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New horizons of retailing in India

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ABSTRACT

The Indian retail sector is going through a transformation and this emerging market is witnessing a significant change in its growth and investment pattern. Both existing and new players are experimenting with new retail formats. The growth and potential of the sector is being widely acknowledged both in the domestic as well as international forums. India topped AT Kearney's Global Retail Development Index 2009 for the third consecutive year, retaining its position in the global market as the most preferred retail destination amongst emerging markets. Consumer dynamics in India is changing and the retailers need to take note of this and formulate their strategies and tactics to deliver value to the consumer. This paper investigates modern retail developments and growth of modern formats in this country. We also discuss the challenges and opportunities available to the retailers to succeed in this country.

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Introduction

The Indian Retail Bazar: Indian consumerism, until the early 1990s remained a point of academic discussion due its immense potential. Similarly, access to cheaper credit and increased disposal incomes to enjoy their aspirations for private homes, cars, and a plethora of other consumer durables was a distant dream. This however, has changed dramatically over the past decade. The Indian economy has evidenced an unprecedented resurgence, with the GDP growth averaging close to 6% per annum placing India amongst the fastest growing economies in the world. This growth has meant an empowerment of the consumer. The transition from a protected economy to market driven regime is apparent as suspicions regarding competition from global players dissipate progressively. With domestic industries gaining confidence in their abilities, competition is no longer the deterrent that it had been.

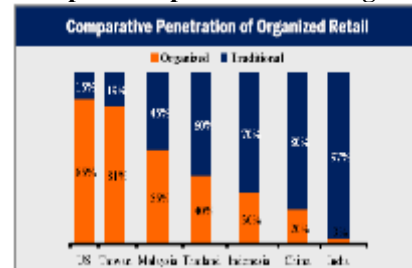
The retail landscape of the country is changing at a rapid pace with malls and multiplexes mushrooming in all major cities. In fact, having reached a substantial capacity at Tier-I locations, the organized retail revolution is now percolating to Tier II and III cities. Retail has clearly been witnessing a transformation from neighborhood-shopping to the concept of malls and family entertainment centers. Entertainment and experience are becoming integral parts of shopping. Global industry analysts have often confirmed the country's potential as one of the most attractive emerging retail destinations in the world. It remains to be seen whether this promise is translated to add further depth to the Indian economy.

Highly Fragmented Retail Sector

The retail sector in India is highly fragmented and organized retail in the country is at a very nascent stage. There are about 12 million retail outlets spread across India, earning it the epithet of a "nation of shopkeepers." More than 80% of these 12 million outlets are run by small family businesses which use only household labour. Traditionally, small-store (*kirana*) retailing has been one of the easiest ways to generate self-

employment, as it requires limited investment in land, capital and labour. Consequently, India has one of the highest retail densities in the world at 6% (12 million retail shops for about 209 million households). India's peers, such as China and Brazil, took 10-15 years to raise the share of their organized retail sectors from 5% when they began, to 20% and 38% respectively. India too is moving towards growth and maturity in the retail sector at a fast pace.

Fig.1.1: Comparative penetration of organized retail



Source: Ernst & Young "The Great Indian Retail story", p.2

Retail is amongst the fastest growing sectors in the country. India ranks 1st, ahead of Russia, in terms of emerging markets potential in retail and is deemed a 'Priority 1' market for international retail. The journey of Indian organized retail is depicted in chart below:

Fig.1.2: Journey of organized Retail in India



Source: Ernst & Young "The Great Indian Retail story", p.3

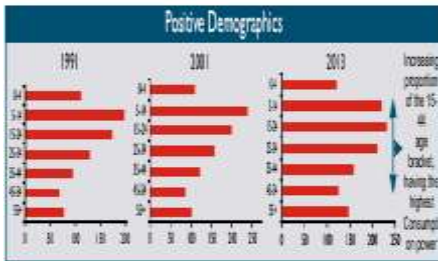
As the diagram indicates Indian retail bazaar is passing

through second stage where the organized retail is trying to consolidate its hold over the market.

The pull factor: who moved the cheese?

Explosive growth in population - unmatched by lagging economic progress - has always been the bane for India. Ironically, with increased financial capabilities of younger generation (the 14-45 age group) off-late, the large urban populace now presents itself as a viable consumer market. According to some estimates, within a decade, India may even have the largest number of people in the world in the 14-45 age group as depicted in Fig.1.3

Fig.1.3: Positive Demographics



Source: Cushman & Wakefield, Corporate briefing “RETAIL IN INDIA: FDI & BEYOND” p.1

The proportion of nuclear families is on a rise, as is the trend of double income households. A large section of urban population now joins workforce at relatively lower ages. The net result of these dynamics is a remarkable increase in disposable incomes. Further, with technological exposure and frequent international travels, upper and middle classes have gained increased awareness of western concepts of entertainment and shopping. Shopping is progressively becoming a fun experience for the complete family unit. Indians with an ability to spend over USD 30,000 a year (PPP terms) on conspicuous consumption represent 2.8% of the entire population. But with a population base of 1.07 billion people, this number amounts to 30 million people, a market next only to USA, Japan and China. While consumer demand is driving retail growth, it is in turn being driven by the following factors:

Economic growth: This has meant greater disposable incomes for the booming Indian middle class, which currently comprises 22% of the total population. This figure is expected to increase to 32% by 2010. Disposable incomes are expected to rise at an average of 8.5% p.a. till 2015.

Demographics: More than 50% of the population is less than 25 years of age and strong growth is expected to continue in this age bracket.

Urbanization: The Indian urban population is projected to increase from 28% to 40% of the total population by 2020 and incomes are simultaneously expected to grow in these segment.

Should Retailers Target only the Affluent?

India has 209 million households, of which the 6 million classified as ‘rich’ have annual incomes of over USD 4700 and 75 million classified as ‘consuming’ have annual incomes between USD 1000-4700. Over half of these ‘rich’ families live in Delhi, Mumbai and Bangalore, and spend around USD 18 billion annually. 62% of the market for premium products in India is also concentrated in these three cities. 85% of India’s retail market is also concentrated in the country’s 8 largest cities. An estimated 1 million households at the top of India’s income map constitute the ‘super-rich’ in the country. Growing by 20% every year, this segments’ buying behavior is in line with its corresponding international segments. While this segment is

worth targeting for high-end premium products, it is not the key driver of the organized retail sector. The real driver of the Indian retail sector is the bottom 80% of the first layer and the upper half of the second layer of the income map (see ‘Map of India’s income classes’ below). This segment of about 40 million households earns USD 4,000- 10,000 per household and comprises salaried employees and self-employed professionals. This segment is expected to grow to 65 million households by 2010 and is currently the key driver behind explosive growth in passenger car sales(USD 5 billion in 2004) and mobile phone penetration (over 70 million).The top 6 Indian cities - Mumbai, Delhi, Chennai, Kolkata, Bangalore and Hyderabad - are the darlings of India’s exploding economy. They represent 6% of the population, but contribute 14% of India’s GDP. They are the centers of business, finance, politics and the emerging sunrise industries such as IT, pharma and ITeS, which have put India on the global map. These cities are also the barometer of India’s economic development and most foreign investors have flocked here.

Fig.1.4: Map of India’s Income classes

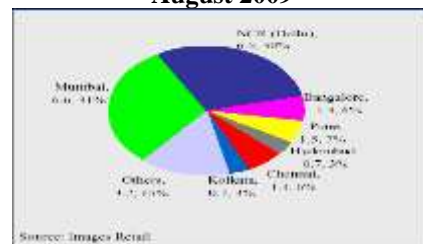


Concentration of Retail activity:

Of the 220 mall projects in the pipeline till 2009, 125 are in the 6 metro cities (139 in the big 8 cities) and 81 in other Tier II cities. Long-term leases are the preferred form of retail real estate acquisition in India. Few retailers prefer a mix of owned and leased space and some prefer own their space.

Of the new malls that became operational in 2005, about 50% of the retail space had already been released and the same holds true for about 30% of space in malls becoming operational in 2006. Availability of space will usher in the next level of competition as requirements of mall space for new players are bound to heighten the intensity of competition. Increased mall space will also attract new Indian entrants. A clear indication of this is the plans of domestic retailers like Piramyd Retail and Lifestyle to scale-up operations and raise capital through the IPO route. With the entry of property funds and investment trusts, this trend of space availability is likely to continue. The Estimated retail space in India is also shown in Fig.1.5;

Fig. 1.5: Estimated Retail space in India (mn. sq.ft) as on August 2009



Focus on Metro cities till 2009

Till the end of June 2009, over 60% of malls in India are in the 6 big metros which account for about 80% of the sector’s revenues. Delhi and the National Capital Region (NCR) will account for about 50% of these malls. Tier I cities such as Mumbai, Delhi and Bangalore clearly have the upper hand in

terms of higher disposable incomes, better infrastructure, awareness levels, propensity to spend and an affluent urban youth population. The respective State Governments have also been proactive in permitting use of land for commercial development, thus increasing the availability of retail space. With the entry of property funds and investment trusts, this trend of space availability is likely to continue.

Change in Focus over the next 5 years

Besides the 6 metros, India has 61 other cities with populations greater than 0.5 million – these cities represent 80% of India’s population and contribute about 14% to the country’s GDP .Even though the 6 metros have the greatest concentration of India’s wealth, the other 61 cities have consistently outpaced the metros in growth rates since 1995. These cities are witnessing higher incomes and a fundamental change in consumer mindset. Increasing awareness levels in Tier II cities are eroding the earlier difference between metros and Tier II cities in terms of ‘urban aspirations. ‘International brands increasingly relying on Tier II cities to drive growth are Nokia, Pizza Hut, Ford, Reebok and Adidas.

Regulatory Enablers Aiding Growth (FDI in Retail Policy Of Govt.)

Even though the decision over FDI has been long overdue, some aspects of the Government’s policy have been favorable on other fronts. We take the example of Delhi & NCR and Mumbai. In Mumbai, the Government is releasing unused textile mill land for retail development. In Delhi & NCR, the Government has released large tracts of land for retail development. Consequently, at 40%, the Delhi& NCR region has the highest mall density in India.

In the future, we see other State Governments also becoming conscious of the easy collection of revenues from land sales and tax from retail development on otherwise useless land. At the same time, while it is difficult to get quality real estate in central locations largely due to private holdings, old regulations and zoning laws, the future will see land and rent reforms driving development in these areas as well. High rental yields will also ensure stronger negotiations between developers and local Government bodies.

In spite of the opposition presented by the Left parties, some headway has been made in this regard. In January 2006, the Union Cabinet approved a major rationalization of the policy on FDI in retail to further simplify procedures for investing in India and to avoid multiple layers of approvals required in some activities. Till now, Government approval was required for FDI in wholesale cash and carry trading and FDI beyond 51% in export trading.

To facilitate easier FDI inflow, instead of having to seek FIPB approval, FDI up to 100% will now be allowed under the automatic route for cash and carry wholesale trading and export trading.

The Cabinet has also allowed FDI up to 51% with prior Government approval for retail trade in ‘Single Brand’ products with the objective of attracting investment, technology and global best practices and catering to the demand for such branded goods in India. This implies that foreign companies can now sell goods sold globally under a single brand, such as Reebok, Nokia and Adidas. Retailing of goods of multiple brands, even if the goods are produced by the same manufacturer, is not be allowed.

Going ahead, the Government is expected to adopt a highly calibrated approach to allowing further FDI in the retail space.

There is a possibility that the relaxation of FDI restrictions may take another 3-5 years. This may deter some international retailers from investing in a big way. However, regardless of the restrictions, international retailers are entering India in droves.

The returns on FDI in retailing in India are likely to be greater than those in China because large Indian retailers are much smaller than their Chinese counterparts. International retailers will find the competitive environment easier on the market share and the growth fronts.

Franchising...Gaining steam with International Retailers

Like Tommy Hilfiger and Wal-Mart, other US retailers are firming up their India entry strategies and if they are already in, they are undergoing rapid expansion. Fashion brand DKNY is also all set to foray into the Indian fashion Industry through a franchisee agreement with Indian company, S Kumar’s. Starbucks recently expressed their interest in entering India through the franchise route, like their American F&B counterparts Pizza Hut, Subway, and the very successful McDonald’s. McDonald’s has major expansion plans lined up; in the next 3 years, it plans to open another 100 outlets in cities across India. The current Retail format of major retailers in India is shown in Fig. 1.6.

Fig. 1.6: Current Permitted Retail Formats for International Retailers



What do Indians buy?

The 4 major organized retail sectors are Food & Grocery, Clothing, Consumer Durables and Books & Music. In 2008-09, private consumption expenditure in India amounted to Rs. 1,690,000crores (USD 375 billion) of which, retail sales constitute about 61% (USD 230 billion). Food & Grocery (USD154 billion) contributes about 41% of private consumption expenditure and about 77% of total retail sales.

However, this segment is largely controlled by the unorganized small outlet sector - penetration of organized retail is about 1% in this segment. This is one of the primary reasons for India’s low organized retail penetration rate.

The sector is defined by low gross margins, but there is a tremendous growth potential in the organized sector in the form of hypermarkets, supermarkets and hard discount chains. In such a scenario, pricing and network will be the key to success. Clothing is the second largest segment in terms of retail sales.

Fig 1.7: Total Retail Sales Pie (2009)



What will make an International retailer successful in India?

Consumer retention and an understanding of the Indian consumer are the key challenges facing Indian retail. Companies which reduce customer defections by 5% can boost profits from 25% to 85%. International retailers need to understand that Indian consumers don't shop and buy the same products as the rest of the world. India is very similar to the EU - the number of states and union territories number 35 and languages, cultures, habits and consumer preferences are different in every one of them.

An international retailer looking to enter India needs to be extremely well versed with local retail culture and know-how. We see a number of strategic partnerships between Indian and international retailers becoming a key point on entry strategy dashboards.

Impact of FDI on organized retail

The impact of FDI in the retail sector on different stakeholders is as discussed below:

Retail Industry

- Growth in organized retail industry will accelerate
- The industry landscape will become more competitive
- A variety of new formats are expected to emerge
- The availability of trained manpower in the industry is expected to go up

Small and Medium Scale Industry

- Big opportunity for exports as retailers are expected to use India as global supply base
- Increase in domestic demand due to local sourcing by international retailers
- Major up gradation of technology is likely due to international expertise in areas like supply chain management, product development, packaging and labeling etc.
- The food-processing sector is likely to get a major boost with capital and technology flowing into the sector

Consumers

- Wider "choice" and availability of greater number of product and service categories
- Improvement in quality of products and services
- Lower prices due to greater competition, economies of scale and more efficient operations
- Higher standards of services and better shopping experience

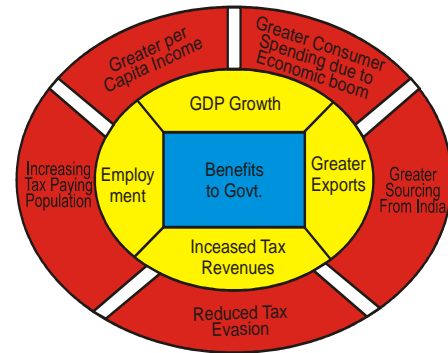
Real Estate

- A big boost in demand for quality real estate is expected with the opening up of FDI in retail
- The industry will have to cater to specific standards demanded by international retailers. As a result, the general quality level of the real estate industry is likely to go up.
- Better technology and managerial know-how is likely to come into the real estate industry

Agriculture

- Reduction in the number of intermediaries due to more direct sourcing by retailers
- Greater demand due to opportunity to export through international retailers
- Reduced wastage and losses owing to more efficient sourcing, effective logistics and supply chain management
- Regulated and stable demand due to well planned operations of large retailers
- Significant benefits are likely to accrue to different stakeholders as a result of Foreign Direct Investment in retail.

Fig: 1.8 : Benefits of FDI in Retail to different Stakeholders



Source: C & W Research

Conclusion

The landscape of retail industry in India has been transformed from a fragmented, family run industry to an organized and professionally managed business in recent years. We, as professionals and participants on the Indian stage, have witnessed this sunrise industry evolve and grow out of the shadows.

From a rather uncertain beginning in late 1990s (paradoxically coinciding with the dotcom boom, which since deceased in an inauspicious manner), the retail industry has gained in stature and momentum.

What assumes critical importance, therefore, is the way the initial organic burst is channelized into a well coordinated growth. The stepping in of the government could not have been at a more opportune moment for the industry.

It needs to be clearly understood that FDI in retail is not means to ensure short term rewards to the national economy. Moreover, whether it possesses the intensity to alter the fundamental fabric of Indian retailing systems also remains debatable. However, it will definitely ensure that the wheels of the nascent Indian retail revolution are set in motion.

As indicated throughout this paper, India does not lack in market size, or essential ingredients. The opportunities for the retailer and consumer alike are large. With the recent developments, it has become evident that this set of opportunities can only become larger in years ahead.

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