Innovative methods to aggregate the fragmented supplier base need to evolve to enable better integration of suppliers into supply chains.

Foreign retailers believe that lack of integration among supply chain leads to: high lead times, high costs and limited supplier flexibility.

d) Increased demand from Consumers: In addition to growing briskly, the Indian retail sector is experiencing increasing demand from customers for product variety, shorter lead times, etc. which, when coupled with intense competition, is leading to increased supply chain complexities and mandating a new focus on developing world-class supply chains. Key aspects contributing to supply chain complexity include:

- ✓ Geographically spread market
- ✓ Fragmented market (especially rural markets)
- ✓ Regional variances in demand patterns, and hence a need for information visibility and need to understand nuances of the local markets
- ✓ Value driven consumer, hence need for cost efficiency

To create strong customer value propositions, retail chains need to: be more cost effective, provide fresher products (reduce lead times), provide better product assortment (high product variety) and have better reach.

Urbanization is driving an increasing need to upgrade or create infrastructure facilities. Transport is a major concern, with a deteriorating railway system and a limited highway network. In contrast to the global standards, the average load carried by trucks in India - around 7 tons -is very low. However, the Indian Government is presently investing heavily in the state highway system. This will help in an overall decline in logistics costs which is currently 10-12% of the total GDP. 10,000 MW of power needs to be added every year for the next decade. Growth in air passenger traffic, estimated at 20% p.a. for the next two years, necessitates quadrupling of airport capacities. Ports will witness 38% increase in tonnage in the next 2-3 years and hence, port infrastructure cannot be ignored. The lack of a distribution sector and specialized distribution companies is a major obstacle for retailers to fully utilize India's retail potential. Foreign retailers feel that private logistics companies offering specialized services, refrigerated transport and warehouse facilities across the country, along with timely distribution of supplies to retail outlets will create some of the much needed back-end support for retailers to enhance operational performance. If addressed urgently and seriously, it can translate into India's biggest opportunity.

1.7: SOURCING OF PRODUCTS[1]

[1] "FDI in Retail Sector"Department of Consumer Affairs, Ministry of Consumer Affairs, Government of India,p.80

One of the arguments against FDI in retailing is that foreign players would not source their products from India. Contrary to this argument, India has significant competitive advantage in terms of low cost of labour, availability of raw materials, etc. and many foreign retailers such as Arrow, Levi's, JC Penny, Wal-Mart, Gap are already sourcing their products from India. With rising labour cost in the developed countries, many companies are shifting their labour cost in the developed countries; many companies are shifting their operations to developing countries such as India and China. The Indian government has also shown keen interest in developing the country as an international sourcing hub for certain products like shoes, textiles, etc. In recent months, Wal Mart has decided to set up a wholly-owned subsidiary in India for product sourcing. In the past few years, Wal–Mart has been sourcing a wide range of products including textiles, diamonds, shrimps, shoes, apparel and kitchen utensils from India trough a liaison office in Bangalore which was set up in 2001.Wal-Mart wants to develop India as an alternative-sourcing hub to China to minimize its risk.

Aalthough foreign retailers have the option of importing products from anywhere in the world, in developing countries like India and China they source most of the products domestically. For instance, in China, Wal-Mart sources 85 percent of its merchandise from products manufactured in China by global manufacturers such as Procter & Gamble and local manufacturers. The respondents also mentioned that with the removal of restrictions on entry of foreign retailers in China, sourcing from the country has increased. In India, Metro Cash & Carry GmbH sources 95 percent of its product domestically. In 2004, the company has entered into an agreement with Punjab Agro Industries Corporation for sourcing food products for its international operations. The Government of Punjab is keen on introducing modern supply chain management technology in the state and particularly in the area of food sourcing. Metro Cash & Carry GmbH is expected to work closely with farmers to bring in best farming practices and internationally accepted storage, grading and packaging techniques. The company is also expected to improve the hygiene techniques and make farmers better aware of the needs of specific customer groups. Metro operates over 476 “business-to-business” self service wholesale distribution centres across 26 countries and this provides an opportunity for Indian Manufactures and suppliers to distribute their products in international markets through Metro. Amul and Khadi are using the Wal-Mart network to source their products abroad. Indian manufacturers, especially textile manufacturers and processed food industries, have pointed out that if FDI is allowed in retailing it would enable them to source their products in international market s through these retail chains. In fact,

they predict that sourcing from India would increase. In case of China, after Wal-Mart was allowed to set up base, it's sourcing from China grew by almost five times. Organised retailers are also of the view that to remain competitive and establish their market share, foreign players would source most of their products domestically. They argued that although there are no majors impediments to imports, most Indian orgainised retailers source 85 to 90 percent of their products domestically. Indian consumers are price conscious and do not have the purchasing power which is required to sustain imports. Players such as Marks and Spencer and Mango who are sourcing the products from international markets are finding it difficult to increase their market share.

Manufacturers have pointed out that owing to the slow growth of organized formats, many Indian products (such as gold and diamond jewellery) are presently being bought and sold in distribution centres located outside India (for instance, the Middle East). If FDI is allowed, they would be able to showcase their products to foreign retailers. As the vendor's processes and sourcing standards of the larger retail chains become standardized throughout the world, Indian suppliers would gain an automatic share of global trade through their established presence and their closer links with global chains.

4.8: GOVERNMENT REGULATIONS

Foreign retailers and prospective entrants have pointed out that lack of clarity of government regulation, uncertainties created by political pressure from trading associations, high and multiple taxes, requirement for multiple clearances, bureaucratic red tapism and high real estate prices is making it difficult for them to enter Indian market and Expand operation. The problems faced by existing foreign players, are acting as a disincentive for them to enter the Indian market. The rigidity in labor laws, scarcity of allied infrastructure facilities such as power, high electricity tariff, logistic problems, high bank lending rates, bureaucratic red tapism.etc. is preventing foreign retailers from setting up Manufacturing facilities.

1.9: INDIAN MARKET BARRIERS: PRECEPTION OF FOREIGN RETAILERS[1]

Although Indian market is portrayed as an attractive Investment destination, foreign retailers point out that there are several barriers. Some of the barriers are listed as under:

- ✓ Foreign retailers point out that although per capita income in India has increased the purchasing power and brand awareness in still very low in India. In fact Carrefour multi format retailers decided against enlarging Indian market because of this reason.

[1] FDI in Retail sector", Department of Consumer Affairs, Government of India,p.116.

- ✓ Heterogeneity in terms of differences in culture and living habits makes it difficult to have a uniform marketing strategy across the country. In India each state is a mini country and demography of a region varies quite distinctly from the others. To be successful, retailers have to identify with different lifestyles; hence, there are more regional players in retailing rather than national players.
- ✓ The complexity of creating a supply chain, differences in taxes across states and poor infrastructure also makes it difficult to have a nation wide chain store.
- ✓ Food and grocery and apparel and accessories are the two main areas where foreign players have shown an interest in entering the Indian market because these two segments constitute bulk of the consumer spending. Most foreign retailers have done a feasibility study before entering the market. Majority of the studies showed that margins in food and grocery retailing are very low and consumers are satisfied with their neighbourhood kirana stores. These kirana stores offer various facilities like home delivery and purchase on credit which are difficult for international players to offer. Moreover, shopping habits in India are different from that of the developed countries where consumers are willing to stock food items and travel long distances for shopping.
- ✓ Some international players have pointed out that even if FDI is allowed in retailing, small sized supermarkets in selected neighbourhood of particular regions or discount chains would be more successful than large formats like hypermarket. Others stated that Indian still does not have so much product variety to have a hypermarket as in countries such as the US. In apparel, players such as Mark and Spencer and Mango are aware that their products have a premium price and they would find it difficult to penetrate the market. They have entered the Indian market only for brand presence.
- ✓ Foreign retailer and prospective entrants have pointed out that lack of clarity of government regulation, uncertainties created by political pressure from trading associations, high and multiple taxes, requirement for multiple clearances, bureaucratic red-tapism and high real estate prices is making it difficult for them to enter the Indian market and expand operations.
- ✓ The rigidity in labour laws, scarcity of allied infrastructure facilities such as power, high electricity tariff, logistic problems, high bank lending rates, bureaucratic red tapism, etc. is preventing foreign retailers from setting up manufacturing facilities.

1.10: CONCLUSION

India is currently facing the world's most dynamic combination, of highly informed and demanding consumers on one hand, and of rapidly increasing consumption levels across various retail product categories and geographies on the other. Growing consumer demands and the consequent response of leading businesses have created a more complex and competitive marketplace - one that requires each firm to be more adaptive to customer needs and more aggressive at exploiting their unique capabilities to meet those needs. In the context of Indian consumer products and retail companies, this spells multiple challenges and opportunities for them.

Having emerged as the world's most attractive market for global retailers, India still faces alarming issues that pose a serious hurdle to the growth opportunity that the retail industry promises for the country's economic progress. The overall positive outlook of the present business conditions is tempered by the fact that the country is grappling with severe infrastructure and policy issues. Cold chain, warehousing and logistics infrastructure will fast become unmanageable challenges for India, if pro-active action is not taken soon.