The Indian Kaleidoscope
Emerging trends in retail

September 2012

Foreword

India's retail market is expected to cross 1.3 trillion USD by 2020 from the current market size of 500 billion USD. Modern retail with a penetration of only 5% is expected to grow about six times from the current 27 billion USD to 220 billion USD, across all categories and segments.

The recently unveiled Vision 2023 by Chief Minister Selvi J Jayalalithaa will ensure that Tamil Nadu reaches the numero uno position in the next 11 years in all parameters enshrined in the Human Development Index (HDI) to make the state an ideal destination for foreign and domestic investments. The CM's emphasis on agriculture including cold storage and associated logistics, as well as terminal market complexes promises to collectively result in a booming retail market.

This report aims to identify key issues and recommend possible solutions to directly and positively impact the growth of this sector. Based on the recommendations, FICCI is expected to interact with stakeholders including government bodies, and relevant institutions.

We are privileged to have PwC as our knowledge partner. I thank them for their contribution and extend my hearty wishes to all those involved for their outstanding effort and immaculate execution.

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Executive summary

Though, the monsoon in India may be deficient but it is raining deals and discounts for the Indian consumers. To attract customers, retailers are sending personalised messages via sms or emails. The Indian retail landscape is evolving from from the brick-and-mortar model to adopt technology for connecting with consumers. The aim is to achieve a complete seamless customer experience.

It's a new world for both retailers and the customers where the latter is the king. Indians spend 25.2% of their time on social networking websites. As we move from the world of skeptics to early adopters to ultimately the tacticians, online retailing and mobile retailing are the new modes of growth.

Though the overall sentiment for the sector continues to be a cautious one, margins are subdued and revenue still under pressure. The June quarter results are reminiscent of this. The off-season sale and advent of festival season in the subsequent months will make the second half of the calendar year a more reasonable. As a strategy, retailers continue to focus on improving the operations machinery of the business, shifting to low cost channels, promoting private labels, emphasis on increasing customer base, improving in cost structure, discounts and offers and innovative strategies such as 'flat discounts', sale during wee hours of morning or late till midnight, are some of them. While it is business as usual for the retailers, the sector is holding its breath for the much anticipated FDI policy. Till then, to be or not to be is the million dollar question.

This report aims to highlight the key areas to help global retailers entering the Indian market. Our sections deal with measures that impact the top and the bottom line.

Setting up shop

01

India's large and aspiring middle class of 75 million households or 300 million individuals want products that are value-driven. The country's 500 million people under the age of 25 have access to more money that has additionally resulted in independence, aspirations and a demand for products.

Reality check

The Indian retail sector accounts for over 20% of the country's gross domestic product (GDP) and contributes 8% to total employment. The cumulative foreign direct investment (FDI) inflows in single-brand retail trading, during April 2000 to June 2011, stood at 69.26 million USD.

Studies like the MasterCard Worldwide Index of Consumer Confidence have ranked Indian consumers as some of the most confident in the world. The more confident the consumers are about the strength of the economy, their personal finances, their career growth, etc., the more they tend to increase their consumption, purchase non-essential products, experiment with products, brands, categories, etc. Besides, the country's rural population of 700 million presents an opportunity for retail and consumer companies that cannot be ignored.

The current estimated value of the Indian retail sector is about 500 billion USD and is pegged to reach 1.3 trillion USD by 2020. The penetration level of modern retail (currently 5%) will increase six-fold from the current 27 billion USD to 220 billion USD in 2020. The Indian retail sector is expected to grow at a CAGR of 15 to 20%. Factors driving the organised retail sector include the following:

- Higher incomes driving the purchase of essential and non-essential products
- Evolving consumption patterns of Indian customers
- New technology and lifestyle trends creating replacement demand

- Increase in rural income as well as urbanisation
- Increase in easy access to credit and consumer awareness
- Growth of modern trade format across urban, Tier I, Tier II and Tier III cities and towns
- Rapid urbanisation and growing trend towards nuclear families

Country	Share of organised retail to total retail
US	85%
UK	80%
Malaysia	55%
Thailand	40%
China	20%
South Korea	15%
Indonesia	25%
Philippines	35%
India	5%

Source: Media reports

Key players in the Indian retail market are as follows:

Pantaloon Retail Ltd (Future Group venture)	Over 2 million sq ft of retail space spread over 35 cities with 65 stores and 21 factory outlets
Shoppers Stop (K Raheja Group venture)	Over 3.21 million sq ft of retail space spread over 23 cities with 51 stores
Spencers Retail(part of RP-SG Group)	Retail footage of close to 1 million sq ft across 45 cities with 200 stores
Lifestyle Retail (Landmark Group venture)	Approximately 15 lifestyle and eight Home Centre stores
Bharti Retail	74 Easyday stores with plans to invest about 2.5 billion USD over the next five years to add about 10 million sq ft of retail space in the country
Reliance Retail	700 stores with a revenue of 7,600 crore INR
Aditya Birla 'More'	575 stores with approximate revenue of 2,000 crore INR. Recently, purchased stake in Pantaloon Retail
Tata Trent	59 Westside stores, 13 Starbazaar hypermarkets and 26 Landmark bookstores

Source: Media reports, company websites

Foreign entrants in the Indian segment are as follows:

- Germany-based Metro Cash & Carry opened six wholesale centres in the country.
- Walmart with Bharti Retail, owner of Easyday stores.
- British retailer Tesco Plc (TESCO), signed an agreement with Trent Ltd (Trent), the retail arm of Tata Group to set up cash-and-carry stores.
- Carrefour opened its first cash-and-carry store in New Delhi.

The Economic Pendulum

The global economy is decelerating. In 2012, majority of the economies are witnessing slow growth as compared to the year before. Even though the US economy has started to show some signs of recovery, failure of the government to come out with a conclusive fiscal plan is affecting investor confidence, employment creation and the capital market. Similarly in Europe, the euro crisis has had a negative impact on the consumer sentiment. Besides, countries such as Greece, Spain and Italy are seething under the economic pressure. The growth in China is also slowing due to tightening of its monetary policy. India too has been affected. To add to the woes, we are facing high inflation across economies.

Inflationary effect

India's growth has slowed to 6.5% in the current fiscal, dragged down by a nine-year low of 5.3% in the March quarter on account of poor performance of the manufacturing sector. This is due to the cascading effect of the global slowdown that originated from developed economies and has impacted both China and India, the major contributors to the world GDP. However, despite these short-term difficulties, the medium outlook is more positive, states an OPEC report.

From the sector's perspective, both consumers and retailers are being negatively affected as currently inflation is supply-based, rather than demand-driven. Before the downturn, consumers subsidised their spending through credit or dipping into savings, but this is no longer achievable or sustainable. As a consequence both margins and sales are under pressure.

A strong GDP growth, rising consumer confidence, consumption-based behaviour, increasing income, and a large pool of consumers provide windows of opportunities for global retailers to invest in the Indian market. Largely deals are happening in the online model whether it is pharmacy, apparel, baby care or books. Considering that we have the youngest population in the world, such companies are bound to see growth, making it inevitable for financial investors to be present in this segment.

Mergers and acquisitions

PwC's 15th Annual Global CEO Survey indicated that half of CEOs in developed countries believed that emerging economies are more important to their company's future. With the developed markets witnessing an economic turmoil, emerging countries are fast becoming the retail hotspot for foreign players. In the past five years, retail chain giants such as Walmart, Tesco and Metro Group, saw revenues in developing countries grow 2.5 times faster than their home markets. India provides an opportunity for retailers seeking to make investment in the emerging economies to participate in the growth and increase their global presence

The nascent stage of organized retail penetration in India and the shortage of availability of cash for expansion will prompt more business activity in the sector. This has been the primary reason for the M&As in this sector, especially in the e-commerce segment. In 2011, the e-commerce sector raised over 500 million USD from 67 deals as compared to 2010 which saw only 18 investments worth 112 million USD. This is backed by strong fundamentals such as critical mass of Internet users, broadband penetration and 3G growth, rising middle class, improved payment gateways and logistics. Some experts feel that this may just be a bubble phenomenon, while others feel this trend is sustainable although steps need to be taken towards improving the supply chain and long-term strategies.

Some of the recently announced deals include the following:

Investor	Investee	Sector
SAIF Ventures	InkFruit	Online apparel site
Tiger Capital, Helion Ventures, Accel India	Letsbuy.com	Online consumer durables site
Fidelity	Bigshoebazaar India	Online shoe site for wholesale purchases
Tiger Capital	CaratLane.com	Online jewellery site
Sequoia Capital India	Lovable Lingerie	Innerwear
Standard Chartered Private Equity	Privi Organics	Indian aroma chemical products manufacturer

Source: Media reports

However, the existing restrictive FDI policy framework continues to pose a challenge and drive the M&A activity.

Ever since the policy on single brand retail policy was announced in 2006, more than 60 brands have set up retail operations in India in strategic joint ventures with Indian partners. Some of these include:

- Marks & Spencer with Reliance Retail
- Georgia Armani with DLF
- Fendi with Chordia Fashions
- Ferragamo with DLF
- Damas with Gitanjali Lifestyle
- Inditex (Zara) with Trent
- Burberrey with Genesis Color
- S Oliver with Orient Craft

The current FDI Policy on single brand specifically require the foreign investor to be the brand owner, and therefore, it closes doors for any direct investment by an international private equity player in this segment.

In January 2012, the government further liberalised the policy on single brand retail trading by increasing the FDI cap from 51 to 100%, subject to certain conditions. This policy has opened doors for further M&A activity, especially for the following:

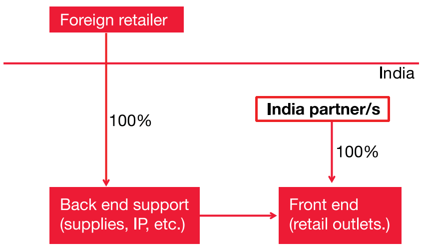
- Existing joint ventures, where foreign investor may wish to acquire the Indian partners stake
- Existing licenced or franchise arrangements, where the foreign principal may now wish to set up stores under 100% ownership and acquire the existing business of such licencee or franchisee in India.

On account of certain ambiguities in the policy, M&A on these have been relatively slow, but it is expected to pick up as and when these uncertainties are ironed-out with further liberalisation in the policy.

The multi-brand retail sector is witnessing calibrated liberalisation, while currently under prohibition. The trading sector was first opened for FDI with a formal policy on wholesale trading in the year 1997 (requiring government approval for 100% FDI). This was further liberalised in 2006 by placing the segment under automatic route. Since 2006, the FDI in wholesale trading has been freely permitted. In April 2010, the government issued certain operational guidelines for Indian companies with FDI engaged in wholesale trading activities. Some of the operational guidelines have substantive impact on the M&A activities in this space. The key ones are as follows:

- Business customers need to have a government licence or registration to act as such
- Group company sales are to be restricted to 25% of wholesale turnover

Currently, most e-commerce companies and multi-brand retail trading companies have adopted B2B route for raising foreign capital or formed strategic joint ventures with foreign retailers. A typical structure is as follows:



The primary advantage of this is that the foreign investor or retailer gets an early mover advantage combined with the hope that the businesses can be consolidated in the future as and when the policy is liberalised. Currently, 100% FDI is allowed in B2B trade. Therefore, the FDI in this segment helps in building up the back-end infrastructure and vendor relationships.

Though, some of the challenges that fraught such commercial agreements include inability of foreign investor to participate in front-end retail business, supply chain inefficiencies, financing the roll-out of retail stores, etc.

There is high expectation from the proposed policy initiatives whereby the government is contemplating permitting FDI in multi-brand retail trading, subject to conditions. If the policy is announced, the following are some of the possible M&A activities:

- New joint ventures with Indian partners for new retail venture
- Acquisition of equity stake or new investments by foreign retailers in existing Indian retail companies
- Consolidation of the above B2B structures into a single entity.

The current proposed policy framework in this segment, as announced in November 2011, contemplates conditions such as minimum investment of 100 million USD with 50% of foreign capital used to develop back-end infrastructure. Such conditions will be more amenable to large hyper-market formats and may not immediately benefit speciality retail such as pharmacy, electronic goods, etc.

The extravaganza

02

From General trade to Modern trade and now going virtual, Indian retail sector is going through its own lifecycle. However, important to note is that the emergence of one mode does not hamper the existence of the other. In this section, we explore how the kirana stores have reinvented themselves to beat the hype around modern trade. Then we talk about how much weightage does customer experience carry and then we move on to the multichannels of retailing.

Co-existence of the kiranas with organised retail

The coexistence of the local kirana store and the organised players is a no-brainer in the current context of the Indian retail sector. There are no two ways to it. Organised players target cities and not the hinterlands. It is the kirana guys who take care of the daily household needs in those areas. In fact, these neighbourhood mom-and-pop stores continue to be the only point of sale for most FMCG players to rural areas of the country. The kiranas have reinvented themselves in the cities to stay relevant to its target audience.

Success story

With over 32 categories, thousands of products from more than 100 FMCG companies to choose from, the 'AaramShop' concept has been launched on a pilot basis in the Delhi and National Capital Region (NCR). Over 3,000 traditional grocers have partnered with it. Selling groceries online is not new in India. Just last year, over a dozen online portals mushroomed across the country selling a wide-range of products-from household items to food. The front-end for these e-grocers were websites and the back-end primarily warehouses. Traditional shopkeepers are now latching on to portals such as www.araamshop.com and www.kiranawalla.com.

When a customer orders online through these portals, it is communicated to the closest shopkeeper partner near his or her house who in turn delivers the purchase order at home. This gives another point of sale to the customer and at the same time lower overheads for the seller who does not have to invest in a physical shop.

The balancing act

The advent of FDI and MNC players in the retail sector was considered to impact the kirana stores. However, these stores have existed since ages and they still continue

to be at the beck-and-call of many households. Their presence in the midst of a residential area is a big advantage. A small item, be it a loaf of bread or few eggs gets delivered at the doorstep. In India, kirana and traditional retailing still continues to be the single largest outlet for sale of FMCG goods. Even the product mix that the neighbourhood shop stocks varies from small cottage industries, especially ayurvedic and other healthcare products, a few FMCG products such as soaps and shampoos, and taste-driven products such as local biscuits and savouries, which cannot make it to a big retail supply chain.

Modern retail has been in existence for sometime now and there have not been many cases where kirana shops had to shut down due to an organised player coming up in the neighbourhood. There have also been certain external environmental factors such as high rentals, demographic change in the consuming class and increased disposable income that led to a slower growth in the traditional retail. In fact, large retailers had to reinvent and evolve their business models to arrive at a format that could compete with a local mom-and-pop-shop.

To outdo the modern trade players, kirana shopkeepers conduct bulk purchases from organised players and avail volume discounts. This has helped them to stay relevant to customers' needs and at the same time earn a higher margin for themselves. Private label is the cash-cow for most players in the developed markets. Similar phenomenon is visible in India as well. We see that the cash-and-carry players are pushing their private labels through the kirana store rather than the modern retailers. This poses serious threats to the FMCG players whose prime point of sales is the kirana outlet.

The experience of China and Indonesia shows that traditional and modern retail can co-exist and grow, albeit at different rates. While kirana stores may be growing at 2 to 5%, organised retail may be growing at 20 to 40% CAGR or more. This is due to the fact that organised retail is growing at a low base. In Indonesia, even after the emergence of supermarkets, 90% of fresh food and 70% of entire food is still controlled by traditional retailers. In Japan, organised retailers co-opt several kirana stores and hawkers drawn from the pool of traditional retailers and are upgraded with capital infusion and trained to meet the demands of customers.

Future outlook

The one difference between the traditional kirana shops in India and the traditional mom-and-pop stores in the West is that the latter, historically, were relatively inefficient as compared to the modern trade. However, it is proved that the traditional kirana stores and outlets in India are ultra-efficient and have been able to compete very successfully with modern retail for a very long period of time. Modern trade has expanded dramatically, but the classical, traditional kirana and convenience outlets have grown, modernised and become self-service outlets to do remarkably well.

New initiatives

The political mayhem over fears of extinction of these shops seems misplaced. Such is the reach and power of these local shops that LIC, the biggest insurance company in India has proposed to include them as their agents for selling its micro insurance plans. Players such as the Future Group plan to expand their corner store format KBs Fair Price (received funding from Japan's retail chain Lawsons) through the existing shops and help to revamp, refurnish and rebrand the outlets while providing back-end support. The idea is to promote inclusive retail growth.

Kirana stores are rapidly adapting technology to remain in touch with their customers. Today, grocery retailers are going online. These players are particularly popular in the metros, catering to the Internet savvy customers, who have limited time.

Dilligrocery.com services the Delhi NCR area and offer home delivery free-of-cost if the bill is over 2,000 INR or they charge a flat 50 INR (which in today's world is less than the cost of fuel one would incur to go to a modern format for shopping groceries) for delivery. They have a turnaround time of one to two days. They even have a clear return policy which is important for online retailers. Greenytails.com has a common website for India and the US. In India, they service Bangalore and Hyderabad and offer free home delivery with an extra service charge in a few areas. Their website is well-designed and user-friendly. The prices are also competitive with the regular grocery stores. They currently offer 'cash on delivery' mode of payment which is actually a good way to get customers to try the website, since customers do not have to pay anything upfront and do not have to worry about credit card fraud or the authenticity of the vendor. They also have reward points for building loyalty.

Chennaionlinegrocery.com also has a sophisticated website. They accept credit cards payments and is very user-friendly. Pristine-nature.com is another online retailer who deals exclusively with delivery of organic grocery.

Customer Experience Management

The Indian retail experience has gone beyond the traditional brick–and-mortar store and includes numerous touch points such as online stores, social networks, call centres, etc. Changing economic dynamics, diverse choices in products and services, numerous shopping formats and unparalleled access to information has empowered customers to expect more from their retail experience.

The recent economic downturn has taught discipline to the customers. In today's rapidly changing and digitally connected world, customers are more value-conscious while making purchase decisions.

Customer testimonials

Our discussions with customers across various sectors provided some useful observations. Some of the customer responses are as follows:

I walked into a store where a sign was displayed: In case you do not find a product on shelf, let us know and we shall deliver it at your home. This, according to me, was an amazing shopping experience.

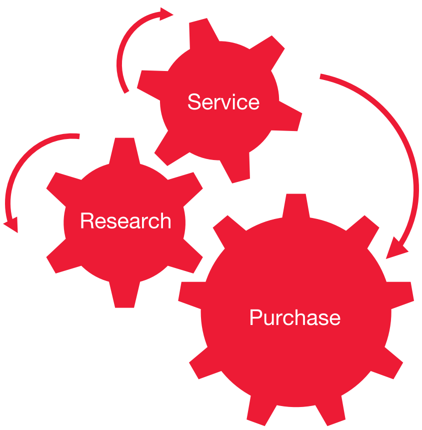
I had bought two shirts from a reputed brand, which were not used for about two years. There was some defect in the quality of the shirts. When I approached the retail store, I was surprised that they managed to retrieve purchase information with the limited information I provided. The retailer also allowed me to exchange the shirts. This was truly a wonderful customer experience.

Quality, price, discounts, availability of products across various categories and express checkouts are some of the few aspects of a complete customer experience.

Customer experience lifecycle

Today, a customer interacts with the retailer multiple times before, during and after the purchase. The interaction may happen across multiple channels. Therefore, it is important for the retailer to provide complete and consistent customer experience across these channels.

Customer experience lifecycle



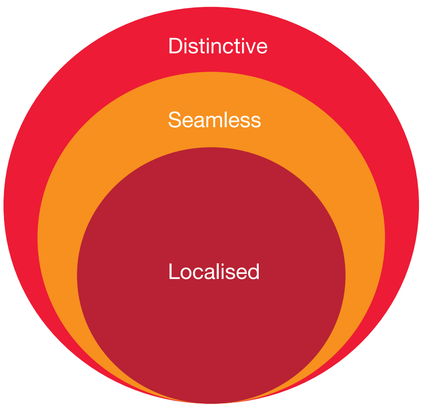
In the research phase, the customer analyses the information available from various touch points, such as word of mouth, newspaper advertisements, mailers or the web, etc. services. Today's consumer is looking for a personalised, seamless and distinctive experience from the retailers.

In the purchase phase, the customer takes the buying decision on the product and pays for it. Various touch points in this phase include the web, the physical store, sales associates, assortments, layouts, etc.

In the service phase, the customer service and loyalty programmes are the key touch points that the retailer has with the customer. After sales customer service includes installation of an appliance or return and exchange of merchandise.

Evolution of customer experience

Customers today care more about the retailing experience than they did in the past. Their expectations from retailers go beyond just shopping of goods and services. Today, consumers are looking for a personalised, seamless and distinctive experience from the retailers.



- **Localised experience:** Given the amount of information retailers have about the customer behaviour, buying habits, etc. the consumer expects the retailer to ensure that the goods and services are available in the stores when the customer walks in to shop. The retailers need to establish the relevance with the customer. Individual attention, personalised promotional offers, best utilisation of time and money are few other basic expectations that customers have from retailers.
- **Seamless experience:** Consumers want to traverse multiple channels easily and enjoy a seamless experience. This means the physical store, web, catalogue, call centre and kiosks have to be integrated to ensure a consistent customer experience across these channels. Best Buy in the US provides seamless experience online as well as in the store. Customers can research online and come to the store for a physical experience. It also offers same pricing, offers, to the customers online as well as in the store.
- **Distinctive experience:** Apart from the competitive price, the customers seek a distinctive shopping experience driven by best customer service. Retailers have developed customer friendly return or exchange policies, loyalty programmes, customer appreciation days, etc. Retailer use better customer service to differentiate between retailers, generate customer loyalty, increase customer purchases and create positive brand image. Retailers have started giving promotional discounts via SMS to customers when they are in the store or in the mall where the retailer has the store.

Apart from the above, various factors that affect the customer experience include the following:

- Customers in the do-it-yourself (DIY) segment (example IKEA) seek customisation and those in the do-it-for-me (DIFM) segment seek convenience.
- Customers expect quick service even at retail stores, not just in fast-food restaurants.
- Stores should be conveniently located and have the right layout.
- Customers want to be entertained and even educated while they shop.
- Retail store staff members (sales persons as well as cashiers) are the brand ambassadors for the store. They are in direct contact with the customers at various touch points and deliver the experience. Continuous investment is required in the training and coaching of staff to deliver on customers' expectations.
- It is important to stay connected with the customers today to remain the top-of-the-mind recall when they shop.
- There is a growing demand for customised products, be it cars, apparel, computers or music.
- Easy returns policy is a must in e-commerce. Retailers need to set up reverse logistics solutions to make returning products bought online easy.

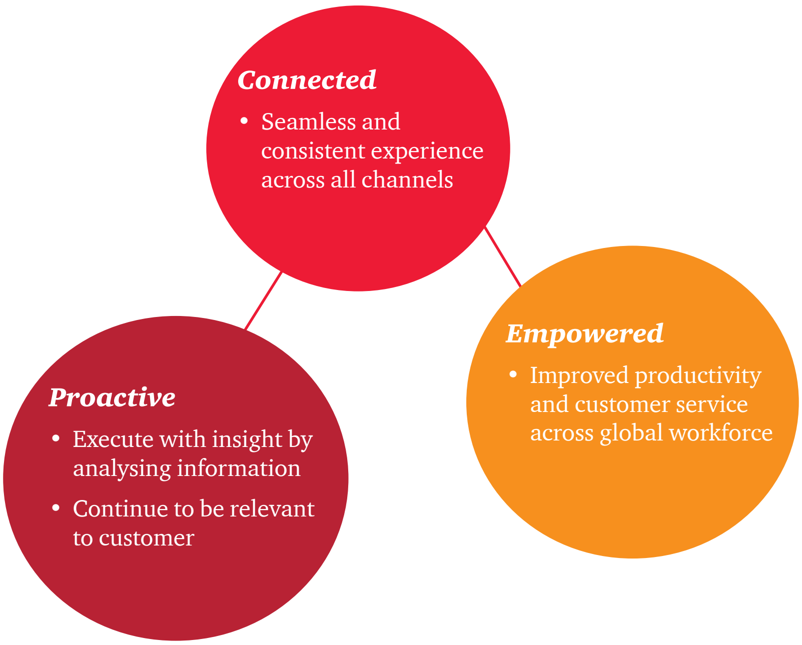
The dynamic retailer

Consumers are leading the way in multichannel shopping, with many retailers lagging behind in meeting their needs. Today's global retailers have a huge opportunity to enhance the mechanisms necessary to keep up with shoppers who are demanding more customisation in terms of delivery, returns, product choice and number of channels from which to choose.

Retailers need to become far more innovative with their online presence. They should refresh their physical formats to emphasise quality and customer satisfaction, and not just price and selection (which is generally researched online). They must align themselves with the buying tendencies of the growing middle-class customers in the emerging markets.

Retailers today know that customers have a wide variety of products and formats to choose from. It is important for the retailers to create bond with the customers by offering personalised experience and be of relevance to the customers. In today's environment, retailers need to have single view of the customer, understand their buying behaviour and yearning to engage, and demonstrate loyalty to the customer.

The global customer requires retailers to be more connected, more empowered and more proactive than ever before.



Customers looking beyond loyalty management in driving customer experience

Customers are loyal to a brand or retail store or restaurant not because of any promotion, discount coupon, or loyalty membership but for the customer experience they derive.

Today's customer is flooded with information about the variety of products and choice of formats for shopping. He/she interacts with retailers via multiple channels, be it the point of sales or the e-commerce portal. Retailers today are working towards shifting the focus from price to value, relevance, differentiation and competitiveness, which in the long run will create value for the customers and thus drive sales.

Customer loyalty is a tool used by the retailers to capture the customer base and thus customer insights. Retailers use business intelligence systems to analyse the customer data, helping them improve merchandise and assortments, defining and executing targeted promotional campaigns, etc. this in turn leads to better shopping experience and incremental sales.

For example: Target in the US has been able to predict if a woman is pregnant five months before the delivery. This has helped the retail giant provide necessary products and services to the loyal customer and also run targeted promotions influencing buying behaviour, thus driving sales.

One of the key performance indicators that measure the effectiveness of the loyalty program is the 'Loyalty Customer Sales vs. Total Sales'. This tells the retailer how much of total sales from a channel are from its loyalty customers. But it is important to analyse how many loyalty customers are redeeming the points earned, which shows the true picture of customer loyalty to the retailer.

Answering the following questions will help retailers increase their loyal customer base and thus increase sales:

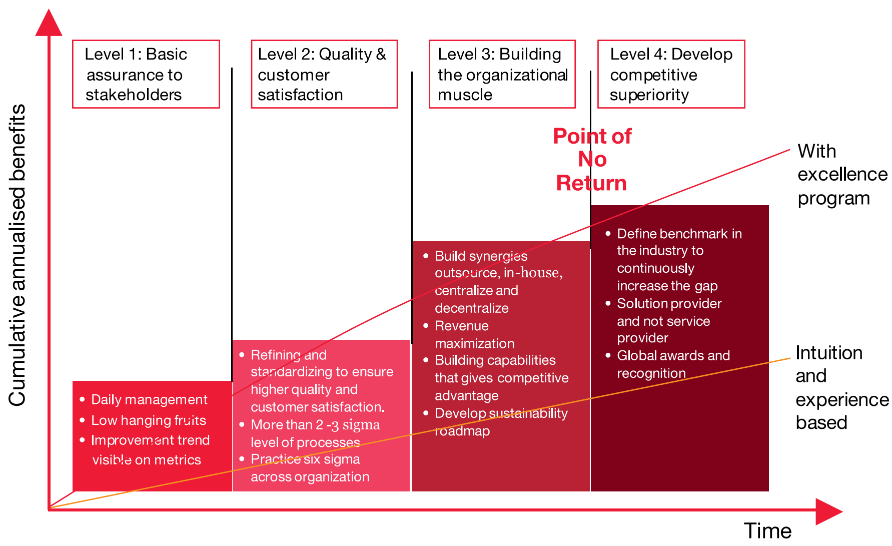
- Am I loyal to my customers?
- What value do I add to the customer?
- How am I different from others in the market?
- How do I continue to be relevant to customer?

PwC model for operational excellence in retail

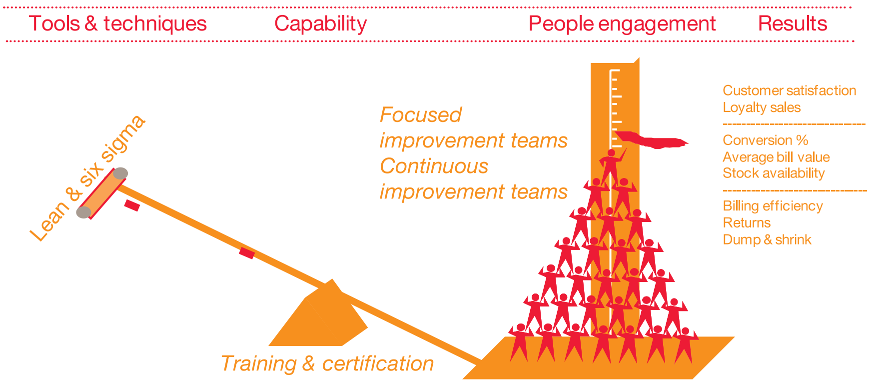
Leading retailers across the world use the operational excellence model to provide a superior shopping experience to the customers. The journey of operational excellence is logically and scientifically divided into four levels.

- **Level 1- Basic assurance to stakeholders:** This level aims at setting up routine management systems to enable all processes to run at a basic level of stability. This is done by the last-mile continuous improvement teams. The focus is on getting quick wins and employee engagement.
- **Level 2- Quality and customer satisfaction:** This level aims at refining and standardising practices to ensure higher quality and customer satisfaction. Variability reduction to improve process capability using concepts like Six Sigma is one of the main themes of this level.
- **Level 3- Building the muscle:** This level aims at building capabilities that give the organisation a competitive advantage in the market and help deliver products and services at a lower cost. These capabilities include lean operations, lean marketing, lean organisation, etc. The focus is on generating quantum benefits once the foundations are in place.
- **Level 4- Develop competitive superiority:** At this level, the company aims at becoming a benchmark in the industry to continuously increase the gap between itself and the competitors.

We can help our retail clients customise these levels to their environment and enable them to objectively evaluate their progress



Retailers across sectors have gained significantly from such programmes which have had an impact on their revenues, cost, quality and responsiveness



Category: Value fashion

Max Retail: Offering value fashion at keen prices

Sector snapshot

Growth opportunities exist in India's apparel market...

PwC's thought leadership report Strong and Steady – 2011 Outlook for the Retail and Consumer Products Sector in Asia indicates that the Indian apparel market is relatively untapped across all categories. Clothing sales have been rising steadily in recent years, supported by a large market of young consumers and an increasing interest in Western fashion. Apparel companies are using marketing strategies to build their brand, increase awareness and create a fashionable, lifestyle-oriented image.

Efforts to raise funds from PEs are enabling apparel brands to grow their store networks, boost production capacity, offer new styles, hire design talent, develop larger format stores, establish shop-in- shops, etc.

Clothing: Market demand growth (% real change) pa

Country	*2010*	*2011*	*2012*	*2013*	*2014*
China	10.9	10.8	10.3	10.9	11.4
India	6.1	7.6	8.4	8.3	8
Japan	1.6	1.2	1	0.9	0.8
Taiwan	3.9	4.8	4.2	3.4	3.8

Source: Strong and Steady—2011 Outlook for the Retail and Consumer Products Sector in Asia, PwC, 2010-14 are forecasts

Company profile

Max Retail: Fashion need not be expensive!

Max's focus on providing "fashion at keen prices" is generating strong current growth...

Keenly priced apparel is priced lesser than affordably priced apparel even! Keenly priced apparel is especially important in developing markets since customers need to be educated about fashion, before making the purchase. Max uses its design strength to produce sharply-priced apparel that has a high fashion component. Designers in the Middle East along with those in India create and localise fashion for global and local markets, respectively.

...across men, women, children, value, premium, plus-size, etc.

For many Indians, low prices are a key purchase driver.

The following factors drive the growth of value fashion retail:

- Increasing incomes are enabling Indian consumers to spend more and experiment across products, brands and categories.
- Apparel is no longer a functional category but one that conveys

appearance, prestige and image. Consumers want to buy apparel that is both affordable and fashionable.

- The growth of modern trade has helped increase the demand for both branded and value apparel. This, coupled with the emergence of new sectors and professional job opportunities, has also helped drive demand for office wear.

- Over 50% of India's population is under 25. Young Indians are aspirational, demanding and focussed on apparel that is both
  - Current penetration of apparel in the organised retail category is 10%. This is expected to increase to 30 to 35% by 2015.

… and presents long-term potential for its parent company, Landmark Group.

By March 2013, Max will operate 100 stores, doubling operations from the current 51 stores. Max is the Landmark Group's fastest growing offering in India, across its formats (food and grocery, department stores, apparel, etc.).

Tier 2 cities like Coimbatore, Indore, Bhopal, etc. are showing strong growth. Consumers in these locations are aspirational and view Max as a strong fashion brand.

Four critical success factors help define the winners in India's apparel market.	
Fashion and pricing	Providing fashion at very competitive prices is a major driver of success for Max. Max does not compromise fashion for price or vice versa. Providing apparel that is beyond normal pricing levels has enabled the chain to grow rapidly both within the Landmark Group and within India. Part of offering good fashion is localising the styling (necklines, hemlines, colours, embroidery, etc.). Max localises one-third of its product range sourced from its global headquarters, enabling it to "be global and connect local."
The customer experience	Customer needs and expectations evolve given their exposure to international travel, media, the Internet, etc. Today, the Indian consumer expects a better experience overall: • Availability of apparel: The consumer wants sharply priced, fashionable apparel to expand their wardrobe both at the workplace and at home. Customers no longer want to dress up just for work, they also want to look good at home, implying access to choice and range. • Store experience: From the time a customer enters the store to when she/he leaves, she/he must have a good experience across several touchpoints that include: Trial room | Interacting with staff | After-sales experience | Billing at the POS | Store ambience
Freshness of category	Freshness takes into account new product promotions, new designs, new colours, new styling, etc. Keeping fashion exciting helps engage and retain customers, results in sales, generates repeat traffic, etc.
Long-term business model	Participants need to build a sustainable business model given that the gestation period for success in the retail sector is long. Sustainable product pricing, offering products that imply longevity, expanding operations in a calibrated but determined manner, etc. are some of the ways in which retailers can convey their commitment to building a long-term presence.

Commerce in e-commerce

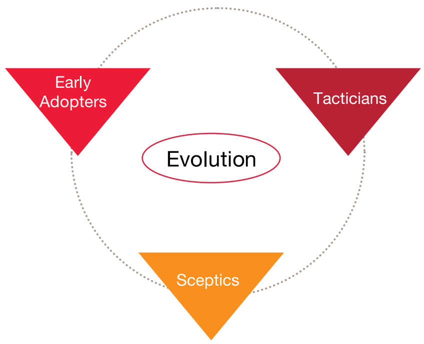
Which movie featured the song 'Why this Kolaveri di'? Few of us might know the correct answer (Tamil film '3'), but the majority of 20 million fans of this song who viewed it on YouTube at least once were not interested in knowing which movie this song belonged to. The song almost started a cult. Now there are several versions of the song, adopted by young and old across the country, eventually making Dhanush a household name.

Today, e-Commerce is about how an e-channel is used by a user to position the product. It helps create the right buzz, is available on more than one platform or device and delivers the product to the customer instantly. The payments can be made online or through cash on delivery.

We will now look at how the new e-commerce models are emerging and helping both consumers and retailers.

Emerging models in India

We can always argue that the Indian e-Commerce industry is evolving. But on taking a closer look at the industry, we realise that it will be worth US$ 70 billion by 2015 (according to ASSOCHAM) with a steady growth of 35% CAGR. So what are the various e-commerce models at play in this industry? We have categorised the models based on this hypothesis.



The retailer and consumers can be in different stages in their approach to the market.

The sceptics

Both the retailers and the consumers have used electronic media cautiously. Issues relating to the use of credit cards, debit cards and online banking have kept some consumers at bay. The legacy of using the touch and feel of the product is a critical attribute to the decision of buying. Internet or the electronic media is largely being used by consumers for search, research, price comparison and finally the 'store locater' to buy the product.

The retailers have adopted the internet channel to have a footprint to position them among search engines, bill boards and name tags. The idea has never been to integrate the store supply chain or inventory to create an electronic model. The benchmark has been to wait for the competitors act first and then understand how they are using the web to market products and then follow the lead.

The early adopters

There are some who have been buying and selling on the web since the last decade or the golden era of Indian broadband internet story. Sites such as fnp.in and indiaplaza.com have wooed the customer for years. The consumer has always been attracted to the value add and convenience of doing multiple things at one time. The quality of service and merchandise was not the focus. This breed of early adopters has constantly pushed the retailers to think of new mechanisms to lure customers to internet shopping.

The global online retail industry has gone through a lot of transformation over the past two decades. E-commerce has become very popular in the areas of apparel, arts and handicrafts, books, car rentals, computers and electronics, cosmetics, financial services, gifts and novelties, etc.

The retailers have managed to maintain the faith of consumer in the internet by being able to integrate the conventional supply chain with order management from the web. Commerce was also changing with mobile payments taking shape. A 2011 global online survey by Nielsen suggests that about 875 million consumers across the world prefer to shop online. This represents a 40% rise from the 627 million online shoppers recorded for 2009. The report confirms that 85% internet users in this period shopped online. The majority of e-shoppers were from South Korea, where a staggering 99% internet users were also e-shoppers. Japanese, German and UK consumers rank second while Indian shoppers rank third. E-shopping has gradually become the most favoured online activity after emailing and surfing.

According to Google, India has more than 100 million internet users, half of whom make online purchases, and the number is growing every year. With such a large market size, retailers as well as consumer goods manufacturers are entering the web space to attract potential customers.

Competing in a high-pressure business scenario has become a challenge for retailers. Retailers are looking at the internet as an effective alternative sales channel, which gives them direct access to target customers. Online retail (also known as e-tail) is a web-enabled interface between a retailer and its target consumers for selling products and services on the web with the facility of ecommerce. These kinds of retailers are also known as e-tailers. Almost all big retailers now have presence on the web.

The tacticians

Global online shopping giant Amazon.com recently launched a new service for Indian consumers, claiming to offer 1.2 crore products from both local and international retailers.

The company claimed that Junglee.com would offer options from hundreds of online and offline retailers, including Homeshop18, Hidesign, Gitanjali, Fabindia, Bata India, Dabur, Microsoft, Reebok, and Amazon.com.

It will have more than 90 lakh books and 30 lakh products from more than 14,000 Indian and global brands across more than 25 product categories, including mobile phones, cameras, toys and games, baby products, books, music, movies and TV, clothing, and jewellery.

This consumer is not only the buyer but also the seller. Websites like olx.com and quikr.com have made the quintessential Indian feel more in control and sense of ownership of doing the 'deal'.

Among Indian states, Maharashtra has the best IT infrastructure, both for retailers as well as consumers. Mumbai accounts for a 24% of India's e-commerce transactions. Some of the popular Indian online retailers are Staples Inc, Home Shop 18, Indiaplaza, eBay India, Future Bazaar, Indiatimes and Rediff. Easy availability of broadband services and increasing internet penetration is supporting the growth of online retailing. The increasing purchasing power of the Indian customers is set to bring an online shopping boom in India. One of the latest additions to online retail is advertising through social media websites like Facebook, Twitter, Google+, etc. Apart from website technologies, retail leaders are trying to adopt video, mobile and social media strategies with a view to provide richer, more engaging and user friendly experience.

It is not only the private sector but also the government sector which has woken up to the possibilities that the internet has in store. This means that today people can not only purchase clothing, utensils, furniture, electronics, books, movies, flight tickets, rent cars and thousands other products online, but they can also book railway tickets and even pay their self assessment and advance taxes online through government websites. The days when people had to stand in long queues at the stores or spend the whole day to pay taxes or buy railway tickets are slowly becoming a thing of the past.

According to eBay, Indian online shoppers remain brand savvy, even when they are shopping online. The eBay India Census has found that brands such as Sony, Nokia, Samsung, Apple and Reebok continue to top buyers' charts. Lifestyle products, such as cosmetics, jewellery, watches, fashion products and fitness equipment account for over 45% of eBay's sales in India.

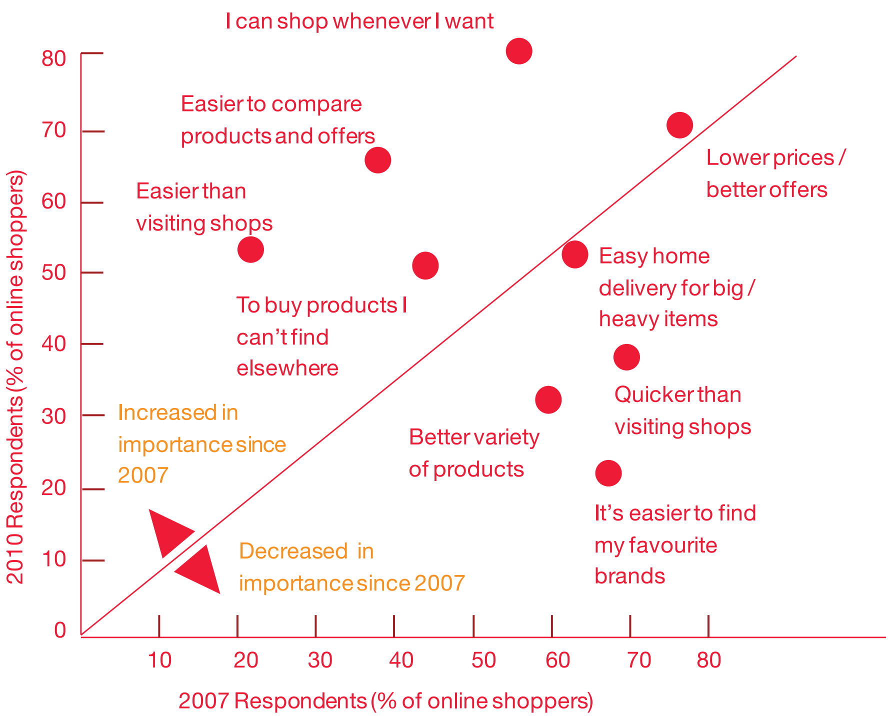
According to industry leaders, portals offering daily deals and discount offers with good delivery services attract the largest number of online shoppers. "The customer behaviour is changing dramatically. People are not only using the Web to book air tickets and movie tickets but also do not hesitate in placing orders for mobiles, laptops and other consumer electronics and home appliances," a senior marketing executive from Flipkart.com, an online shopping portal, told Mail Today. "Seeing this bold consumer behaviour, more companies are collaborating with such daily deal and discount sites. All the top consumer electronics and home appliances companies are listed with us. In the growing competition space companies with good delivery services score points over others," the executive said.

The tacticians have pushed the e-tail environment from being connected to virtual. E-tail stores are open 24x7. Discounts happen at midnight. Flash discount mailers and SMSes are sent out and sites see millions of concurrent users logged in for a few hours. This seems to be a social phenomenon. It is similar to the advent of supermarkets in the late 1990s when people used to queue up for hours to be able to touch and feel products which were earlier handed over to them across the counter by the salesperson. Retailers are trying to target the social media to be able to influence the decision of the buyer. However, monetising social media is still a nebulous topic. Several papers and researches have been done to be articulate the manner in which retailers or client at large should and are using social media to target customer. We would like to look at this topic from a multichannel approach and ask the question: What are people looking for online?

Price is a big factor, but it's not the only one: many shoppers are prepared to pay a bit more for a big item like a plasma TV if it means the retailer will also install it, remove the packaging, and take the old one away. The internet makes it easier to establish the real correlation between price and value, and what 'value for money' really means for a particular product, and a particular person.

The various incentives of online shopping include competitive pricing, speed, convenience, variety of products, home delivery and ease of shopping from anywhere at any time.

However, even though people are spending much time and money on the web, they haven't abandoned physical stores. They're just using them for different things. Retailers should now focus on understanding, adopting and monetising multichannel retail.



Source: PwC UK survey on 1000 consumers in the last quarter of 2010

What areas should retailers concentrate on for the multichannel strategy?

- They need to learn **new skills and develop new tools –** and fast. It is mostly about getting better and more responsive in marketing and merchandising, so that the landing pages of the web store can respond instantaneously to external events that might prompt a specific impulse purchase. Many of the more traditional retailers still have a lot to learn about customer relationship management and direct marketing, and could gain some useful insights from studying how the catalogue operators exploit their customer data.
- **Where and what to invest in:** Money and resources are always going to be limited, but the new retail environment is throwing out so many new product and service propositions that it can be hard for even the most experienced and professional retailers to know what customers will really want, and what will genuinely create long-term value.
- **The 'dark channels':** These are called so because most retailers don't understand what's really going on there, but because they need to, if they're to stay ahead of the curve in a multichannel world. An enormous wealth of data can be harvested about how your customers behave online, how often they visit, what they look at, how long they're there, and what they buy, or don't buy.
- **Develop a truly multichannel business:** Online operations need to be treated like any other part of the company, and not as some sort of incubator venture, or an offshoot of the marketing or IT departments. Business development has to become business as usual, which demands new business practices, new roles and responsibilities, and new approaches to incentives and remuneration. E-commerce has to move into the main organisational structure and be treated as an integral part of the brand proposition, rather than an independent business governed by its own rules.

The state of play on multichannel retail is still evolving, but we believe there are five key factors that retailers should be addressing now, if they're to stay ahead of the game.

1 Most favoured

With shoppers consolidating their spending on fewer retailers, the winners will be those who ensure they make it onto the 'most favored' list for their large customers.

2 Most Valuable

Operating in a multi-channel world makes it even more important to understand your most valuable customers, and to be able to serve them when they want, and how they want.

3 Most Vocal

The digital space provides a raft of new opportunities to engage consumers, and to learn from their behaviours from Twitter and Facebook, to online campaigns and consumer reviews.

4 Key KPIs

New performance measures that reflect the realities of this new multi-channel world are the next essntial building block to making profitable decisions and choices.

5 Real Winners

The real winners will be those who can deliver a sustainable advantage by developing new operating models, designed to handle the realities of multi-channel retailing.

The last peg in this puzzle of commerce is the most critical and possibly the most important one that completes the discussion on commerce. Commerce in e-commerce is about money making its move from the wallets of the customers to the cash registers of the retailers. In the e-tail world, conventional payment methods continue to provide strong infrastructure support for commerce to exist. Cash on delivery (COD) has recently equipped the retailer to address a large number of Indian customers who do not use plastic money over the web.

We would like to focus our attention on the future of how commerce would be done by 800 million subscribers in India. This opportunity is being debated by analysts, bankers and the masses in view of the changing form of money.

Mobile commerce is the new avatar of e-commerce, bringing a revolutionary change in the retail space. A growing country like India, which has over 800 million mobile subscribers, provides huge opportunity to retailers. Tapping this medium will change the way we do business transactions, access entertainment, conduct personal finances and much more. It is one of the most powerful mediums for one-to-one marketing. Opening up a new spectrum of branding and awareness, its reach is far better and larger. Advancement in technology and boom of 3G and wireless devices has added to the growth of e-tail.

Even advertisers have bought this story. India is the top-performing mobile advertising region in Asia. The growth in global mobile advertising expenditure has been tremendous with a year-on-year growth of 139%. More than 126 billion ads were served in 2011, as compared to 52 billion in 2010. These numbers represent the scope of opportunity not only for marketing specialists but also the untapped potential for mobile transactions. In fact some brands have been successful in doing so with their advanced applications and proven credibility.

As per a report by Buzzcity, it will be a great surprise to know that 35% of mobile subscribers are not even aware about the basic mobile transactions available on their phone. Nearly the same number of women and men use internet services on mobile phones, which is fairly surprising and interesting to know. This is in contrast to mobile subscriber base, which comprises 70% men and 30% women.

Transaction pattern for the past six months from the users aged over 35 years is given below:

Particulars	Statistics
Travel-related purchase	19%
Grocery purchase	23%
Household utility payments	21%
Entertainment and lifestyle – books, music and movies	28%
India's population on mobile viewing and booking travel through their handsets	14%

Source:The BuzzCity report

With Flipkart, homeshop18 and new entrants like Jabong, m-commerce has achieved success in India as well. Travel is one of the fastest growing segments in m-commerce. People tend to buy tickets and source hotel accommodation through their mobile phones. About 14% of India's population views and books travel tickets through their handsets.

Flipkart

Pioneering India's online commerce market

Sector snapshot

Online retail is nascent in India and will over time, evolve and more closely…

PwC's thought leadership report Strong and Steady – 2011 Outlook for the Retail and Consumer Products Sector in Asia predicts online commerce to be the next major area for retail growth in Asia. Though nascent, India's online retail market is growing at double-digit rates and is likely to be the next format that retailers will incorporate into their array of channels.

Growth drivers include the following:

- Internet penetration, the use of broadband, etc. are making it easy (and quick!) for consumers to shop online at home, at the office, etc.
- Global and local E-commerce participants have launched websites that offer Indian consumers a range of products (apparel, baby products, electronics, etc.).
- The market has seen the emergence of a range of buying
- propositions, such as group buying sites, direct sales sites, etc.
- Consumers are more willing to experiment with new forms of retail purchase and feel confident to search for and buy goods online.
- Convenience, speed and 24-hour accessibility in purchasing products is being valued increasingly.

Company profile

Flipkart: Offering new categories, reaching more customers, expanding operations

India's E-commerce market is growing at 20 to 30% CAGR and…

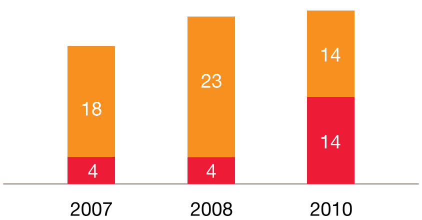
Flipkart offers a range of goods online, including books, music, consumer electronics, etc. Several factors are driving the growth of India's online retail market, including internet penetration, the convenience of purchasing products online, etc. Senior management at Flipkart believes that consumer behaviour is changing and in a few years, "Everyone will be buying everything online, just like they buy only their tickets online today." As the market evolves, so will the consumer.

…resemble E-commerce markets in mature retail environments.

Since 2007, PwC has been conducting surveys on online shopping, in the UK, examining new and emerging retail developments in the digital space. Since then, the value of online retail has increased to almost eight percent of the total retail market, with growth expectations of 10% per year. Interviews with more than 1,000 consumers in the last quarter of 2010 revealed that we are witnessing a new pattern in consumer behaviour. When PwC began this series in 2007, only 63% of the people we spoke to were actually using the internet regularly to shop. In 2010, things had changed.

Nearly 20% of respondents were spending more than half their disposable income online.

- Fourteen percent were buying on the web every week.
- Fourteen percent were doing it more often—a figure that wasfour percent only two years ago



■ More than once a week

■ Once a week

Source: Pick 'n' Mix - Meeting the Demands of the New Multi-channel Shopper, PwC

...online retail players have aggressive growth plans.

By 2013-14, Flipkart plans to:

- Offer new categories on its website
- Increase its footprint of warehouses
- Expand operations into new cities
- Increase staff size from 2000 to over 10,000
- Grow revenues 10 to 30 times over

Customer service will be a critical success factor for online retailers.

Customer service is important for online customers since it builds trust and comfort. When online customers have a positive experience with Flipkart's customer service, they convey this to their friends (word-of-mouth).

Customer service and satisfaction

Flipkart maintains customer service teams to manage customer queries, track the movement of goods ordered, ensure timely delivery, etc. Providing good customer service enables Flipkart to enjoy high levels of customer satisfaction, generate repeat business and ensure positive word-of-mouth.

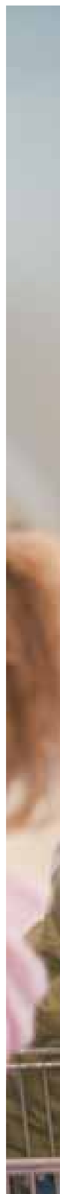
Senior management believes that as the retail sector evolves, customer satisfaction will be a key driver of success for most brands and organisations.

Social Media

As part of its efforts to enhance the customer experience, Flipkart manages its social media presence carefully. A part of Flipkart's customer support team manages the company's presence on Facebook and Twitter. Only five or six of the 200 tweets each day are negative. The group's SLA for responding to negative feedback on social media sites is one hour but on an average, customers are responded to within 15 minutes.

Customer insights

Indian consumers are generally perceived as price-driven and value-conscious. While that may be true, senior management at Flipkart believes that their online consumer is driven by both price as well as a minimum level of quality (in terms of the end-to-end experience). As the economy grows, incomes rise and aspirations increase, the Indian consumer will evolve into a more quality-conscious consumer.



The high price

03

The growth in organised retail faces unprecedented challenges, both on the regulatory front as well as at the operational level. In the below section we try to look at the operational, tax and regulatory issues and challenges.

Operational issues & challenges

'Don't make customers happy, make happy customers'. To ensure this 'content' experience, retailers have to incessantly work on the operational aspects of the business. In our next chapter we talk about some of these issues that must be oiled to make sure the customer has a 'delightful' experience.

Fragmented market with unorganised players

The Indian retail market is dominated by unorganised retailers (mom-and-pop or kirana stores). The organised retail penetration stands at 5% and is growing at a CAGR of 15 to 20%.

Organised retailers continue to face stiff competition from the unorganised sector. The latter have a low cost structure, are mostly owner-operated, with negligible real estate and labour costs and pay little or no taxes. Consumer familiarity that runs from generation to generation and easy access are big advantages for the traditional retailing sector. Most modern retailers find it hard to replicate this level of intimacy.

Traditional retailers have also risen to the competition from organised retailers. The adoption of IT systems, surveillance systems, tracking the customer database, loyalty management, SMS marketing, credit purchase, and free home delivery have helped unorganised players retain customers.

Infrastructure, supply chain and logistics network

Availability of the right merchandise at the right place, in the right condition, within the right timeframe and at a minimum cost is the primary objective of retail supply chain management. Goods in store but not on shelves could mean loss of sales and an undesirable customer experience. It is also important to vary the assortment and merchandise form one store to another, even in a single state, to cater to market sensitivities.

Investments in specialised supply chain management (SCM) IT solutions help retailers manage the store as well as warehouse replenishment and lower inventory holding cost.

An economy of scale for the procurement of goods is also another challenge faced by retailers. Few large retailers have been able to consolidate requirements and enjoy economies of scale.

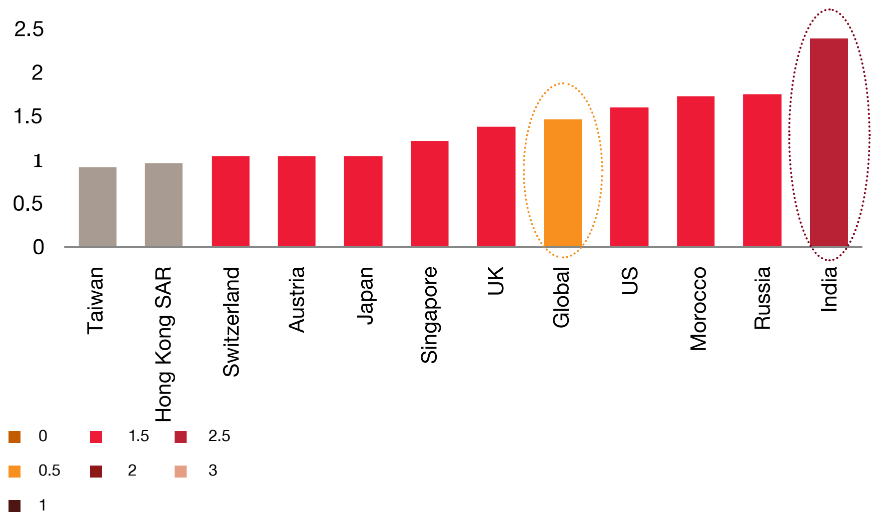
Poor infrastructure and the availability of only a few organised supply chain and logistics players further increases the problem for retailers leading to a delayed availability of stock and huge costs.

With the government investing heavily in infrastructure, and with global logistics giants investing in India, we shall soon witness the consolidation in the supply chain and logistics sector. This will help retailers and consumers significantly.

Retail frauds

Retail frauds have been a concern for the Indian sector. According to the Global Retail Theft Barometer (GRTB) 2011 covering 45 nations, the shrinkage in India stood at 2.38%, the highest in the world. The average global shrinkage was estimated at 1.45%. The good news is that as per the GRTB, the retail shrinkage loss for India in 2011 is less than 2010.

Shrinkages as a percentage of total retail sales



Source: The Global Retail Theft Barometer 2011, CARE Research

As per the GRTB, the key reasons for the retail shrinkage or pilferage in India include the following:

- Shoplifting (accounting for more than 50% of total shrinkage value)
- Internal administrative errors
- Employee theft
- Vendor frauds

Retailers have started investing in loss prevention and security measures such as CCTV, surveillance cameras, RFID, etc. This will help them in scaling down the shrinkages but the investment in these areas is still at a nascent stage.

Diverse customer needs

India is characterised by varying consumer tastes, preferences and buying habits. Customer needs, tastes and preferences differ in every state, town and village. This puts a lot of pressure on the retailer in planning the assortments of stores to cater to the diverse customer profile.

Easily available information via the Internet or mobile, global lifestyle of consumers, increasing income, aspiration for global brands, overseas travel, etc. are making Indian customers more knowledgeable than before. They are demanding premium products in health, food and beverage, dietary supplements, skincare, etc.

The changing customer needs and desires require retailers to continuously innovate with the product mix as well as offers and promotions. Customer loyalty programmes play an important role in helping retailers understand the customer behaviour and plan the right product mix.

Long gestation period

Margins for the retailers are very thin and it takes a few years for a store to break even after it starts operating in the Indian subcontinent. Retailers believe that patience, deep pockets, continuous innovation and localisation of products and services for the consumers is the key to long-term success.

Skilled workforce

Availability of trained manpower both at the store and managerial level has been a major concern for the Indian retail sector. The problem is escalating with the rise in organised retail and large global players entering the country. The attrition rate in the industry stands at 25 to 35 %.

While the paucity of skilled manpower is a challenge, it is important to ensure continuous learning for the existing staff. Large retailers have setup dedicated teams to conduct training workshops and coach the retail workforce both fresh as well as experienced on topics such as product information, customer service, customer complaint management, etc. Some of the large corporates have partnered with premium management institutes and designed retail-specific courses.

Looking beyond price

Economic factors such as the increasing choice in products and shopping formats and unparalleled access to information are fuelling today’s empowered shoppers, who expect more from their retail experience.

Today's customers are flooded with diverse options for products and services. Today, the price of a commodity is not the only differentiator for the retailers. The discerning consumers are expecting more from retailers in terms of products that deliver its brand promise, quality, services and store ambiance, etc. Retailers in mature markets have used customer service as a tool to generate footfall and create a positive brand image.

High cost of real estate

Lack of readily available quality real estate as well as high rentals in India are major challenges for the retailers. Property rentals in the country are among the highest in the world and add considerably to operational cost. The Indian real estate cost accounts for 5 to 9% of the net revenue of the retailer as compared to 3 to 4% of global retailers. At the same time, real estate sector is undermined with high stamp duty cost on transfer of property.

Availability of quality retail space at the right price has been holding the expansion plans of retailers. In recent times, retailers have moved out from prominent malls of Tier I cities and even renegotiated the rental agreements with landlords to reduce costs. Retailers have also started expanding their presence in the Tier II and Tier III cities.

Lack of industry recognition

After agriculture, the retail sector is the second largest employer in India (considering both organised as well as unorganised retail). Despite this, the sector is yet to be given the industry status.

Retail sector status as an industry and having a dedicated minister responsible for the development of the sector and balancing stakeholder interest is the key. Setting up a single window clearance system for licences and approvals is necessary.

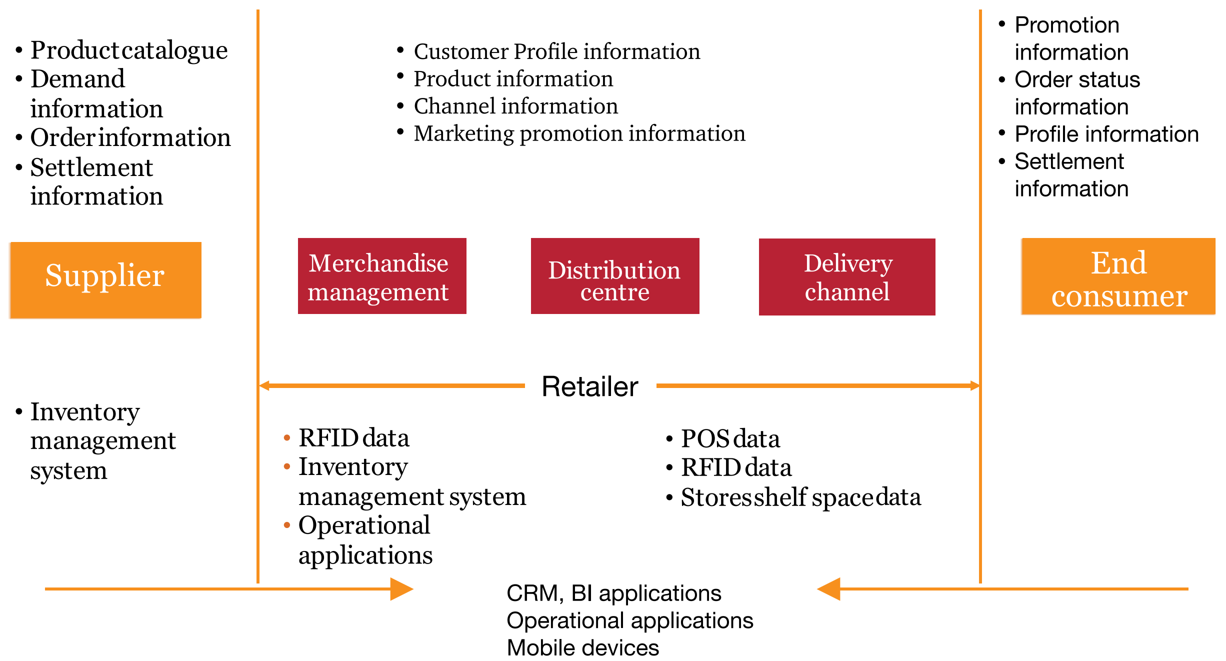
IT optimisation

With the evolution of retail sector, IT adaptation is increasing continuously. Modern retailers are relying on IT systems to manage the rapidly changing business scenarios and diverse customer needs.

The sector is now focussing on IT optimisation and effectiveness. Large players are investing in the SCM, merchandise management, customer relationship management, business intelligence systems, etc. This is helping retailers to become agile and responsive apart from being able to reduce inventory holding costs and thus be profitable in the long run. Small regional modern players in the retail sector have started investing in the point of sales, barcode software, etc.

According to Cisco India, "Of the total investments made by the Indian retail companies, approximately 4 to 10% is invested in IT and within this approximately 30 to 40% is meant for networking infrastructure."

Information requirement for retailers



Tax-related issues

Companies in the trading sector are facing several challenges that curtail the growth of the sector and prevent it from reaching its true potential and providing benefit to consumers. Some of the key challenges are set out below:

Complicated indirect tax regime

In India, VAT is a state levy. Companies operating across the country find it difficult to configure different state tax rates for the same products. In addition, due to different tax rates and imposition of local levies, such as Octroi, in some states, companies either have varying margins or different pricing for each state. Further, compliance requirements under the state VAT legislation are not uniform, which adds to the cost of doing business in India.

Also, companies that are not engaged in the manufacture of excisable goods or providing taxable services are not eligible to offset any input service tax. This input tax is usually a significant cost for retail companies.

Transfer pricing litigation

Transfer pricing (TP) has become the single-largest topic of tax litigation for MNCs in India. One of the main points of contention is determining who should bear the expenses and enjoy the fruits of creating marketing intangibles in the country of operation of the distributors. Marketing intangibles typically refers to benefits emanating from sales or distribution functions, e.g. trademarks, distribution and dealership networks, customer lists and relationships, etc.

Tax authorities have challenged distributors incurring advertising and marketing expenses higher than the industry average or 'bright line', questioning whether they are actually carrying out significant additional functions compared to other comparable distributors, and therefore should be expected to receive additional rewards or remuneration.

In order to tackle this issue it is critical for companies to have a well-defined TP policy that clearly spells out the functions,

assets and risk profiles of transacting entities and have well-drafted inter-company agreements that echo the group TP policy.

Another issue faced by MNCs pertains to the disallowing by the tax authorities of royalty or franchisee fee payments. The taxpayer is required to justify the payment of royalty or franchisee fees, demonstrate the economic benefit realised and prove that services received from overseas associated enterprises are not in the nature of shareholder or stewardship services. The taxpayers are required to demonstrate the economic benefit by submitting documentary evidence for all services received and their utility to the Indian business.

Apart from a TP analysis that benchmarks payments for services, it is critical for taxpayers to set up processes to ensure that documentary evidence to demonstrate economic benefit is readily available at the time of the TP audits. This is critical for defending payments of royalty or franchisee fees before the tax authorities.

Agriculture procurements

Several states and union territories have enacted the Agriculture Produce Marketing Committee (APMC) Act, regulating the procurement of different kinds of agricultural produce, fisheries, fresh fruits and vegetables. A few states permit direct procurement from farmers. Others require the agricultural produce to be brought into designated market yards and sold through an auction mechanism.

With a view to streamline the procurement system, the central government has asked the various state governments to review their APMC Acts and enable direct procurement from farmers and also simplify the procedures.

The government has also taken measures to improve the existing supply chain and facilitate farm-to-fork integration. For example, tax benefits have been provided and foreign currency loans are permissible for establishing cold chain storage facilities.

Moderinsation of these laws for agricultural procurements by state governments will help in development of an efficient farm-to-fork supply chain infrastructure.

M-commerce, e-commerce and prepaid instruments

Companies wanting to reach out to mass markets are increasingly looking at e commerce solutions to create efficient and cost effective outreach. With the introduction of the Payment & Settlement Systems Act in 2007, Reserve Bank of India has framed rules for licensing and regulation of payment system providers. In addition, payment intermediaries are expected to comply with restrictions on routing payments through bank accounts on T+3 basis. Licenses are required to operate prepaid cards, gift cards or any other semi-closed or open-loop payment system. In addition, cross border e-commerce is subject to FEMA restrictions.

Although e-commerce has been known for innovation and ability to adapt to consumer demand and behaviour, the relatively straight-jacketed regulatory architecture is not conducive to out of box solutions and it may be difficult for operators using e-commerce model to offer all services they may be able to offer is other geographies.

Regulatory framework

Foreign direct investment (FDI) in retail trading business is currently not permitted, except in single-brand retail trading, which now allows up to 100% FDI subject to conditions. In addition, several FIIs and NRIs have invested in several large Indian retail companies under the portfolio investment route.

In November 2011, the government had announced a policy permitting up to 51% FDI in multi-brand retail trading, which was subsequently put on hold due to political opposition, with the objective of holding further discussions with the stakeholders to achieve a consensus.

This chapter outlines the existing FDI policy of the government in trading sector together with recent policy developments, especially highlighting some practical issues.

Existing FDI policy framework

India has an 'open-arms' policy for regulating FDI in the country. Under the current FDI policy, foreign investment is permitted in virtually all sectors without

government approval, except for a few sectors of strategic importance (such as banking, defence, media, telecom) where the policy prescribes equity caps or certain conditions for obtaining prior approval from the government.

The FDI policy is framed by the Department of Industrial Policy & Promotion (DIPP), the Ministry of Commerce & Industry and implemented by the Reserve Bank of India (RBI) for cases falling under the automatic route (i.e. not requiring prior Government approval), while for cases falling under the government route, approval is granted by the Foreign Investment Promotion Board (FIPB), which includes representatives of various central government ministries and grants approval on a case-by-case basis.

Apart from the sectors that are of strategic importance and require government approval, there is a small list of sectors in which FDI is currently prohibited. At present, this list includes retail trading (except single-brand retail trading).

With the above background, we provide an overview of the FDI policy framework prevalent for the different segments of trading sector in India:

- ***Wholesale trading***

FDI up to 100% is permitted under the automatic route (i.e. without government approval), for wholesale trading and cash-and-carry wholesale trading. This enables foreign retailers to engage in business-to business (B2B) trading activities in India, i.e. selling to other wholesalers, retailers, businesses, and institutions.

However, such entities need to follow certain operational guidelines prescribed by the government. Some of the key principles emerging from this operational guideline are set out below:

- The type of customer to whom the sale is made, and not the size and/ or volume of sales, is the yardstick for determining whether a sale is wholesale or not.
- Licenses, registrations or permits, as specified under the laws, regulations, rules or orders of the Government, are required to be obtained for undertaking wholesale trading operations.
- Sales under wholesale trading can only be made to customers holding the following registrations or licences:
  - Entities holding sales tax, VAT, service tax, or excise duty registration
  - Entities holding trade licenses

- Entities holding permits or licenses for undertaking retail trade (like licenses for hawkers) from government authorities or local self-government bodies
- Institutions having certificates of incorporation or registration as a society or registration as public trusts for their self consumption

- Full records of sales need to be maintained by the wholesale trading company on a day-to-day basis.
- Wholesale trading of goods to companies within the same group should not exceed 25% of the total turnover of the wholesale venture

• Test marketing

FDI up to 100% is permitted with prior government approval for test marketing of items for which a company has approval to manufacture. The test marketing facility will be for available for a period of two years and investment in setting up manufacturing facility should commence simultaneously with test marketing.

• Single-brand retail trading

Over the last seven years of existence of the single-brand retail trading policy, over 60 foreign brands have been approved to set up own stores under this window. An indicative list of companies approved is given in the table below:

S.No	Categorisation	Approved brands
1	Apparels and accessories	LVMH, Fendi, D&G, Hermes, Armani, s.Oliver, Crocs, Armani, Puma, Christian Dior, Marks & Spencer, Canali, Zara, Burberry, Tod, Matteo Basso, Gucci, Gas, Diesel, Cartier, Giordano, Ferragamo, Celio, Boggi, Paul & Shark
2	Jewellery	Damas, Cartier
3	Electronics and telecom	Nokia, Socomec, CT Brand,
4	Cosmetics	L'Occitane,
5	Home furnishings	Lladro, Damro, FabIndia, Signature Kitchen, Aran
6	Heath and fitness	Power plate, Mothercare,
7	Others – Auto, toys, hearing aids etc.	Toyota, Toy Watch, Unitron, Sona and Connect hearing, FIAMM S.p.A , Verve Hearing Systems, Delsey

FIPB website

Under this policy, proposals worth 196 crore INR have so far been approved by the government of India.

FDI up to 100% is permitted with prior government approval, for the retail trading of single brand' products, subject to the following conditions:

- Products to be sold should be of a 'single brand only.
- Products should be sold under the same brand internationally.
- Single-brand product-retailing would cover only products that are branded during the manufacturing.
- The foreign investor has to be the brand owner.

In respect of proposals for FDI beyond 51%, the retail company would need to fulfil one additional condition of sourcing a minimum of 30% of the value of goods sold from Indian small industries/ village and cottage industries, artisians and craftsmen. Small industries for this purpose have been defined to mean industries in which the gross value of plant and machinery (i.e. without depreciation) does not exceed 1 million USD.

One of the key challenges that need to be addressed with respect to single-brand retail trading policy is the condition relating to sourcing of 30% of the value of products sold from small industries. While it is a fact that large number of foreign retailers source products from Indian entrepreneurs, it is not necessary that all such sourcing is being done from small industries. A similar condition also exists in the proposed policy for FDI in multi-brand retail trading, which is more implementable as the multi-brand retailer will have a choice to source a wider array of products from small industries. On the contrary the retailers who typically fall under the single-brand window are luxury brands or niche-market players. Keeping in mind the nature of their products and target customers segment, it is practically not possible for single-brand retailers to source products from small industries having plant and machinery less than 1 million USD.

Hence, keeping in view the business reality, it would be appropriate for the government to reconsider the limit imposed on the size of plant and machinery and provide the single-brand retailer a wider choice of small, medium and large enterprises to source goods from.

The existing policy allows only the brand owner to be the investor under the single-brand window. In other words, the government discourages FDI in retail sales of third-party products. The ownership of the brand by the foreign investor, therefore, becomes an important entry condition. It is quite possible that on account of business reasons, including the efficiency in tax costs, the brands may be housed in a separate entity being the overseas retailers group in an appropriate jurisdiction. Switzerland, the Netherlands and Singapore are some of the countries used frequently for this purpose. The brand need not be held in the investing company itself. Companies also try to keep their products insulated from their business, through a corporate veil. Such foreign investors do not cease to be the brand owners merely because they have segregated and structured their operations or functions in various wholly owned entities or subsidiaries for commercial reasons.

There is a need to have a policy framework to allow foreign investors, as brand owners, to invest under this window in some and spirit notwithstanding the corporate structure.

- ***Multi-brand retail trading***

FDI in an Indian company engaged in multi-brand retail trading is currently not permitted. Many foreign retailers engaged in this segment globally have set up a wholly owned subsidiary in India to undertake business-to-business trading activity and have forged partnerships with Indian retail partners.

We anticipate that the government is likely to come up with a policy statement allowing FDI in multi-brand retail segment soon. It is, however, expected that as and when the policy is announced, it will come with the conditions which may include:

- Minimum investment of 100 million USD by the foreign investor, of which 50% would need to be used for developing back-end infrastructure
- Minimum 30% procurement of manufactured or processed products from small industries
- Stores to be set up only in cities having population in excess of 1 million (there are 53 such cities in India)

One important area that needs to be addressed in the proposed policy is the mandatory sourcing of 30% of the value of products from small enterprises, which are defined to mean enterprises having a total investment in plant and machinery not exceeding 1 million USD. It is possible that such small enterprises may become large organically on account of long-term contracts with the retailers in compliance with the said conditions. To encourage development of small enterprises that organically become large, they should also be considered as eligible suppliers to the Indian retail trading companies for meeting the said requirement. This principle is similar to the concept of the 'carry-on business licence', which historically applied to small-scale enterprises which grew large organically, to carry on their business and continue to avail benefits of the SSI sector.

- ***E-commerce activities***

E-commerce activities are also governed by the principles mentioned above i.e. companies can engage only in B2B e-commerce trading and not in retail trading (except single-brand retail trading).

Conclusion

04

"There is only one boss: the customer. And he can fire everybody in the company from the chairman on down, simply by spending his money somewhere else."

As rightly observed by Sam Walton, retail is all about customer experience and taking it to the next level. In these changing times, price is no more the only differentiator; customer experience has emerged to be equally important. While retailers are doing everything to woo customers, the 'million dollar' question is 'How do I increase customer stickiness to the brand?'

Customer loyalty has been shifting across all formats—be it the kirana stores or the hypermarkets. Stores are reinventing themselves to stay relevant and convenient. Retailers are not necessarily adopting one-size-fits-all strategies. Thus, success lies in the fact that 'what can be measured can be managed'.

Expanding the product offering, promotional strategies and offers to draw higher footfalls is passé. Innovation is a more tactical term now, and it is having positive effects.

- For the generation that works on laptops and mobile phones, quick turnaround time is utmost important. Thus, being present across multiple channels has become inevitable. The discussion point is when and how to monetise it.
- Growth is no more seen as a success measure. Profitable growth is the norm in the board rooms. Shedding all inhibition, letting go of formats that do not make business sense and closing unprofitable stores are some steps taken to send a clear message to the stakeholders, that profitability is the key to sustainable growth.

We believe that now is as good as a time to enter the Indian retail space as it has ever been. International chains that have entered India through their JV partners are starting to feel at home. The legislators are adopting more practical ways of dealing with difficult issues.

The Indian customers today have several choices that they can make. The boundaries among cities are fading quickly. Infrastructure and connectivity are improving by the month and customer awareness is at an all-time high. The Indian customer is creating the new 'Indian Bazaar'.

Retail success stories from Tamil Nadu

Tamil Nadu is one of the largest retail markets in the country. It is also the preferred test market for most of the FMCG players as the state is renowned for its penchant to try out new products. In case, a product fails to live up to its expectations, the people do not purchase it again.

On the other hand, the customers from Tamil Nadu are loyal to their brands. Therefore, if a company captures and gets well-entrenched in the market and continues to provide the customers with quality products, its market share will remain intact.

Following is the list of retailers, who have managed to create a niche in the market and have contributed to the state's retail success:

Aachi Masala	With product range comprising 170 variants, reaching consumers via 5,000 agents and 10 lakh retailers, the company's sales turnover during 2011-12 stands at 495 crore INR. It adopts a consumer-oriented approach and as per its quality guidance and specifications, products are made by its partner through an oriented programme. The company's model shops acts as franchisees and carry its entire range of products. This model is gaining momentum and another 10,000 model shops are planned by the end of this year in Tamil Nadu.
Cookie Man	In 2000, Australian Foods (I) Pvt Ltd, the makers of Cookie Man, commenced its business operations in India. The lack of recognised cookie players in the country motivated the company to enter the market and open its first store in Chennai. Currently, Cookie Man operates 43 outlets in 17 cities. The cookie dough, toppings and related materials are produced in the Cookie Man Commissary in Chennai. The company has developed an efficient and successful franchising model to increase operations in the country at a rapid pace. Based on a shared passion for food retail, effective communication, the company has forged successful partnerships with its franchisees across India.
GRT	The company founded in 1964 gained a household name for its purity and design. Such is the power, reputation and the goodwill of the brand that their venture into hotel business (started in 1998) has year-on-year clocked the fastest growth rate.
Muthu Pharmacy	The company has been in the business for over four decades. The pharmacy has 51 retail and 17 wholesale outlets and is known for its CSR initiatives.
Nalli	Established in 1928, the brand name is synonymous with silk and has been a leader in the textile and retail business for over eight decades. Attention to cultivating vendor and customer relations has been at the helm of the Nalli management. In a radical departure from convention, the company decided not to indulge in discount selling, an unheard prospect in the 1950s. Its product offering varies from sarees to fabrics, apparel and home furnishings. It also has a sizeable private label collection such as costume jewellery and accessories.
Vasanth and Co	Based in Chennai, the company is dealer of consumer electronics, home appliances and mobile phones. Started in 1978, it has over 50 showrooms in almost every town in Tamil Nadu and some in Pondicherry and Bangalore as well.
Vivek and Co	Right from the very beginning, the company's objective was to offer quality products and services to people at affordable costs.
UniverCell	Founded by Sathish Babu in November 1997, it is an example of how innovation can bring success. It started as a Skycell Teleshop (now AirTel Connect) selling post paid mobile connections. After studying the buying behaviour of the customers and the market potential, he opened the first large format mobile retail store in 2000, the first of its kind in South India.
BharatMatrimony	It is recognised as the most successful matrimony brand in the world and has consistently topped traffic and usage ratings by ranking agencies. It has also been rated as the most visited matrimony portal in the world. A recent Juxt Consult study revealed that 80% of the country's population use BharatMatrimony. It is the only matrimony brand to be featured in the Limca Book Of Records.

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