

Winning in India's retail sector

Factors for success



Foreword

We are delighted to launch our new thought leadership report, **Winning in India's retail sector: Factors for success**. PwC research indicates that although the Indian retail sector is worth US\$ 350 billion, it has a low organised retail penetration of 8%. Modern trade is growing between 15 and 20% per annum. India is becoming an exciting and dynamic retail destination due to the following:

- A large market size
- Low organised retail penetration
- Strong GDP growth
- Increasing personal incomes
- Large number of aspirational consumers (middle-class, young Indians, rural population, etc.)

The Indian retail market is evolving rapidly and we observe the following features:

- Previously, shopping was viewed as a functional activity. It meant buying only the essentials. In fact, unnecessary shopping or self-indulgence was frowned upon. However, liberalisation in the 90s, increasing incomes and foreign trips, exposure to the internet, growing confidence in one's personal success, etc. are making it acceptable to not only buy non-essential products but also to splurge on luxury goods.
- India's retail sector is developing quickly and becoming more competitive. Retailers understand the importance of meeting consumer demands.
- Supply chain mastery will be a driver of competitive advantage. As the retail sector becomes more crowded, the use of supply chain and logistics will enable retailers to become agile and cost-competitive.

In this report, we present the following:

- An in-depth look at the main drivers, trends and issues in India's retail sector
- An overview of the key tax and regulatory issues
- A discussion on the benefits of modern trade
- Three factors for succeeding in the Indian market

We also present three key examples of retailers in value fashion, fashion jewellery and online retail, who have been able to achieve double digit growth.

We hope that this report will provide you with a detailed view of the Indian retail sector.

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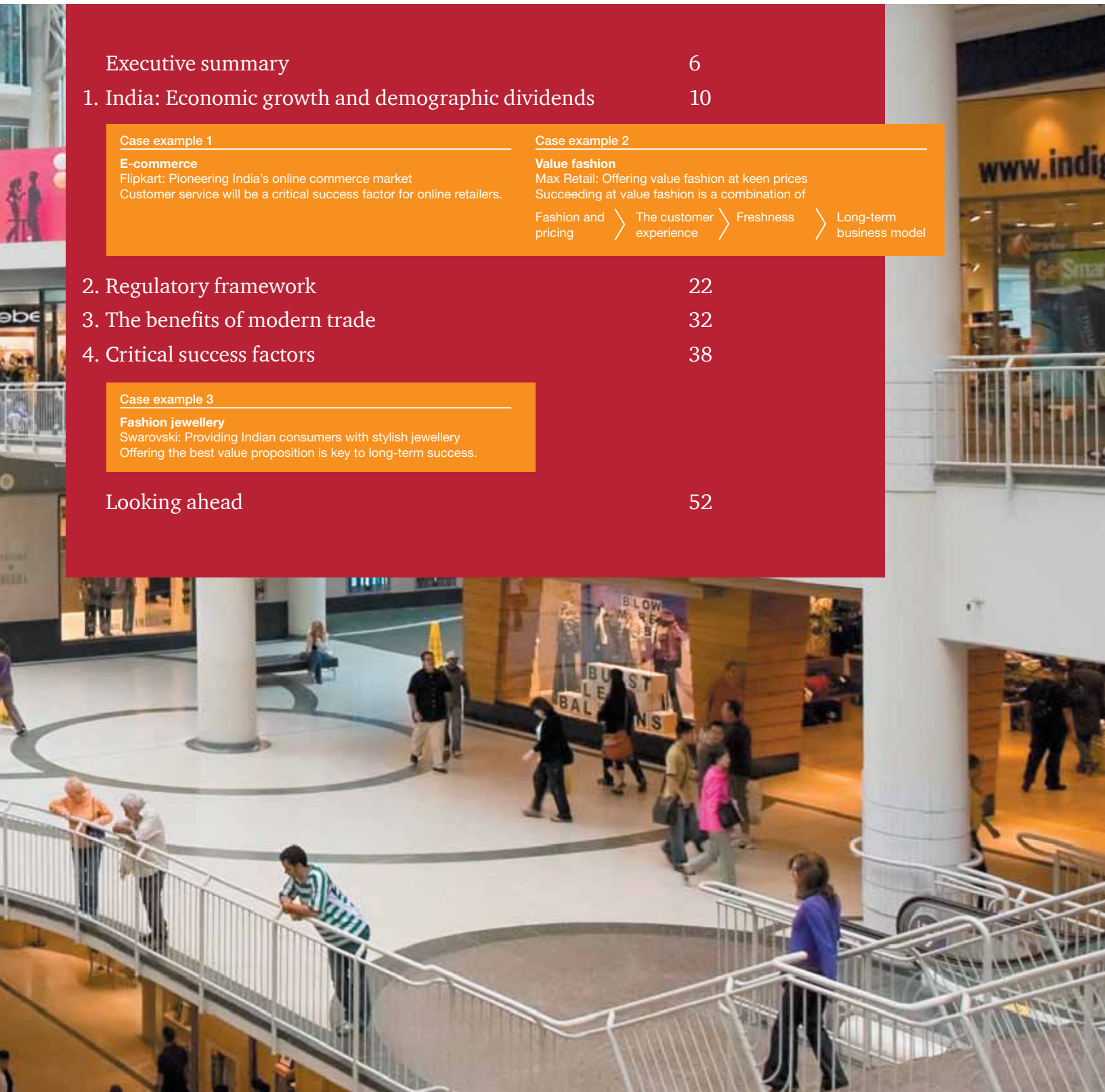
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Executive summary

#1

India is one of the most desirable retail destinations in the world.

India's twin growth engines of economic growth and demographic profile set it apart from other nations and present a compelling business case for global retailers looking to enter the market.

- India has a large and aspirational middle-class of 75 million households or 300 million individuals. Middle-class consumers want products which are value-driven.
- India also has 500 million Indians under the age of 25. Young Indians are driving purchases in mobile phones, fashion, accessories, food and beverages, quick service restaurants, etc. Young Indians have access to more money than before and with this has come independence, aspirations and a demand for products.
- According to the 2010 World Wealth Report by Capgemini and Merrill Lynch Wealth Management, the rise in the total number of millionaires (or Indians with investible assets, excluding main residence and consumer durables, of more than US\$ 1 million) grew almost 51%, the second fastest in the Asia-Pacific region.
- The 700 million Indians residing in rural India are an opportunity that retail and consumer (R&C) companies cannot ignore. Penetration levels for several products, such as personal care, hair care, skin care, consumer durables and electronics are low in rural India. Retail and consumer companies who localise their products for this market, with regard to price points, packaging, stock-keeping units (SKU) size, promotion, will succeed.

Indian consumers are driving purchases in:

- Two-wheelers
- Skin care
- Hair care
- Apparel
- Accessories
- Mobile phones

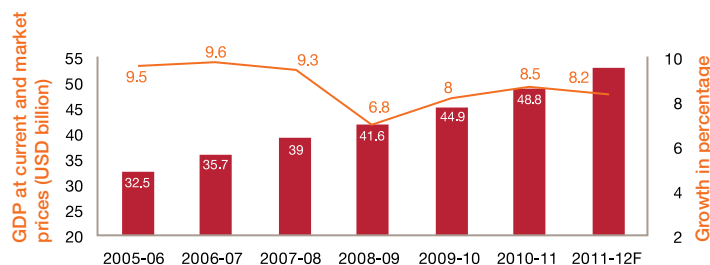
Strong GDP growth

Business and consumer confidence

Capital markets buoyancy

Since 2005-06, India has been growing at an average GDP of 8.6%. Foreign investment into India is increasing, Indian companies are stepping outside their national borders to acquire companies overseas, incomes are increasing and capital markets are buoyant reflecting the strength of the company. Studies have also ranked Indian consumers as some of the most confident in the world. The more confident consumers are about the strength of the economy, their personal finances, their career growth, etc., the more they will increase their consumption, purchase non-essential products, experiment with products, brands, categories, etc.

Strong and stable economic growth



Source: Prime Minister's Economic Advisory Council, Government of India

#2

Understanding the tax and regulatory framework is essential to starting or operating a retail business in India.

We discuss the following aspects of India's tax and regulatory framework, which is relevant to retailers either operating or setting up presence in India:

- FDI policy framework
- Direct tax framework
- Transfer pricing framework
- Indirect tax framework
- Tax issues faced by retailers operating in India

Most major global brands and retailers who are not yet in India are assessing the market with keen interest, recognising its strengths as a retail destination. India's retail sector is not yet fully liberalised. That said, the entry of single brand retail in 2006 is viewed as a major step forward towards liberalising the sector. Another development is the Committee of Secretaries' recommendation, in July 2011, of allowing FDI in multi-brand retail, subject to conditions.

#3

FDI in the retail sector will benefit several constituencies and stakeholders.

The benefits of modern trade to India will positively impact several constituencies.

What are the benefits of FDI?

Consumers

Modern trade allows for an explosion of choice. Consumers can access products that improve the quality of life. Modern trade will benefit consumers in several ways:

- Avail rationalised prices that better reflect market value due to competition
- Access better quality food products resulting from knowledge transfer regarding best practices in grading, sorting and processing techniques, the establishment of a robust cold chain system, etc.

Government exchequer

Modern trade players are tax-compliant and are large tax-payers. The organised retail sector also facilitates the generation of significant tax revenues through the building of a sophisticated supply chain. This impacts the logistics, transportation, warehousing, freight forwarding and other similar service sectors, all of which contribute to the exchequer through payment of indirect taxes, primarily the service tax.

Farmers/producers

Establishing an efficient supply chain that links farmers and small manufacturers directly with retailers, will maximise value for stakeholders. Together with back-end infrastructure, this will minimise wastage (especially of fresh foods and vegetables), increase farmers' realisations, encourage best practices in crop management and improve food safety and hygiene. While inefficiencies increase consumer prices, farmers suffer from extremely low realisations.

Unorganised trade

Kiranas (i.e., mom-and-pop stores) can exist alongside modern trade players and can explore partnership models (e.g., sourcing, franchise partners) in a rapidly changing retail environment.

Why should the retail sector be liberalised?

Reduce wastage across India's food supply chain

When entering new countries, most major food and grocery retailers engage and work with local farmers. Empirical studies in emerging market economies have shown that the growth of organised retail results in several eventualities:

- Technology transfer
- Improvements to the quality of produce locally available
- Boosts to local economy since local suppliers are engaged and integrated into global retailers' food and grocery procurement practices
- More competitively priced products

Increase employment

FDI in retail will generate employment since new entrants will need to hire staff. Current employees of unorganised retail players do not receive healthcare or other benefits. Once individuals become absorbed in retailer operations, they can access more equitable wages and benefits. Modern trade's effect will be most apparent at the bottom of the population pyramid, as it will unleash opportunities such as non-agricultural employment for rural youth and a better quality of living for the existing agricultural society.

Strengthen India's position as a sourcing hub

Global retailers have been sourcing from India for years and their retail presence in the Indian market will enhance exports from India, as they develop and leverage relationships with local suppliers. Most global retailers who have entered India have expressed their intentions to source and export a range of products from the country. The extent of sourcing from India will increase when global retailers are allowed to operate in the Indian market.

FDI creates better retail infrastructure, which helps to support overall sector growth.

Access to funds

Best practices transfer

Supply chain mastery

Reduced wastage in the food supply chain

More products, better prices

Boost to employment

Higher levels of sourcing and exports

Higher tax revenues



#4

Key success factors are finding the right real estate, localising products and mastering the supply chain.

Succeeding in India's retail market is not easy given the following:

- There is a large heterogeneous group of consumers who have significantly varying buying power.
- The majority of Indian consumers are value-conscious.
- India-based retailers with a first-mover advantage have aggressive and ambitious expansion plans.
- New brands are entering the Indian market

Succeeding in India's retail sector is a combination of the following factors:

#1

Securing the right retail real estate

When it comes to the retail sector, it is location, location, location! A fundamental aspect of retailers operations is the availability of good quality retail real estate.

A few years ago, there were not enough retail real estate options and many retailers were forced to rent (high-priced) space that skewed their profitability metrics. Today, the scenario is different in that there are more retail real estate options to choose from. Positive market and consumer sentiments, the entry of new foreign brands, incumbents' expansion plans and increasing hiring needs are helping drive demand for retail space in Tier I cities. Industrial growth and expansion is also ensuring that several retailers are planning to expand operations to Tier II and Tier III cities given that there are aspirational consumers earning increased incomes who would like better access to products.

#2

Localising products to delight and excite Indian consumers

R&D, innovation and new product development are emerging as key drivers of success. As part of this effort, product localisation has emerged as a driver of sales, customer excitement, customer interest, etc. Indian consumers, while they want access to products available overseas, also want to feel that a product has been created especially for them.

Localisation can take several forms which include but are not limited to the following:

- Creating and launching products specifically for Indian consumers
- Making changes to store layout to appeal to Indian consumers
- Customising production or food preparation practices for cultural sensitivities and local palettes

#3

Mastering the supply chain as a driver of competitive advantage

Mastery of supply chain dynamics is a critical enabler for the growth of modern trade. India is a large and fragmented country and the absence of strong infrastructure and logistics systems make it challenging to reach consumers located across vast distances. With the Indian government making investments into state highways, an overall decline of logistics costs is bound to occur. Studies suggest that logistics costs are between 10 to 12% of total GDP.

Creating efficient supply chains and achieving competitive advantage for retailers is a function of the following:

- Integrating vendor-managed inventory programmes with planning and forecasting processes
- Integrating components of the value chain
- Using a multimodal transport network
- Encouraging skill development
- Using innovative techniques such as use of voice-based solutions in retail logistics
- Leveraging technology

1

The Indian retail sector is one of the most exciting and underpenetrated markets in the world

Economy and demographics make India the envy of many nations.

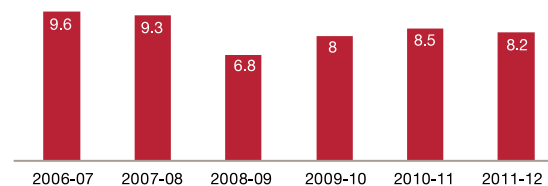
The Indian economy was liberalised in the 1990s and since then, the country has seen booming capital markets, the emergence of new industries, an evolution in consumer shopping habits, the entry of global companies, etc. India is a vibrant economy and since 2005-06, has been growing at an average gross domestic product (GDP) of 8.6%. The six core industries of crude oil, petroleum refinery products, coal, electricity, cement and finished carbon steel grew by 6.8% in February 2011 as compared to 4.2 % in February 2010¹. According to the Centre for Monitoring Indian Economy, private final consumption expenditure is projected to grow by 7.5%².

While the influx of foreign capital is increasing, Indian companies are also acquiring assets overseas. Also, the strength

of the country is reflected in its growing personal income. The Indian government is supporting this growth through reforms and by improving the state of infrastructure (roads, highways, ports, airports, special economic zones, etc.).

Powered by strong internal demand, the country has displayed robust growth which is likely to be sustained in the coming years. A large and educated middle-class and young consumers are helping drive demand across categories. Studies have also ranked Indian consumers as some of the most confident consumers in the world. This is based on the strength of the economy, personal finances, career growth, increase in consumption, purchase of non-essential products, brand awareness, etc.

Indian economy displays resilience in the midst of global crisis (GDP, %)



Source: Prime Minister's Economic Advisory Council, Government of India

India—macro-economic details

Indicator	Unit	2010	2011	2012	2013	2014
GDP, purchasing power parity (per capita)	International dollars	3453.826	3777.925	4103.794	4434.577	4819.58
GDP, purchasing power parity (per capita growth)	%	12.013	9.3838	8.6256	8.0604	8.6819
Gross disposable income per household, USD (absolute)	USD	5295.26	6151.04	6867.1	7627.55	8447.77
Gross disposable income per household, USD (growth)	%	16.3786	16.1612	11.6413	11.0738	10.7534
Rural population as % of total population (absolute)	%	70.2085	69.9835	69.7581	69.5317	69.3049
Urban population as % of total population (absolute)	%	29.7915	30.0165	30.2419	30.4683	30.6951

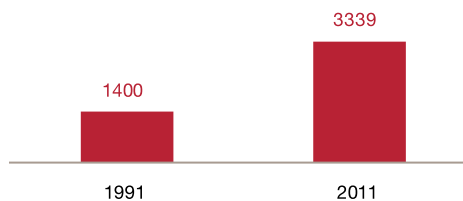
Source: Datamonitor Country Insight, 2011

¹ <http://www.ibef.org/india/economy/economyoverview.aspx>

² <http://www.ibef.org/india/economy/economyoverview.aspx>

India's two decades of growth

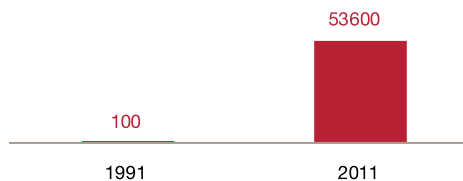
GDP per capita (PPP basis)



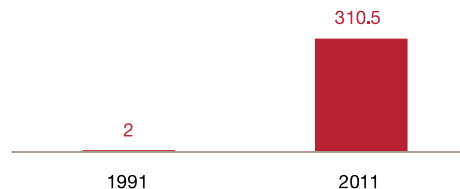
Middle-class consumers (million people)



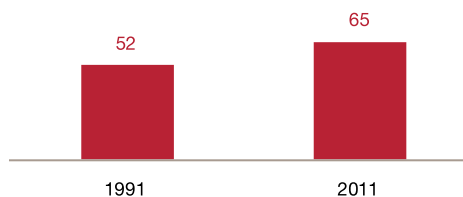
Foreign investment (USD million)



Forex reserves (USD billion)



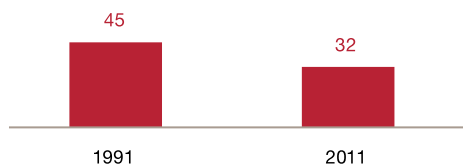
Literacy (%)



People below the poverty line (%)



Average age of house-owner (years)



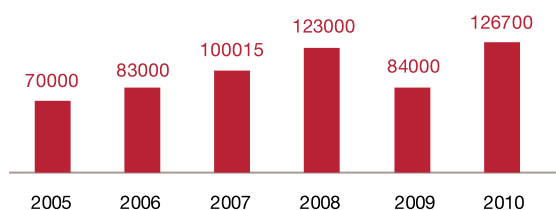
Cellphone subscribers (million people)



Also, India's unique demography makes it an attractive market for companies operating across categories. These include apparel, footwear, accessories, mobile phones, personal care, food and beverages, hair care, etc.

- India has a large and aspirational middle-class of 75 million households or 300 million individuals. Often referred to as the growth engine of the Indian economy, the middle-class wants products which provide value for money.
- India has a population of 500 million under the age of 25. These young Indians are independent, have high aspirations and access to money. Therefore, they drive purchases in mobile phones, fashion, accessories, food and beverages, quick service restaurants, etc.
- According to the 2010 World Wealth Report by Capgemini and Merrill Lynch Wealth Management, the rise in the total number of Indian millionaires with investible assets, excluding main residence and consumer durables of more than US\$ 1 million, grew almost 51%. This is the second fastest in the Asia-Pacific region after Hong Kong.
- India's rural population of 700 million presents an opportunity for R&C companies, which they cannot ignore. The agriculture sector has been witnessing record foodgrain output, giving a boost to agro-industries and rural incomes. But, penetration levels for several products, such as personal care, hair care, skin care, consumer durables and electronics are low in rural India. However, R&C companies, who are localising products for the Indian market (price points, packaging, SKU size, promotion, etc.), will succeed.

Number of Indians with investible assets of over US\$ 1 million



Source: Capgemini, Merrill Lynch Wealth Management

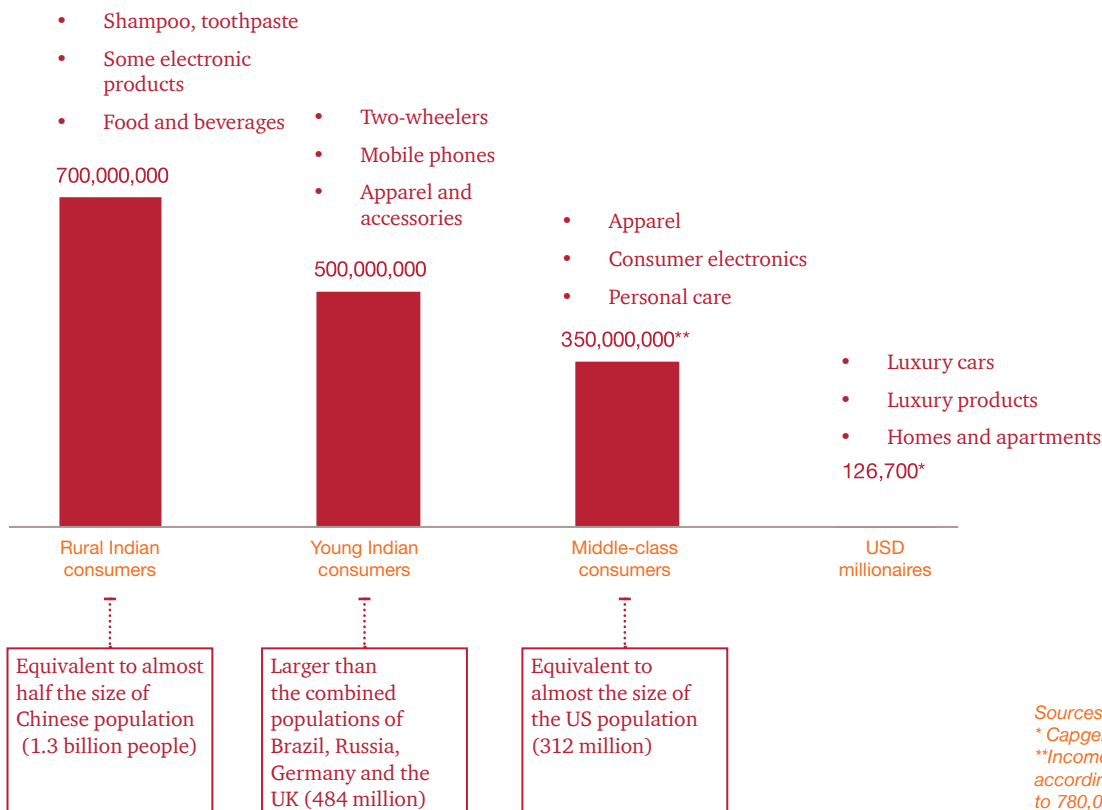
Ownership of consumer durables by households in rural India

All states*	DVD player	Electric iron	Computer	TV	Fridge	Washing machine	Digital camera
Penetration %	3	12.7	0.3	34.9	5.4	0.8	0.1

*Estimated households (000s) 157,454. Source: IRS, 2009 R1, Hansa Research, The Marketing Whitebook 2010-2011 (Businessworld)

The power of India's consumer groups

Major demographic groups are driving purchases across categories



Sources: PwC analysis

* Capgemini, Merrill Lynch Wealth Management

**Income levels for middle-class consumers, according to the NCAER, range from INR140,000 to 780,000, which using a conversion rate of USD1 equivalent to INR45, is IUSD3,111 to 17,333.

India's evolving retail sector is exciting and dynamic.

PwC research indicates that India's retail sector is worth US\$ 350 billion and has a low organised retail penetration (ORP) of 5 to 8%. Modern trade emerged during the 90s, primarily in the food and grocery sector, and is now growing at a CAGR of 15 to 20%.

A large market potential for a range of categories is indicated by low ORP, increasing urbanisation, growing incomes, increasing consumer confidence, etc.

India's retail sector comprises organised and unorganised participants. Given the size of the country's retail market, PwC research and other reports suggest that the 12 million mom-and-pop stores comprising India's unorganised market can co-exist with modern trade players.

Recognising the long-term growth potential of India's retail market, some of the country's largest conglomerates have allocated billions of dollars to launch large scale retail initiatives that span cash-and-carry, food and grocery, books, music and leisure, gems and jewellery, footwear, apparel, accessories, etc. India-based retail incumbents are expanding their presence across a range of categories, experimenting with formats, launching private labels, strengthening supply chain systems and more.

Global retailers are also assessing the Indian market with keen interest. They have recognised that the next wave of growth in terms of generating revenues, reaching new customers (including the large number of middle-class consumers) and harnessing research and development (R&D) and innovative skills will come from emerging markets. PwC's 14th Annual Global CEO Survey indicated that 93% of retail CEOs believed that they will expand their Asian operations over the next 12 months.

Whether global or domestic, retailers want to capitalise on the India growth story. An aspiring middle-class of 300 million consumers, a large demand-driven population of 500 million young consumers and a relatively untapped rural population of 700 million people constitute the growth story. Besides, a strong GDP growth, rising consumer confidence, consumption-based behaviour, increasing incomes and a large pool of consumers have made India one of the world's most attractive retail destinations.

India's retail fundamentals	
Market size	US\$ 350 billion
CAGR	15-20%
Unorganised retail	12 million mom-and-pop stores
Organised retail penetration	5-8 %
Retail density	6%
Contribution to GDP	14%

Drivers fuelling the growth of the retail sector are below:

- Demand drivers
 - Demanding consumers: Indian consumers are demanding access to products and services that delight and excite them, are of good quality, and provide value for money.
 - Increasing incomes: Strong GDP performance, capital market growth and the emergence of new industries are creating new millionaires and boosting income levels. This acts as an incentive for consumers to spend more on products. They are also experimenting with brands, trying new products, etc.
 - Evolving consumption patterns: Traditionally, the focus of Indian consumers was on saving. However, positive macro-economic fundamentals, an evolving retail market, lifestyle influencers, etc. are ensuring that consumers spend more across categories. Other aspects, like the emergence of double-income households, easier access to credit and society's acceptance of self-indulgence, are changing purchasing habits.

- Supply drivers
 - Expansion: The growth of modern trade and expansion plans are enabling consumers to easily access retail products and services across urban, Tier II and Tier III cities and towns.
 - New entrants: Some of the world's largest and most prestigious brands and retailers have a presence in India. Most global retailers believe that the next wave of growth will come from the emerging market economies. Those who have not yet entered India are assessing the market with interest.
 - Growth opportunities: Some high growth categories in the retail sector include the following:
 - Children's wear
 - Accessories
 - Consumer durables
 - Leisure
 - Apparel
 - Footwear

India's retail sector is an evolving market. The sector will grow and develop over the next four to six decades, since consumers will earn more, those below the poverty line will cross over, the gains from economic growth will be felt more inclusively, etc. As more retailers enter the market and expand operations, consumers' buying patterns and shopping habits will also evolve. Retailers currently operating in the market, and those who plan to enter the market, will have enough time to understand local market dynamics, develop robust supply chains, establish formats and choose the right product assortment to meet the needs of diverse Indian consumers.

Opportunities exist across retail categories in India.

Selected high demand categories

Apparel

<i>Demand for:</i>	<i>Demand in Asia</i>	<i>Demand in India</i>
<ul style="list-style-type: none"> • Branded apparel • Children's wear • Club wear • Private label apparel • Uniforms • Women's professional attire 	<p>The Asian fashion market will witness a healthy average annual demand growth of approximately 5% through 2014.</p> <p>Among global fashion retailers, China evokes confidence.</p> <p>The Indian apparel market is relatively untapped across categories.</p>	<p>Compared to other Asian countries, the Indian apparel market is significantly smaller. However, over the past few years, clothing sales have been increasing steadily. This is supported by a growing market of young consumers and an increasing interest in western fashion.</p>

Consumer durables and electronics

<i>Demand for:</i>	<i>Demand in Asia</i>	<i>Demand in India</i>
<ul style="list-style-type: none"> • Air-conditioners • Cameras • Laptops • Media tablets • Mobile phones • Refrigerators • TVs 	<p>In 2010, Asian countries witnessed an increase in sales of consumer durables.</p> <p>China, India and Hong Kong will drive growth in Asia in the appliance and houseware category.</p>	<p>Most consumer durables sold in India are manufactured in the country.</p> <p>Cost is an important factor that determines the sales of consumer goods. Production capabilities for budget models are also well developed.</p>

Food, beverage and tobacco

<i>Demand for:</i>	<i>Demand in Asia</i>	<i>Demand in India</i>
<ul style="list-style-type: none"> • Cooking • Energy drinks • Frozen foods • Noodles • Ready-to-eat foods • Value-added dairy • Non-carbonated beverages 	<p>Demand for food, beverage and tobacco in Asia is expected to increase in the next two to four years.</p> <p>In value terms, food sales are set to almost double from US\$ 2.7 trillion in 2010 to US\$ 4.6 trillion in 2014. The growth in demand will be the strongest in China, with an average of 5.7% in the forecast period of 2010 to 2014. India will witness a 3.2% average annual demand growth.</p>	<p>Beer, processed foods, fast food and coffee will be strong sellers during the forecast period.</p> <p>Groceries account for two-thirds of India's total retail sales and were a driver of growth in 2009.</p> <p>Innovations in packaging are making products more affordable.</p>

Source: PwC analysis. Strong and Steady 2011 Outlook for the Retail and Consumer Products Sector in Asia



Sector snippets

Retailers are using a mix of formats which consider availability of the right real estate, fundamentals relating to the catchment area, value propositions, etc.

A relatively new but rapidly growing retail format is the online channel, which offers consumers convenience, price benefits and the ability to shop 24 hours a day.

India's modern trade category comprises global and domestic participants

Food and grocery		Consumer electronics/durables		Apparel	
Global	Carrefour Max Hypermarket-SPAR Metro Tata Tesco	Global	Bang and Olufsen Bose LG Samsung Sony Whirlpool	Global	Diesel Esprit Levi's Mango Marks & Spencer
Indian	Bharti-Walmart Food Bazaar More Nature's Basket Reliance Fresh Spencer's	Indian	Croma eZone Pai Electronics Reliance Digital The Electronics Store Vivek's	Indian	Chemistry Dolphin Lilliput Mustard Seed Provogue Wills Lifestyle
Luxury products		Footwear		Watches	
Global	Chanel Christian Dior L'ladro LVMH Mont Blanc	Global	Aldo Bata Charles & Keith Hush Puppies Nike Nine West	Global	Baume & Mercier Cartier Chopard Citizen Longines Omega
Indian	Amrapali Manish Arora Rohit Bal Ritu Kumar Tarun Tahiliani Titan Nebula	Indian	Catwalk Inc. 5 Reliance Footprint Woodland	Indian	Ethos Fastrack Helios Titan Watches and More

Since the mid-to late 2000s, some of India's largest conglomerates set aside billions of dollars to launch large-scale retail initiatives spanning food and grocery, cash-and-carry, apparel, footwear, gems and jewellery, etc.

Retailers use a mix of formats that include the following:

- Cash-and-carry
- Convenience stores
- Department stores
- Discount or value
- E-commerce

- Hypermarkets
- Malls
- Shop-in-shop
- Specialty retail
- Supermarkets
- Rural retail

Reliance Retail	Bharti Retail	AV Birla Retail
Projected investment of US\$ 5.5 billion in food and grocery, leisure, apparel, accessories, gems and jewellery, hypermarkets, home and living, eyewear, etc.	Projected investment of US\$ 2.5 billion in cash-and-carry and food and grocery.	Projected investment of US\$ 2.5 billion in food and grocery. Market rumors suggest that the retailer may launch an offering in specialty retail.

Category: Online commerce

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.

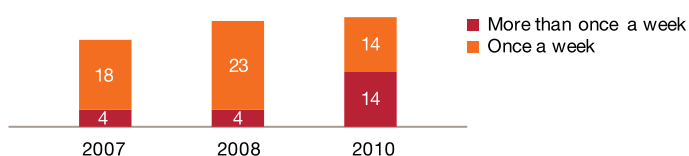
Growth drivers include the following:

- 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.

...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 was four percent only two years ago.



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

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.

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.

...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.

Source: Discussions with senior management at Flipkart, PwC analysis

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.



Sector snippets

Indian consumers are value-conscious. Private labels offer consumers the twin benefits of quality and value for money.

Retailers are expanding operations.

Key trends

Growth of private labels

Most retailers in India are bullish about the success of their private label products across food and non-food categories. PwC's **Strategic Issues for Retail CEOs** indicates that retailers are launching new private label offerings, enhancing their private label portfolios and will be launching robust promotional offers to quickly move their own brands. India's major retailers are expected to embark upon the following strategies for their private label products:

- Increase the range of offerings
- Increase share of revenue from private label sales
- Embark upon promotional offers and sales
- Increase the visibility of products in store outlets
- Offer selected products through other retailers' outlets

Experimenting with formats

Most of the large modern trade players are experimenting with formats and launching hypermarkets, supermarkets, electronic kiosks, shop-in-shops, etc. Retailers are also experimenting with size even within the same format category. For example, instead of having one standard size for hypermarkets, some retailers are varying the size according to considerations like real estate rentals, the size of the catchment area, etc. The hypermarket is a popular format especially for many of India's food and grocery operators. According to PwC's thought leadership report **Strong and Steady 2011 Outlook for the Retail and Consumer Products Sector in Asia**, "Hypermarket expansion is sweeping across Asia, with China in the lead."

Increasing consumer confidence

Reports suggest that Indian consumers are some of the most confident in the world. Buoyed by a sense of confidence in the economy, their job prospects, industrial growth, capital markets, etc., they are more willing to spend across non-essential product categories. The increasing use of credit cards has enabled consumers to buy products that may be out of their reach.

Key issues to address

Infrastructure and supply chain

The absence of world-class roads, highways, ports, etc. is a major challenge for retailers who are looking to move goods efficiently from point of source or procurement to the shelf. Related to this is the idea of supply chain, logistics, warehousing and distribution. Indian retailers are experiencing high levels of demand and need to deliver on time by managing stock keeping units (SKUs), maintaining inventory, guarding against stock-outs, etc. The use of IT optimisation systems and overall synchronisation from both suppliers and retailers will enable the latter to use supply chain efficiency as a lever for success.

A heterogeneous market

- Indian consumers vary in terms of socio-economic grouping, education levels, attitudes, purchase drivers, buying preferences, behaviours, etc. As a result, it becomes imperative for stores to stock a mix of merchandise.
- Indian consumers are often referred to as value-conscious. This does not necessarily imply that consumers 'want a steal.' Instead, they want a well-made product that is priced fairly, and that meets its stated promises.
- Indian consumers are demanding access to more, improved and better priced products.

Workforce management

- Retail is a respectable career path that provides opportunities for advancement for men and women in rural, semi-urban and urban India.
- The retail sector is relatively new in India considering modern trade emerged in the 90s. Therefore, there is an absence of retail training academies. Some large modern trade players are either establishing their own retail academies or are partnering with business schools to develop retail accreditation programmes to develop retail talent.

India's retail sector is a study in evolution.

We outline the five forces shaping the Indian retail sector:

1. Splurging is pleasurable.

Prior to the liberalisation policy, shopping was viewed as a functional necessity i.e. buying only the essentials and not purchasing extra or unnecessary products. In fact, unnecessary shopping or self-indulgence was frowned upon. However, increasing incomes, frequent overseas travel, exposure to the internet, growing confidence in one's personal drivers, etc. are making it acceptable to:

- Buy more non-essential products than before
- Switch between products and brands, often making first purchases in new categories
- Splurge on luxury products like fine wine and scotch, expensive handbags, branded jewellery, etc.

2. Innovation is imperative.

Today, the focus on innovation and R&D is greater than before. R&C companies who want to assume leadership positions will use R&D and innovation as a lever for growth.



- New products are being launched across a range of categories that include private labels, apparel, footwear, consumer durables and electronics, personal care and grooming, hair care, skin care, etc.

Innovate > Create > Dominate

- Competitors are establishing innovation centres in order to prepare for future growth, capture new target consumers, etc. Hiring R&D talent is critical in developing world-class centres of excellence. Most global companies recognise that the next wave of growth will come from India and China. These brands are committed in increasing their R&D expenditure and innovating products to cater to these markets.
- Companies are increasing their efforts to hire senior staff and support teams. They are entrusted with role of innovating new products, product development, R&D, understanding consumer behaviour, etc.
- As the market becomes more crowded, product differentiation will be critical and will separate today's leaders from tomorrow's game-changers.

3. Shopping with family is fun!

To enjoy their increased spending power, Indians typically prefer to shop in the company of their families by visiting malls, looking at brands, experimenting between categories, etc. Some retailers and brands have launched family stores to cater to men, women and children.

Real estate developers are also creating spaces where retail and entertainment converge, making it a fun experience for the whole family. Modern trade has made shopping enjoyable, with malls offering multiplexes, restaurants and food courts, a range of shops, arcades for children, etc.

Winning the game of innovation

Lifecycle leadership

Rapidly evolving customer demands, technology, competitor actions, etc. are ensuring that product lifecycles shrink.

Companies that continually innovate and launch new products will extend the longevity of their products and product categories.

Local market needs

Establishing R&D and innovation centres in regional areas enables global companies to create products that meet local market needs. While products may be similar in terms of the availability of product lines around the world, local market nuances exist in terms of product size, pricing, fragrance, look-and-feel, etc.

Game-changing ideas

R&D and innovation labs can help companies identify game-changing products.

Discontinuous in nature, these products can redefine a category, create new opportunities for growth, make products obsolete and help companies establish leadership positions in the minds of consumers.

4. The consumer is king.

India's retail sector is developing quickly and becoming more competitive. R&C companies understand the importance of meeting the demands of Indian consumers. Non-performance will result in consumers migrating their preferences and purchases to other brands. Retailers need to develop and offer products which meet consumer demands and also delight and excite them. To meet consumer demands, R&C companies are using R&D as a means to launch new products.

- Private labels: Consumers want quality products priced competitively. Price is the primary determinant of purchase for many Indian consumers.
- Premium personal care: With access to the internet, frequent foreign travel, increasing desire to experiment with products, a pre-occupation with celebrity culture, etc., Indian consumers want to look, feel and smell good.
- Non-carbonated beverages: Consumers are focussed on health and wellness and want to consume healthy juice-based, energy or fortified beverages.
- Ready-to-eat meals: Consumers lead busy lifestyles and want convenience in the kitchen, the ability to prepare meals easily, etc.

5. Customer service can be improved.

As the Indian marketplace becomes increasingly crowded with new entrants, customer service will be a key factor in determining profitability and survival. Today, Indian consumers are flooded with diverse products and services. Therefore, it is important for retailers in India to provide good customer service as a means to encourage repeat purchases and build brand loyalty. Retailers in mature markets have used customer service as a tool to generate footfalls and create a positive brand image. They have developed consumer-friendly policies in terms of return and exchange, loyalty programmes, customer appreciation days, etc. Customer service aims at the following:

- To help consumers differentiate between retailers
- To generate customer loyalty
- To increase purchases
- To create a positive brand image

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 fashionable and affordable.
- 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	<p>Customer needs and expectations evolve given their exposure to international travel, media, the Internet, etc. Today, the Indian consumer expects a better experience overall:</p> <ul style="list-style-type: none">• 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.

applicable for all retailers

Source: Discussions with senior management at Max Retail, PwC analysis

2

Selecting the right investment and transaction structure is key to developing a presence in India's retail market

Understanding India's tax and regulatory framework is important.

Most major global brands and retailers who are not yet in India are assessing the market with keen interest, recognising its strengths as a retail destination. India's retail sector is not yet fully liberalised. That said, the entry of single brand retail in 2006 is viewed as a major step forward towards liberalising the sector. Another development is the Committee of Secretaries' recommendation, in July 2011, of allowing FDI in multi-brand retail, subject to conditionalities.

FDI policy framework

India has an open-arm policy for regulating FDI into the country. Under the current 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 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 and Promotion (DIPP), the Ministry of Commerce and Industry and implemented by the Reserve Bank of India (RBI) for cases falling under the automatic route (i.e. not requiring prior government approval). For cases 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 which are of strategic importance that require government approval, there is a small list of sectors in which FDI is currently prohibited. Presently, this list includes retail trading (except for 'single brand' retail trading).

We provide an overview of the FDI policy framework prevalent for the trading sector in India:

A. Wholesale trading

For wholesale trading or cash-and-carry wholesale trading, 100% FDI is permitted, without government approval. However, the government has prescribed certain operational guidelines for companies in the wholesale trading sector.

Some of the key principles emerging from this operational guideline are set out below:

- Wholesale trading is defined as the sale of goods or merchandise to retailers, industrial, commercial, institutional or other professional business users or to other wholesalers and related subordinated service providers.
- The yardstick for determining whether a sale is wholesale or not is the type of customer to whom the sale is made, and not the size and/or volume of sales.
- Licences/registrations/permits, as specified under the acts, regulations, rules, orders of the government, are required for wholesale trading operations.
- Sales under wholesale trading can only be made to customers holding the following registrations/licences:
 - Entities holding sales tax, VAT, service tax, excise duty registration
 - Entities holding trade licences
 - Entities holding permits/licences, etc. for undertaking retail trade (like licences for hawkers) from government authorities/local self government bodies
 - Institutions with certificates of incorporation or registration as a society or registration as public trusts for 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.

B. E-commerce activities

E-commerce activities are also governed by the principles mentioned above i.e. companies can engage only in Business to Business (“B2B”) E-commerce trading and not in retail trading.

C. Test marketing

With prior government approval, 100% FDI is permitted for the test marketing of items for which a company has approval for manufacture, for a period of two years. This is true provided investment in setting up a manufacturing facility commences simultaneously with the test marketing.

D. Retail trading

FDI up to 51% is permitted with prior government approval, for the retail trading of ‘Single Brand’ products, subject to the following conditions:

- Products sold should be ‘single brand’ only.
- Products should be sold under the same brand internationally.
- ‘Single brand’ product-retailing will cover only products which are branded during manufacturing.
- The foreign investor should be the owner of the brand.

Applications seeking government permission for FDI in the retail trade of ‘single brand’ products are to be made to the DIPPP. The application should specifically indicate the product or product categories proposed to be sold under the ‘single brand’. Any subsequent addition to the products or product categories to be sold under the ‘single brand’ would require fresh approval from the Government.

E. Recent developments—The possibility of FDI in multi brand retail trading

In July 2010, the DIPPP released a discussion paper inviting public comments on issues concerning FDI in multi-brand retail trading. This discussion paper included an analysis of the following:

- The contribution of organised and unorganised retail to the Indian economy
- The need for FDI to fill the gaps that exist in the Indian system in terms of weak back-end infrastructure
- The impact of FDI permissibility on the retail sectors in China, Thailand, Russia, Chile and Indonesia.

The views of stakeholders were invited on issues such as the proposed FDI cap to be imposed, mandatory investment in developing back-end infrastructure, minimum employment opportunities for rural youth, minimum percentage of sourcing from the small and medium enterprises (SME) sector, the integration of small retailers in the upgraded supply chain, etc.

More than 250 responses were received and a panel, including members from various ministries, was set up to analyse the responses and formulate the policy on the government permitting FDI in multi-brand retail trading. The matter is currently under consideration by the government. If it is decided to allow FDI in multi-brand retail trading, it is expected that the policy will impose certain obligations on foreign investors such as a minimum capital infusion and the use of funds for the development of an organised trading retail infrastructure.

Another development is the Committee of Secretaries’ recommendation, in July 2011, of allowing FDI in multi-brand retail, subject to conditionalities.

Property/real estate

FDI up to 100% is permitted under the automatic route for construction-development projects (including shopping malls), subject to compliance with certain minimum area and capitalisation conditions being met.

In most cities, it is difficult to find suitable properties in central and downtown

locations for large format retail stores, primarily due to fragmented private holdings and the infrequent auctioning of large government-owned vacant lands. This has led to a shift in preference towards the suburbs of cities.

Agriculture procurements

States and union territories have enacted the Agriculture Produce Marketing Committee (APMC) Act regulating the procurement of agricultural and fisheries produce, including 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 streamlining the procurement system, the government has asked state governments to review their APMC Acts and enable direct procurement from farmers, besides simplifying the procedures.

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

Other important considerations

Some of the other significant policy considerations that a foreign investor should keep in mind for setting up/carrying out retail operations in India are highlighted below:

- High stamp duties on transfer of properties, varying by state
- Rigid land use and zoning policies that make the conversion of land use rights time-consuming and complex
- Legal processes for determining clear title of ownership to avoid property disputes

- Foreign trade policy to regulate the physical import of goods and the issue of licences for it
- A robust contract law for trade activities
- With a view to ensuring fair trade, the government has put in place a Competition Act which deals with anti-competitive agreements such as price-fixing, bid-rigging, joint boycotts, etc., as well as abusive practices undertaken by dominant entities such as predatory pricing, abusive conditions of supply and the regulation of combinations.
- Trademark and copyright registrations are an important aspect for protecting intellectual property rights (IPRs) in the country. Registration under the Trademarks Act 1999 and Copyright Act 1957 can be used by retailers to protect their IPRs in India.
- Liaison office: Can only act as a communication channel for the overseas group.
- Branch office: Can undertake limited activities such as import/export trading, consultancy services, etc.
- Investment in an Indian company: Will be subject to activities permitted under the FDI policy of the government of India. In context of the trading sector, please refer to the section entitled FDI policy framework.
- Limited liability partnerships (LLP): An LLP is a very effective and tax-efficient option for cash mobilisation purposes. Foreign companies can set up or invest in LLPs engaged in activities permitted for 100% FDI under the automatic route.

Direct tax framework

Income tax is a central subject in India. There are no state-level income taxes provided for under the Indian fiscal system. The income tax provisions are codified in the Indian Income Tax Act, 1961 (the “Act”) and the Income Tax Rules, 1962 (the “Rules”). The Act is amended from time to time, including through annual Finance Bills that are required to be ratified by both Houses of Parliament. The Central Board of Direct Taxes is empowered to issue circulars and notifications which aid in the interpretation of the law. The tax year in India runs from 1 April to 31 March of the succeeding year.

A corporate entity incorporated in India (referred to as a company) is subject to tax at an effective rate of 32.45%. The income from business operations is computed by following the generally acceptable principles of accounting regarding the recognition of revenue. However, the deduction of certain expenses is admissible in accordance with the provisions codified in the Act (e.g. deductions for the payment of taxes, employee dues, etc. are allowed on a payment basis). Further, any expenditure

subject to withholding tax is allowed as a deduction only in the year in which taxes are deposited. Any expenditure incurred in contravention of the law or not for business purposes is not tax-deductible. There is no concept of a group scheme of taxation in India.

A company is also subject to the minimum alternate tax provisions whereby a company is liable to pay tax at an effective rate of 20.01% of the book profits (computed in a prescribed manner) if this tax is higher than the tax payable under the normal provisions of the Act.

The Act does not have any specific taxation regime for companies engaged in retail operations. There are some sector-specific incentives for cold chains, warehousing facilities for storage of agricultural produce, etc.

Business losses can be carried forward for a period of eight tax years and offset only against business profits, whereas tax depreciation can be carried forward indefinitely. Carry-back is not permitted.

• Direct Tax Code (DTC): on the anvil

On 12 August 2009, the Indian government released the draft DTC for public debate. The objective was to moderate the tax rates and simplify tax laws. All direct taxes including wealth tax and income tax will be brought under one code. Public and stakeholder feedback on the proposals was analysed by the government, and suggestions for amendments received from the public, business associations and other bodies were taken into account.

A revised discussion paper addressing the major issues was released in June 2010. Further feedback was received on it. The Direct Taxes Code Bill 2010 was tabled in Parliament on 30 August 2010 as an outcome of this process.

A summary of the significant proposals of the DTC is as follows:

Entity options for doing business

Entrants to the retail sector also need to decide on the model they intend to use for operating in India. For example, whether to enter into a joint venture arrangement with an existing company in India with equity participation, whether to enter into a plain franchise arrangement with an existing Indian company, etc.

Typically in these arrangements, tax and regulatory issues need to be addressed upfront—the manner of funding the operations, the repatriation options, the characterisation of receipts from and payables to foreign investors. Moreover, tax authorities generally scrutinise the commercial terms of arrangements to determine whether the foreign company is carrying on business in India through a permanent establishment.

Such issues would also depend on the entity vehicle chosen. The following entity options are available to retail investors as an India entry strategy:

- Companies having a place of effective management in India at any time in the year will be considered to be resident in India.
- Controlled Foreign Corporation (CFC) provisions are proposed to be introduced as an anti avoidance measure.
- The provisions of the DTC or the Double Tax Avoidance Agreement, whichever is more beneficial to the taxpayer shall apply, except in the following circumstances:
 - When General Anti Avoidance Rules (GAAR) provisions are invoked
 - When CFC provisions are invoked
 - When branch profit tax is levied
- The DTC contains the provisions of GAAR, under which the income tax authorities have been empowered to declare an arrangement as impermissible if it has been entered into with the objective of obtaining a tax benefit and lacks commercial substance.

Transfer pricing framework

With the introduction of formal transfer pricing (TP) regulations in 2001, in line with similar regulations prevalent in other developed countries, TP has emerged as the single largest source of tax litigation for multinational corporations (MNCs) in India. The provisions of Indian TP regulations apply to 'international transactions' entered into by MNCs with their overseas associate enterprises (AEs). They prescribe that intragroup transactions should meet with the arm's length standard and prescribed documents in this regard should be maintained.

An international transaction is a transaction between two (or more) AEs involving the following:

- The sale, purchase or lease of tangible or intangible property
- The provision of services
- Cost sharing arrangements
- The lending and borrowing of money
- Any other transaction having a bearing on the profits, income, losses or assets of such enterprises

The AE relationship is determined based on the participation by one enterprise, directly or indirectly, in the management, control or capital of the other enterprise. Some of the situations where two enterprises can become AEs are as follows:

- Direct or indirect holding of 26% or more voting power of an enterprise by the other enterprise or by the same person in both the enterprises
- Guaranteeing by an enterprise of 10% or more of total borrowing of the other enterprise
- Appointment by an enterprise of more than 50% of the board of directors or one or more executive directors of an enterprise, or appointment of specified directorships of both enterprises by the same person
- Complete dependence of an enterprise (for carrying on its business) on the intellectual property licensed to it by the other enterprise, etc.

Where a transaction is entered into with an unrelated party and there exists a prior agreement in relation to this transaction between the unrelated party and the AEs, even transactions with unrelated parties can fall into the ambit of TP regulations.

The TP regulations require any enterprise that has entered into any international transaction (with an AE) during a financial year to maintain prescribed information/ documents, obtain and furnish a report (to the tax authorities) from an accountant on or before the date of filing of the corporate income tax return (for companies, on the

last day of November following the relevant financial year).

The following penalties have been prescribed for default in compliance with the provisions of the TP code:

- For failure to maintain prescribed information or documents: 2% of transaction value
- For failure to furnish information or documents during audit: 2% of transaction value
- For adjustments to the taxpayer's income: 100% to 300% of tax on adjustment amount

Some important transfer pricing considerations to keep in mind while finalising business models are set out below:

A. Franchisee model

There are many corporations that prefer to operate in India through a franchisee model whereby a third party in India is given the licence to use the brand or intellectual property and is provided valuable services in lieu of payment of a franchisee fee to the overseas IP owner or service provider. Money can be repatriated to the franchisor from India through two mechanisms:

- The import price of products imported by the franchisee from the franchisor
- The payment of franchisee fees

The above option is definitely workable in the Indian context, but has its own share of challenges. One of them being the applicability of TP on transactions between franchisors and franchisees (which are rank third parties) on the pretext that the franchisee has complete dependence (for carrying on its business) on the intellectual property licensed to it by the franchisor and this dependence may result in the non arm's length pricing of transactions.

This challenge can be appropriately addressed by conducting a robust TP study to benchmark the abovementioned international transactions. In fact, such an

analysis can also be helpful for negotiations between the franchisor and franchisee regarding appropriate franchisee fees and the prices of imported products.

B. Distribution model

For single brand retail, MNCs can invest up to 51% to set up a joint venture with an Indian partner having 49% stake. The overseas partner may choose to set up the joint venture with an active or passive Indian partner depending upon long-term objectives. Money can be repatriated to the franchisor from India through the following mechanisms:

- Import prices of products imported by the franchisee from the franchisor
- Payment of royalties for the use of brands or intellectual property
- Payment for services

All of the above transactions are subject to TP and a robust TP study to benchmark the abovementioned international transactions is critical to limiting TP exposure. It is imperative that taxpayers have a proactive approach to avoid TP audit issues at a later stage.

Indirect tax framework

Presently, there are multiple indirect taxes either levied by the central government as federal taxes or by the state governments on sales, purchases or movements of goods in their respective jurisdictions. Typically, any company in the Indian retail industry has to deal with all of these taxes at some point in time during the entire supply chain.

The Constitution of India envisages the governance of the country as a federal structure, comprising the Union Government at the Centre, and the State Governments in the different Indian States. Under the Indian Constitution, the central government is empowered to impose taxes in the form of excise duty on the production or manufacture of goods, as well as taxes on the provision of services. The central government can also authorise and regulate the imposition of taxes on inter-state sales or purchases of goods, although they may be levied and collected by the states.

The states themselves are empowered to impose taxes on intra-state transactions concerning the sales or purchases of goods. The states are also authorised to impose certain other local taxes such as entry tax. Finally, local authorities and municipalities impose local taxes.

In addition to all of the above, the central government is also empowered to impose customs duties on the import of goods into the country.

To summarise, the following regulations/indirect taxes exist in relation to the field of commodity/service taxes, commonly known collectively as consumption taxes.

- Customs duty: Customs duties or import duties are levied by the central government under the Customs Act, 1962 (CA) and the Customs Tariff Act, 1975 (CTA). These duties are imposed on goods imported into India. At

present, the peak rate of customs duty is 10%. In addition, there is a levy of education cess (EC) at 2% and senior and higher education cess (SHEC) of 1%. The overall rate of customs duty with all components of custom duties (i.e. basic custom duty, counter-veiling duty and additional duty of customs) is approximately 27%.

- Central Value Added Tax (CENVAT): A tax on the manufacture or production of goods in India is imposed by the central government. It is also referred to as excise duty. At present, the peak rate of CENVAT duty is 10.3% (including EC and SHEC).
- Service tax: A tax on identified services rendered by persons defined in the statute is imposed by the central government. Present rate of service tax is 10.3% (including EC and SHEC).
- Central Sales Tax (CST): A tax on the inter-state sales or purchases of goods is imposed by the originating state. Rate of CST in case of transactions between two VAT registered assesseees is 2%¹.
- States Value Added Tax (VAT): A tax on the intra-state sales or purchases of goods is imposed by the states. There are two major slabs of VAT rate across the states—5% and 12.5% to 15%. In addition, there are some goods exempt from VAT.
- Entry tax: A tax on the entry of goods into the state is imposed by the states.

In addition, local levies, such as octroi or local area taxes, can be imposed by municipal or local authorities.

In view of the evolving nature of all of these multiple indirect taxes, it is imperative for companies operating in India to not only understand the present indirect tax regime in India but also to keep pace with changes in these areas.

¹ A rate of 2% is applicable on the fulfillment of prescribed conditions.



- **Goods and Services Tax (GST): On the anvil**

Currently, India has multiple indirect taxes with variances in several aspects such as tax rates, taxable events, the taxable base, eligible input credits, the point of eligibility of input credits, etc. This makes the indirect tax regime quite complex. There continues to be a distinction between the taxes on goods and the taxes on services. In order to integrate all of these taxes into a single unified tax system and bring about broad-based reforms in the indirect tax regime, the government of India has envisaged the introduction of a uniform Goods and Services Tax (GST) across the country. The date of introduction has not yet been announced.

As India is a federal country, in the first discussion paper on GST in India, the government recommended a dual GST model, consisting of a central GST (CGST) to be levied by the central government and a state GST (SGST) to be levied by the state governments. With the introduction of GST in India, a number of central as well as state taxes would be subsumed into the GST.

Based on the present information, the rate of GST on services is likely to be 16%, comprising both CGST as well as SGST. On the other hand, the rate of GST on goods is proposed to be at 20% (10% each for CGST and SGST). The major change in the proposed GST regime will be that credit of input GST will be available for both goods and services.

GST is likely to be a big boon for the retail sector since it will allow retailers to make use of a seamless credit on all input taxes and pass on the benefit of these tax savings to consumers. It will be a win-win situation for both retailers and consumers.

The proposed GST is an inflexion point in India's fiscal landscape and marks a transition from the existing origin-based to a destination-based taxation regime. The introduction of the dual GST is expected

to remove the present problem of tax cascading by moving to a common tax base and by subsuming various central and state taxes and levies into the CGST and SGST respectively.

One of the key challenges relating to the GST is with regard to supply chains. At present, the supply chains are impacted by several forces, some intrinsic to the organisation, some market-specific and some fiscal in nature. Fiscal considerations have historically been a key determinant of supply chain structuring in India with manufacturing bases and distribution networks engineered primarily to harness fiscal benefits. The availability of tax exemptions/benefits and the prevalence of differential taxes based on geographical locations have influenced the structuring of supply chains, procurement patterns and distribution networks. The proposed GST will significantly impact supply chains from procurement through manufacturing to distribution. In essence, GST presents both challenges and opportunities in this regard.

The existing indirect tax regime has several characteristics which negatively impact supply chains. These range from irrecoverable taxes such as the CST, complex documentation of inter-state movement of goods, entry barriers at state borders resulting in long transportation times and imposition of local levies such as entry taxes and octroi upon physical entry of goods into designated areas. These characteristics add to the cost of doing business in India.

GST moves away from origin-based taxation to a destination-based consumption tax. This means that all taxation will be based on where consumption of a good or a service takes place. Also, the taxable supplies under the GST will extend to all inter-state movement of goods, including on branch or consignment transfers not resulting in a sale of goods. This has major implications for supply chains of most companies.

These changes pose challenges for companies as to how they might engineer their supply chains so as to be GST-efficient. It is probably fair to suggest that the longer the supply chain, the more the tax points in the GST scheme of things and hence increased compliance costs. The challenge and opportunity is to thus compress supply chains for GST efficiency while ensuring that the business objectives in and around supply chains are also met. The dual GST consequently affords companies significant opportunities for re-alignment of procurement, manufacturing and distribution/sales patterns and to engineer their supply chains on purely economic considerations as opposed to fiscal considerations.

The time is therefore opportune for companies to gear up to face the challenges and also to seize the opportunities that the transition from the present tax system to the GST has provided.





Tax issues faced by retailers operating in India

We present below some of the common business issues faced by players in the retail sector:

A. A complex tax structure with varying VAT rates

Since each state has its own VAT legislation, it is very difficult for a retail company operating on a pan-Indian basis to configure different tax rates for a product. In addition, due to different tax rates, companies either have varying margins or different pricing for each state. In addition, compliance requirements under the state VAT legislation are not uniform, adding to the cost of undertaking all compliance activities between states.

The VAT system also faces a challenge in keeping pace with the variety and complexity of the number of judicial pronouncements passed by the state government and the Supreme Court.

B. Withholding tax implications on management/intercompany charges

Indian companies often enter into arrangements with their associated enterprises outside India to avail of certain common shared or pooled services within its group such as HR, IT, finance, legal, training services, etc. The purpose of entering into such arrangements is to achieve economies of scale and avoid duplication of work for the group as a whole. In such arrangements, each participant bears its proportionate share of the combined cost for availing such common shared or pooled services. Typically, the understanding among independent parties in such cases is that the cost-sharing arrangement has been entered into for mutual benefit and hence, each participant is required to make a contribution only at actual cost. The tax authorities generally scrutinise such transactions to examine the withholding tax compliance on the payer of charges. Furthermore, tax authorities also examine

the taxability of these charges in the hands of recipient.

C. Withholding tax implications of discounts given to distributors

Large groups operating in the retail sector generally enter into an arrangement with various distributors for the distribution of their products. The mechanism generally followed is that goods are transferred by the company to the distributors, who sell them to the final consumer. At times, the companies offer special discounts to their distributors to be competitive in the market and increase their market share.

The key tax issue under these arrangements is whether the discounts given to distributors by the companies is a commission by nature, and subject to withholding tax under the provisions of the Act. An important factor in determining the characterisation of the discounts given to distributors by companies is the relationship between the distributor and the company, i.e. whether the distributor is operating as an agent (an extended arm of the company) or as an independent entity acting in his/her own individual capacity. The terms of arrangement between the distributor and the company generally determine the relationship between the two. In cases where a relationship of agency is established between the distributor and the company, Indian tax authorities generally characterise the discounts given to distributors as commission subject to withholding tax under the provisions of the Act. The classification of the payments to distributors as a discount or commission is also important for computing the tax liability relating to non-compliance with the withholding tax provisions, leading to the disallowal of expenditure. Also, there could be tax, interest and penalty exposure.

D. Withholding tax implications on the distribution of gifts

In order to promote the business and increase sales, companies in the retail sector often provide their agents with scratch cards, promotional offers or gifts. These agents in turn provide scratch cards, promotional offers or gifts to the final consumer. What needs to be analysed in these arrangements is whether liability to withhold tax arises on the distribution of gifts, promotional offers or gifts under the provisions of Act.

E. Obsolescence of stock

Typically companies in the retail sector have to maintain optimum stocks of goods in order to run their business smoothly and meet the demand for products in various geographical regions across the country. Furthermore, the maintenance of optimum stock levels of finished goods is subject to quality standards. If the quality standards are not met for any reason, e.g. the expiry of shelf life of finished goods, damage of goods in transit, etc., these finished goods need to be destroyed physically and written off. The tax authorities have in the past disallowed obsolete stock written off in the books, contending that obsolescence of stock is not an allowable business expenditure or loss.

F. Prepayment of sales tax deferral

VAT laws for various states provide for deferral and package schemes of incentives. Under these, an eligible company collects the applicable VAT from its customers but pays it to the government at the end of the deferral period without interest, as part of an incentive scheme. Thus the amount of tax collected by the eligible company serves as an interest-free loan up to the period of deferment. The government has also introduced schemes in the past for the advance payment of VAT on the basis of the net present value of VAT payable after the deferment period. Thus a difference arises

between the amount of VAT collected by the company and the VAT paid by the company to the government.

The tax issue arising on the payment of the present value of VAT is whether the difference between the VAT payable after a deferment period and the present value of VAT is a capital receipt not subject to tax, or whether there is any remission or cession of trading liability by virtue of which the difference becomes taxable under the provisions of the Act.

G. Tax deductibility of advertisement, marketing and sales promotion expenses

Large companies operating in the retail sector incur significant expenditure on the advertising and marketing of their products in order to create awareness among their potential customers. These expenses are incurred in order to promote sales, make products more competitive and to further penetrate the market. Companies generally promote their products through advertisements in print or the electronic media, by incurring expenditure on the sponsorship of events, and through display materials and promotional schemes such as buy-one-get-one-free, etc.

The tax authorities have in the recent past disallowed expenditure on advertising, marketing and sales promotion activities on the basis that it is capital expenditure, and they are not merely acts of providing information about products, but also brand-building exercises of enduring benefit to companies. Tax authorities also contend that the entire aim of brand-building is to secure a larger market share and extract a premium from the customer. Therefore by advertising, companies are building intangible assets such as goodwill, reputation and credibility, which cannot be allowed as revenue expenditure.

H. Cascading effect of indirect taxes paid on input services not allowed to be set off against the VAT liability arising from sales of goods

Companies 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.

I. Customs valuations in cases of imports from related parties

Cross-border transactions between group companies are treated as transactions between related parties and closely scrutinised by the special valuation branch (SVB) of the customs department to determine whether the value declared by the importer is arm's length. The entire process of determination of values by the SVB is time-consuming, and during the interim period the importer has to pay extra duty on a provisional basis.

J. Continuation of the Central Sales Tax

Under the present system of levying taxes on inter-state sales or purchases of goods, the buyer is not eligible to credit input central sales tax charged by the seller in the originating state. This adds to the cost of procurements of the buyer. CST is intended to be phased out before the introduction of the GST regime in India, currently expected in 2012-13. In the interim, CST continues to coexist with state VAT.

K. Strict compliance requirements under state VAT legislation

There are varying compliance levels under various state VAT legislations and most of these are paper-driven. Lately, states have started to move towards the electronic payment of taxes and filing of returns. Any default in compliance results in the levying of interest and penalties.

Another important challenge is the documentation requirement in the case of inter-state movement of goods. India is a large country with 28 states and seven

union territories. The various state VAT legislations prescribe various types of documentation for bringing goods into the respective states. Complying with these requirements is generally a challenge for retail companies. In the absence of complete documentation, there are provisions for levying penalties and the detention of goods.

L. Litigation

Since formal TP legislation was enacted in India, it has become the single largest source of tax litigation for MNCs in India. Incidentally, India contributes more than 70% of global TP disputes at tribunal level and above. We have discussed below a couple of issues that have been frequently raised by Indian TP authorities and are relevant for MNCs engaged in the retail business.

One of the major TP disputes on transactions between principals and Indian distributors is the issue of marketing intangibles—who should bear the expenses and enjoy the fruits of creating marketing intangibles in the country of operation of the distributors. Marketing intangibles typically refer to benefits emanating from selling or distribution functions, e.g. trademarks, distribution or dealership networks, customer lists and relationships, etc.

One of the key concepts here is that of the ‘bright line’, which is the general threshold limit of advertising and marketing (A&M) expenses, reflected as a percentage of turnover. This is what a distributor generally incurs while selling products belonging to the principal manufacturer. The trademark relating to the product is legally owned by the manufacturer and the distributor obtains a licence to sell the branded products in the designated territory. Tax administrations have investigated cases where the distributor incurs A&M expenses, generally above the industry average or ‘bright line’. They ask whether the distributor is actually carrying out

significant additional functions compared to other comparable distributors, and whether they should be expected to receive additional rewards and remuneration, through any of the following:

- **Reimbursement of the excessive A&M expenditure by the principal, being the legal owner of the brand:** In a case where the significant personnel functions relating to A&M activities are carried out by the principal and the distributor merely develops the brand and creates the marketing intangibles in its territory for and on behalf of the principal
- **Profit split mechanism:** Where significant personnel functions relating to A&M are performed by Indian distributors and marketing intangibles are created by these distributors on their own account. In this case, the distributor goes out of the realm of benchmarking against normal distributors, having contributed significant non-routine intangibles.

The tax administrator’s concern in such a situation is understandable, as there remain opportunities for the passing-on of entrepreneurial profits related to marketing intangibles by the distributor to the principal, by loading on to the prices of imported goods and payment of brand royalties. However, the concept is being applied by tax authorities at lower levels in a mechanical manner without considering the functions, assets and risk profiles of the transacting entities. At this stage, several cases on the issue are pending before the tribunals and the outcome of this matter is difficult to predict.

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 is in relation 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 AEs are not in the nature of shareholder or stewardship services. The economic benefit has to be demonstrated by submitting documentary evidence for all services received, and their utility for 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.

3

Modern trade benefits several stakeholders and helps create a more robust retail ecosystem

Liberalising the Indian retail sector benefits multiple stakeholders.

The PwC thought leadership report titled *The Rising Elephant - Benefits of Modern Trade to Indian Economy* indicates that liberalising the retail sector will result in three major macro-economic benefits:

#1

Reducing wastage

Managing wastage in India's food supply chain is imperative.

Empirical studies in emerging market economies have shown that the growth of organised retail results in the following:

- Technology transfer to reduce wastage in the food supply chain
- Improvements to the quality of produce available in local markets since it creates local distribution channels for produce
- Benefits to local economy since local suppliers are engaged in it
- More competitively priced products for all consumers
- Fresher produce with higher levels of hygiene and quality
- Produce with a longer shelf-life

Like other developing economies, India's supply chain is fairly one-dimensional and there is very little value-added activity, since distribution remains fragmented and unorganised. India is a fragmented country with 70% of the population residing in rural areas. The ability to reach consumers and transport goods to them is challenging given the absence of robust infrastructure and logistics. Due to the presence of large local and multinational companies, India has a well-developed non-food manufacturing supply chain.

One of the arguments in favour of foreign direct investment (FDI) is that it will usher in technologies and expertise required to build robust food supply chains. In the Indian food chain, from farm to

fridge, distribution involves multiple intermediaries and wastage during transportation and storage. The current food supply chain situation in India is weak:

- Existing intermediaries cause delays and eat up a large portion of the earnings that essentially belong to the farmer, resulting in a chain replete with inefficiencies.
- Increased wastage levels are between 24 and 40%.
- Several small stakeholders (farmers, wholesalers, food manufacturers, retailers) work in silos.
- A large portion of fruits and vegetables are lost due to inadequate post-harvest handling, cold storage, processing facilities and convenient marketing channels.
- Huge quantities of grains are wasted because of improper handling and storage, pest infestation and poor logistics management.

India's food supply chain is among the least developed in the world. It is a challenge to unlock operational efficiencies, facilitate growth, reduce costs and improve the time it takes for food to move from the point of manufacture to the point of consumption. To solve these issues, robust and scalable supply chains need to be built and the government needs to make appropriate legislative changes to catalyse this transition in the food supply chain.

#2

Employment

Retail can boost employment in India.

Modern trade emerged in the 1990s and is a relatively new sector in India. Given India's attractiveness as a retail destination, foreign brands, if not already here, plan to arrive soon. In addition to global retailers, Indian incumbents have aggressive expansion plans in terms of growing their store networks, launching new formats, entering Tier II and Tier III cities, etc. To staff their operations, retailers will hire millions for front- and back-office functions. Retailers are also investing in training and creating captive training academies. Others are partnering with local business schools to create retail certification courses, where students are absorbed into retailers' operations after graduation.

FDI in retail will generate employment since new entrants will need to hire staff for operations. Most individuals currently employed by unorganised retail players do not receive healthcare, educational or other benefits. Once individuals are absorbed in retailer operations, they can access more equitable wages and benefits. The effect of modern trade will be most apparent at the bottom of the population pyramid, as it will unleash opportunities such as non-agricultural employment for rural youth and better quality of living for the existing agricultural society. Retail can be an enabler for the unemployed in urban, semi-urban and rural India.

#3

Sourcing

Retail can strengthen India's position as a sourcing hub to the world.

Global retailers have already been sourcing products from India. Their presence in the Indian market will enhance exports

from India, as they develop and leverage relationships with local suppliers. The extent of sourcing from India will increase when global retailers are allowed to operate in the Indian market. PwC's research indicates that China is the most important sourcing destination for many R&C companies. Having said that, since factors like quality control, risk profiles, innovation capabilities, logistics and existing relationships are also important, countries like the US, Germany, China, India, and Brazil are considered some of the most important future suppliers¹.

Wal-Mart plans to source 'hundreds of millions of dollars' from India². In India, Wal-Mart and its Indian partner plan to locally source a range of agricultural products. "We are already making a contribution to India's agricultural sector by working with a large number of farmers in Punjab. I am pleased to announce that Bharti Wal-Mart will be directly sourcing from 35,000 small and medium farmers by 2015," said Mike T Duke, CEO, Wal-Mart Stores Inc.³

Retailers who source locally-made products can avoid import duties and pass on better prices to consumers. Global retailers are not the only winners in the sourcing game. Domestic retailers who source locally-made products can meet market needs and remain competitive.

Some global food and grocery retailers are sourcing locally-procured food items that include fruits, vegetables, poultry, fish and lamb, as outlined in the case example below. These participants are working with local suppliers and farming communities to improve quality and hygiene levels, farming and processing practices, etc.



Sector snippets

Products that can be sourced from India include but are not limited to the following:

- Accessories
- Apparel
- Baby products
- Food and grocery items
- Footwear
- Furniture
- Textiles
- Toiletries
- Toys

¹ PwC's R&C Worlds Express, 'Growth re-imagined- Succeeding on the world stage' (May 2011)

² <http://www.reuters.com/article/2010/04/14/us-walmart-india-idUSTRE63D04320100414>

³ http://articles.economictimes.indiatimes.com/2010-10-26/news/27615345_1_bharti-wal-mart-retail-sector-rajan-bharti-mittal

Modern trade benefits several constituencies.

The benefits of modern trade to India are manifold and will positively impact several constituencies, as outlined below:

#1

Consumers

Choice, improved quality of life, better prices mean more satisfied consumers.

The growth and development of modern trade ushers in several benefits for consumers, some of which include better prices, increased product choice and an improved quality of life. Consumers are experimenting with products, brands and categories, and are trading up in their purchases, wanting to use products of good quality. Modern trade retailers, on their part, will also help consumers understand how to use products (e.g., skin creams, consumer durables and electronics, etc.). This ongoing 'education' from retailers to consumers will enable buyers to improve their knowledge and understanding of products and product benefits.

Modern trade will enable consumers to benefit from the following:

- **Price rationalisation:** Greater supply of products, increased competition, new product launches, etc., increase the flow of products into the market. As a result, prices tend to fall and become more competitive. Locally sourced products (leather, footwear, apparel, accessories, etc.) are competitively priced and price benefits can be passed onto Indian consumers. As modern trade develops, retailers will be able to source in greater volumes and will benefit from more agile and cost-competitive supply chains. This will enable them to pass on price efficiencies to consumers.
- **A zero tolerance policy for defective products:** The growth of modern trade enables the entire retail ecosystem to evolve and develop. Here, better customer service policies are created, staff is trained to focus on customer satisfaction, companies offering quality products with value succeed, etc. We observe that as the market evolves and becomes more competitive, consumers become more aware of their rights and are vocal when products do not meet their stated objectives or value propositions. This ushers in new tolerance levels for both efficiencies and inefficiencies. This, in turn, enhances the overall effectiveness of the retail industry in terms of new business practices, the pace of innovation, the availability of products and services, etc.
- **Better quality:** Modern trade helps improve the quality of products supplied by retailers, due to competition, new entrants, etc. When looking at the food supply chain, we observe several benefits when modern trade participants are able to interact directly with farmers. Modern trade players transfer best practices in grading, sorting and processing techniques, help reduce the number of intermediaries, stabilise wages for farmers, reduce final prices paid by consumers, etc. Thus, hygiene and quality of food improve.
- **'Lifestyle parity':** Liberalisation in the 90s, globalisation, exposure to the Internet and increasing incomes have fueled consumer aspirations and the desire for best-in-class products. Consumers in India now want access to the same products and services available overseas. This 'me-too' attitude has resulted in consumers demanding better products, this helping equalise standards of living between countries. This parity in product choice boosts consumption and helps level the playing field.

#2

Government exchequer

Modern trade players are tax-compliant and large tax payers.

The organised and unorganised retail sectors differ not only in their size and infrastructure but also in terms of their contribution to the government exchequer. Collecting revenue from the unorganised retail sector is a challenge for authorities:

- Kirana stores and kiosks are located across urban and rural India.
- Street vendors and rural outlets do not have a postal address.
- Most people who own and operate these stores or kiosks do not have basic education.

Sector snippets

*The PwC study entitled **The Benefits of Modern Trade to Transitional Economies** indicates that in a democracy, one of the fundamental tenets of progressive policy changes is that the main beneficiary must be the consumer. It is essential that nations, as they embark upon more sophisticated economic policies, should not be influenced by the politicisation of issues. The government can help serve as a catalyst towards providing consumers with access to products that improve the quality of life.*

The Benefits of Modern Trade to Transitional Economies puts forth the following:

- It is challenging to make *kirana* owners aware of tax laws and unrealistic to expect them to come forward and comply with tax obligations. In addition, the availability of exemption or composition schemes enabling small retailers to effectively not pay VAT of any significance leads to a large number of retailers not contributing much to the exchequer. There is also the related issue of such schemes facilitating possible tax evasion. Organised retailers, on the other hand, are both tax-compliant and large taxpayers. Given their significantly larger turnover, there is typically no means by which they will be able to avoid taxes.
- The organised retail sector also facilitates the generation of significant tax revenues by building a robust and sophisticated supply chain which impacts the logistics, transportation, warehousing, freight forwarding and other similar service sectors. These contribute to the exchequer through the payment of indirect taxes, primarily the service tax.



#3

Farmers and producers

Farmers will become integrated in the food supply chain.

A major challenge in India's food landscape is the farm-to-fork supply chain, characterised by high inflation levels, several levels of intermediaries (eg., agents, middlemen), high wastage levels, etc. Total food inflation remains a concern revealing shortcomings in distribution and marketing systems. Farmers are not being paid fair market value and consumers are paying high prices. Several studies have indicated that India can become the food basket to the world if it addresses fundamental issues in its food supply chain. These include high inflation, inadequate supply and delayed freshness.

The majority of the Indian population resides in the rural areas. Due to issues like long distances, inadequate infrastructure and the absence of a robust supply chain and logistics, the freshness and overall quality of the food is affected.

Establishing an efficient supply chain that links farmers and small manufacturers (who have limited infrastructure or distribution strength) directly with retailers will maximise the value for all stakeholders. Together with back-end infrastructure, this will minimise wastage (especially for fresh foods and vegetables), increase farmers' realisations, encourage best practices in crop management and improve food safety and hygiene.

Modern trade players will be able to work more closely with farmers to provide training in terms of best practices related to harvesting, demand forecasting, weighing, cleaning, grading and sorting, shelf-ready packaging and work towards cutting intermediaries and also automising and mechanisation. This will cut cost, increase shelf-life, preserve freshness, increase hygiene and quality.

On recognising that food inflation, quality of food and its supply are major issues, India's finance minister, through the union budget 2011-12, put in a series of measures aimed at improving the country's food ecosystem; some of which include the following:

- **The state governments have been advised to review and enforce a reformed Agricultural Produce Market Committee Act (APMC Act):** Creating a unified agriculture market in India will facilitate farm-to-fork integration and enhance efficiencies. Reforming the APMC Act will enable the following:
 - Enable direct interplay between farmers and modern trade players
 - Reduce the layers of intermediaries in the supply chain
 - Reduce wastage levels
 - Enable farmers to get a fair price
 - Reduce final prices paid by consumers
- **A series of allocations has been made for the agriculture sector which spans access to credit, interest subvention, encouragement ideas like the Green Revolution, production of palm oil and pulses and organic farming, etc.:** Many of these allocations ought to increase farm production, enable farmers to access greater funds and raw materials, reward those who pay back loans in a timely manner with interest subvention, generate further food processing gains with the establishment of mega food parks and encourage the development of storage capacity and cold chains.
- **The government proposes to recognise cold chains and post-harvest storage as an infrastructure sub-sector:** The placement of cold chain and post-harvest storage as a subsector in infrastructure will enable companies to

secure better loan terms from domestic banks. This will result in capital infusion which can be used to expand operations.

Partnership models that can be explored between farmers and modern trade include the following:

- **Contract farming:** Contract farming is likely to improve food safety since large corporates will partner with farmers to teach them best practices in crop management and food safety. This will help decrease the hazards associated with fresh foods and produce. Also, cold chain facilities which refrigerate foods, robust transportation networks, etc. will also help maintain the freshness of foods and reduce health risks.
- **Cooperative models:** Farmers, retailers and agri-universities can explore partnership models. Through collaboration, stakeholders can share best practices in harvesting, crop management, soil conservation and protecting the environment.

In addition to farmers, small and medium scale industries will benefit from the reach and distribution potential offered through organised trade. One of the main challenges faced by smaller entrepreneurs is to develop distribution strength in the local market. Also, creating a presence in other cities, states or regions is a challenge. Local entrepreneurs will benefit by supplying goods to modern trade players who buy in bulk and distribute goods to outlets across India. Small and medium scale participants will be able to extend the reach and presence of their products, across India, relatively quickly.

#4

Unorganised mom-and-pop stores (i.e., *kiranas*)

Organised and unorganised participants can co-exist peacefully.

India's retail sector is large enough to accommodate both organised and unorganised participants. PwC believes that *kiranas* can exist alongside modern trade players and can explore partnership models in a rapidly changing retail environment. Modern trade players, on the other hand, are subject to high operating costs in the form of renting land, employing people, paying for air-conditioning and bright lighting, making capital investments in IT such as retail software,

Most *kiranas* are owned and managed by small business owners and their families. *Kirana* stores are typically located in good catchment areas, and in addition to having a detailed understanding into consumer behaviour in that area, have virtually no operating costs. The operators often own the land their shop is located on and use household labour to operate the store.

CEOs of leading retail companies who participated in *The Benefits of Modern Trade to Transitional Economies* believe that as modern trade grows, *kiranas* will continue to be a major part of Indian retail. Case studies of other transitional economies indicate that globally, both organised and unorganised retail can co-exist given the different value propositions that are offered. Participants in the Indian retail sector believe that this will also occur in India.

To adapt to the developing retail sector, *kiranas* can explore a variety of options to upgrade themselves and in some cases, partner with modern trade players:

- Limited availability of credit is a major constraint for *kiranas* who are looking to expand and upgrade operations. The government can consider providing

kiranas access to credit and other means through which they can grow in an environment that is increasingly becoming modernised.

- *Kiranas*, in order to avail of competitively priced products, can enter into sourcing agreements with modern trade players for food and grocery items. This reduces costs and helps them offer competitively priced products to the customer base.
- *Kiranas* can also become franchisee partners to retailers and benefit from retailers' supply chains, promotional assistance and offers to train and upgrade staff skills. This mechanism allows *kirana* owners to become a part of a larger brand and this in turn, improves brand image and builds brand equity.

As the retail sector develops, operations of unorganised players will become more professional as they improve their merchandising. Their sales per square foot will also increase. With time, these mom-and-pop stores can also evolve into becoming convenience stores and mini supermarkets, from where they will source and procure their products from wholesale cash-and-carry stores. They can also organise themselves into buying cooperatives, thereby improving negotiation powers with suppliers. Over time, their unique selling proposition will be as follows:

- Offering a targeted assortment of goods to meet the needs and preferences of consumers in the local catchment area
- Providing a superior level of personalised customer service with deep insights into local behaviours which larger players may be unable to replicate

#5

Small vendors

Small vendors can also be integrated into modern trade.

Headload vendors are a particularly vulnerable group since many are middle-aged widows or women with little family support. They earn small profit margins and are impacted by sales from food and grocery stores, modern or unorganised. A major asset of headload vendors is their mobility since they traverse areas on foot.

Most headload and pushcart vendors require credit to fund their working capital. However, small vendors are often unable to access credit due to issues pertaining to high interest rates and lack of access to credit societies. Credit is required to fund daily and longer-term working capital needs, smooth out sales and seasonal fluctuations and also fund family needs. Some companies are embarking upon the following initiatives that involve working with headload and pushcart vendors:

- Providing marketing and branding assistance
- Providing back-end assistance to small vendors
- Offering microfinance as a means to upgrade operations

Several constituencies are positively impacted by modern trade

Farmers/producers	Consumers	Government exchequer	Unorganised trade
<p>Inefficiencies in India's food supply chain</p> <ul style="list-style-type: none"> • Several layers of intermediaries • High wastage levels (24-40%) • Lower than fair market value paid to farmers • High final prices for consumers • Agents controlling prices 	<p>Modern trade improves the quality of life</p> <ul style="list-style-type: none"> • Greater choice • More competitive prices • Better quality of food products for modern trade players to transfer best practices to local farmers • 'Lifestyle parity' where Indian products are similar to those available overseas 	<p>Increased tax inflows for the government</p> <ul style="list-style-type: none"> • Organised and unorganised trade that is different in structure, size and in terms of taxes paid to the exchequer • The challenge of revenue collection from the unorganised retail sector • Tax-compliant modern trade players who are large taxpayers 	<p>Kiranas as a major part of India's retail sector</p> <ul style="list-style-type: none"> • India's large retail sector that accommodates both organised and unorganised trade
<p>Farmers benefit from modern trade.</p> <ul style="list-style-type: none"> • Wastage is reduced. • Income flow for farmers is stabilised. • The quality of fruits, produce, dairy, poultry, etc. is improved. • Farmers are integrated into modern trade. 	<p>Consumers benefit from modern trade</p> <ul style="list-style-type: none"> • In a democracy, a fundamental tenet of progressive policy changes is that the main beneficiary must be the consumer. • As economies evolve, governments should provide for inclusive growth and minimal displacement. 	<p>The government benefits from modern trade.</p> <ul style="list-style-type: none"> • State VAT revenues increase as modern trade grows and develops. • Modern trade helps develop related sectors (supply chain, logistics, cold chain, etc.). Companies in these sectors contribute to the exchequer in terms of indirect taxes. 	<p>Unorganised trade benefit from modern trade.</p> <ul style="list-style-type: none"> • Kiranas can source food and non-food items, essential for operations, from cash-and-carry providers, benefitting from bulk discounts. • Kiranas can become franchise partners for modern trade players' neighbourhood format.

Source: PwC's The Benefits of Modern Trade to Transitional Economies

4

Succeeding in India's retail sector is a combination of choosing the right retail real estate, localising products and mastering the supply chain

Retail is a long-term play in India and success is a combination of several factors.

#1

Securing the right retail real estate

Retailers believe that the key to success lies in choosing the right real estate.

India's real estate sector is witnessing high demand across categories such as hospitality, commercial, retail, etc. Several demand and supply factors influence the growth of real estate in India:

Demand pull factors

- Robust and sustained macro-economic growth
- Surge in industrial and business activity
- Favourable demographic parameters
- Significant rise in consumerism
- Rapid urbanisation and nuclearisation
- Availability of easy financing options

Supply push factors

- Policy and regulatory reforms
- Positive outlook for global investors
- Fiscal and tax incentives to developers
- Simplification of urban development guidelines
- Infrastructure support and development initiatives from the government

Factors impacting real estate in India

Impact

- Increasing number of occupiers
- Significant rise in demand for office and industrial space
- Demand for new avenues for entertainment, leisure and shopping
- Creation of demand for new housing

Impact

- Entry of several domestic and foreign players, increasing competition and consumer affordability
- Easy access to project-financing options
- Increased developers' risk appetite and large-scale development
- Improved quality of real estate assets
- Development of new urban areas and effective utilisation of prime land parcels in large cities

A few years ago, there were not enough retail real estate options and retailers were forced to rent (high-priced) space that skewed their profitability metrics. Today, the scenario is different. Presently, there are many shopping malls in metros with little differentiation in terms of the brands present (given that the retail sector is not yet fully liberalised). To develop a strong national presence, one has to choose the right location. Your choice depends on the availability of land, consumer needs, the type and availability of products, etc.

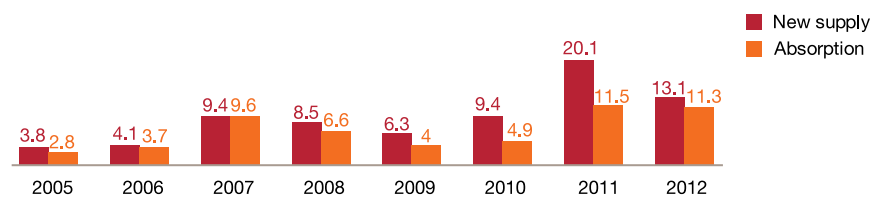
Positive market and consumer sentiments, the entry of foreign brands, incumbents' expansion plans and increasing hiring needs are driving the demand for retail space in Tier I cities. Consumer aspirations, higher incomes and better product knowledge against the backdrop of industrial growth and expansion ensure that several retailers are planning to expand operations to Tier II and Tier III cities as well.

Selected major retail real estate formats present in India include the following:

- **Five-star hotels:** These are most often used by luxury brands where accessing the 'right' customer is important (affluent travelers, well-heeled Indian consumers, etc.). India also has a 'hotel culture' where families gather at hotels for meals, wedding celebrations, festivals, fashion shows, soirees, etc. Luxury brands have capitalised upon this to target consumers who frequent hotels for recreational and lifestyle pleasures.
- **High streets:** High streets are a main part of India's retail landscape with some of the most expensive rentals in cities like Delhi and Mumbai. They are also a major part of the traditional Indian shopping experience. High streets that used to offer a range of India-made products like slippers (*jootis*), cloth bags (*jholas*), trinkets, etc. are slowly giving way

Good quality retail real estate is a fundamental aspect of retailer operations and important from several aspects:

Location	<ul style="list-style-type: none"> • Developing catchment areas offer favourable retail infrastructure • Easy access to consumers • Where there is demand for retail space and limited supply • Good infrastructure facilities like connectivity, power, water, etc.
Features	<ul style="list-style-type: none"> • Good frontage • Sufficient parking facility
Government policies	<ul style="list-style-type: none"> • Government initiatives to encourage organised retail sector • Government regulation in terms of approvals, project development standards, etc. • Support from local shopkeepers and <i>kirana</i> stores
Contracts and agreements	<ul style="list-style-type: none"> • Tie-ups with reputed developers • Contracts with efficient facility and property management companies for maintenance



Source: ibef, Kinghtfrank report on retail

- to high streets that have stand-alone stores from premium Indian and global brands.
- **Malls:** Large regional developers are expanding their reach and launching malls in newer regions. For example, one large west India-based mall developer, according to media reports, is planning to open new malls in south India. Mall developers are starting to launch mall chains and are focusing on building their brand, ensuring strong anchor tenants are in place, etc. However, most malls in India lack differentiation, an offshoot of the country's regulatory framework.
- **Discount malls:** Value malls are also expanding their presence in the Indian retail real estate sector. Some value malls straddle a double-edged positioning of both premium and mass fashion brands. These malls offer large discounts throughout the year, thereby encouraging consumers to feel that any time is a good time to shop! These malls also hold a range of promotional activities to ensure larger footfalls, especially around festivals. Value malls that offer the following are doubling footfalls, driving sales and increasing revenues from non-shopping areas:
 - Vast food courts that offer a range of cuisines
 - Large multiplexes with several screens that offer tiered pricing structures

- Family entertainment areas or kid-zones which offer video games and other activities
- **Hypermarkets:** This format is becoming popular with cash-and-carry operators as well as those in food and grocery. Usually with a mix of 40% food and 60% non-food, hypermarkets enable retailers to generate greater returns from the higher margins on non-food categories like electronics, houseware, home goods, apparel, etc. The Images Retail Report 2011 indicates that with a 40-60 mix of food to non-food, retailers should yield a blended gross margin of 18 to 19%. Most modern trade food and grocery majors have already started increasing their presence in the hypermarket area. One large food and grocery operator plans to open over 20 hypermarkets over the next two to three years, covering mostly Tier I and Tier II cities. Another food and grocery retailer plans to 'aggressively' increase both its hypermarket and supermarket presence, as well as push its private label products, planning to increase by 50% the portion of total revenue derived from private labels.
- **Luxury malls:** India's luxury malls include DLF Emporio (Delhi), UB City (Bangalore) and The Palladium (Mumbai). When these malls opened their doors, many luxury brands quickly assumed space in them. These multi-tiered malls (frescoed ceilings and valet parking included) enable luxury brands to convey the right image, attributes and positioning. Yet, these malls face the following issues:
 - Due to space constraints, in some luxury malls, premium brands and luxury brands vie for consumer attention.

- Some luxury malls have open-air entertainment, recreational areas and food courts. These food courts offer a range of dining options to attract consumers other than just pure-play luxury consumers. This often attracts non-pure luxury consumers too.

Today, a range of activities are occurring with regards to the retail real estate scenario.

- **The convergence of hospitality, residential, retail and commercial spaces:** Developers are launching mixed-use space to draw footfalls, meet consumer needs, provide a range of convenient offerings (e.g., offices, multiplexes, shop, live), etc. These mixed-use areas are being launched either as stand-alone properties or with foreign joint venture partners who have specific areas of expertise (e.g., managing service apartments). Developers are positioning these offerings as world-class in terms of connectivity, infrastructure, shopping and customer experience.
- **Development of large gated communities:** The development of large-scale gated communities across India's urban centres has led to the growth of retail real estate, mainly malls. These malls have established operations near gated communities in order to serve the thousands of people residing in these areas. Also, there is an absence of modern trade shopping formats due to difficulties in finding large enough spaces to accommodate these buildings.
- **Large number of malls slated to become operationalⁱⁱ:** At the end of Q3 2010, NCR-Delhi and Mumbai have 70% of the total retail space contributed by shopping centres in India. These cities house 127 of the 192 shopping centres currently operated

in India. Bangalore and Kolkata have a retail stock of 3.8 to 3.9 million sq ft respectively, followed by Hyderabad, Pune and Chennai. In addition to shopping centres, high streets with stand-alone outlets of established brands are prevalent across cities. 65 shopping centres (24 million sq ft) are expected to become operational during the next five quarters of the fourth quarter of fiscal year 2010 to 2011 cross the top seven metropolitan cities. Increased construction activity is occurring in Tier II markets, which are relatively underserved.

- **Revenue sharing modelsⁱⁱ:** A recent trend is the emergence of revenue-sharing where the retailer and developer determine a portion of revenue that will be paid as rent. This helps minimise the downside risk and enables both parties to share profits. Many retailers were able to re-negotiate rental rates after a brief period of a slowdown, asking for revenue-sharing models.

Anchor stores: Revenue share %

Category	Revenue share
Hypermarket	3-4
Department stores	7-8

Source: Jones Lang LaSalle, 'Indian Real Estate: An Outlook on Industry Trends'. 2011

Vanilla stores: Revenue share %

Category	Revenue share
Apparel	12-18
Footwear	15-18
Jewellery	2-2.5
Health and beauty	10-12
Food	15-20
Entertainment	8-10

Source: Jones Lang LaSalle, 'Indian Real Estate: An Outlook on Industry Trends'. 2011

#2

Localising products to delight and excite Indian consumers

R&D, innovation and new product development are emerging as key drivers of success for R&C companies. As a part of this effort, product localisation has emerged as a driver of sales, customer excitement, customer interest, etc. Indian consumers, while they want access to the same products available overseas, also want to feel that a product has been created especially for them.

Localisation can take several forms which include but are not limited to the following:

- **Creating and launching products specifically for Indian consumers:** Creating products that appeal to the local market and adhere to cultural sensitivities (e.g., not serving beef in restaurants) can boost sales.
- **Creating a store layout to appeal to Indian consumers:** Some global food and grocery companies have installed large open containers in their stores filled with pulses and grains. This is because Indian consumers typically like to touch and feel products before scooping out the desired amount and placing it in a plastic bag.
- **Making adjustments to certain production or food preparation practices:** This is perhaps most appropriate for quick service restaurant (QSR) companies, who not only avoid serving beef products in India but have also established separate vegetarian and non-vegetarian food preparation lines in outlets.

Following are the examples of localisation for both the R&C sectors, across a range of brands, categories and also price points.

Luxury

Accessories	Judith Leiber	Leiber and Indian designer Suneet Varma have partnered to create a line of minaudieres that reflect India-inspired moods, motifs and patterns.
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Fashion and accessories	A global fashion and accessories brand	This global brand introduced a limited collection of bags and shoes for the Indian market.
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Consumer durables and electronics

Media tablets	An India-based consumer electronics brand	The company launched a new range of tablets in early 2011. Positioned as India's first tablet with localised content, it was created with the Indian user in mind. The company also strengthened its back-end systems to support the product through its lifecycle.
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Consumer durables and electronics	An Asia Pacific-based consumer durables and electronics brand	The company's website indicated that it has launched a range of products customised for India. The company understands the habits of the modern Indian consumer and has designed products keeping these specifications in mind.
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Quick service restaurants

Menu items	Global QSR brands	Increasing incomes, the growth of dual income households, the desire to experiment with different cuisines, busy lifestyles, etc. drive the growth of India's QSR market. Global participants in the Indian market are witnessing double-digit growth rates, as they have localised their products to suit Indian consumers. QSR brands do not serve beef, have increased their assortment of vegetarian offerings, use local ingredients (e.g., cottage cheese) and flavours, launched spicy ranges (to cater to the Indian palate), etc.
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Food and beverages

Savoury snacks, carbonated and non-carbonated beverages	Global F&B brands	In order to appeal to the Indian consumer, two large F&B companies have created offerings in savoury snacks and beverages with a local appeal. They have even given Indianised names to the products.
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Localisation is closely related to the idea of R&D and innovation. Investing in future ideas and technologies will help create game-changing products which in turn change the dynamics of the marketplace. A range of R&C companies, especially those in the fast-moving consumer goods sector, plan to increase their R&D spend in the current and upcoming fiscal years. Companies who have set up R&D and innovation labs leverage India's technical talent and ensure that they produce for local, Asia-Pacific and global markets.

FMCG



The Hindustan Unilever Research Centre (HURC) was established in 1967 in Mumbai. It focusses on non-edible oil seeds, infant foods, perfumery chemicals, fine chemicals, polymers and nickel catalyst. Over the years, HURC

Beauty care and cosmetics



Quick service restaurants



Yum! Restaurants, the owner of brands like Kentucky Fried Chicken, Pizza Hut and Taco Bell, created the Food and Innovation Technology (FIT) Centre in Gurgaon, to invest in R&D and innovation. Yum! holds 'innovation days' twice a year where stakeholders and departments come together to create out-of-the-box ideas. Promising ideas are then tested to assess viability. From this point, new product meetings take the process forward where products selected on the innovation days are taken

Consumer electronics



Lenovo maintains a global marketing centre in Bangalore. Professionals from different backgrounds including marketing, creative, software, analytics and research work at the hub. The analytics team in Bangalore works on understanding the Lenovo customer

¹<http://www.hul.co.in/careers-redesign/careerschoices/researchanddevelopment/OverviewofResearchCentres/>

²<http://timesofindia.indiatimes.com/articleshow/7289240.cms?prtpage=1>

³http://articles.economictimes.indiatimes.com/2011-04-06/news/29388975_1_innovation-centre-innovation-labs-innovation-process

⁴http://articles.economictimes.indiatimes.com/2011-04-06/news/29388975_1_innovation-centre-innovation-labs-innovation-process

has helped create new brands and build new businesses. Significant improvements were made to manufacturing processes too. HURC's breakthrough innovations include structured bar soap, fairness cream, zero alcohol soap, poly-coated scouring dishwashing bar, fortified salt, instant tea, critical components for a water-purifying device, and value-added (nature care) tea. Many of these received significant success in the marketplace. At the same time, HURC became recognised

as one of the six global R&D centres of Unilever with the creation of Unilever Research India in Bangalore in 1997. Towards the end of 2006, with the construction of an additional set of laboratories, all the research programmes in India were integrated into a single research establishment of Unilever Research Bangalore.ⁱ

In January 2011, Jean-Paul Agon, CEO, L'Oreal indicated, "...India is really at the centre of strategy for L'Oreal for the next 20 years. After the crisis, we have redirected our strategy to certain key priorities such as recruiting one billion new consumers around the world. Definitely, we are going to find many of them in India. Number two priority is innovation and India will play an important role here as well. We are going to create a new R&D centre in India to help the team accelerate

innovation for India and for the world. But the third very important aspect of our strategy is to accelerate our international expansion. For this, we need talent. India will be a great source of talent for L'Oreal, not only for India but also for the world... We are going about our innovation process to make and design products relevant for Indian consumers. Our ambition is to increase market share every year."ⁱⁱ

through the stage gate process for further fine-tuning. Test runs are done in real-life situations to assess the viability from several perspectives (e.g., flavour, serving portions, service time taken). Vijay Sukumar, director R&D and QA at Yum! Restaurants India and head of FIT, elaborates, "It is the backbone of the innovation process and involves going through a stage gate process of approval and calibration... It also led to a few interesting learnings—the consumer still wants to share the pizza and keeping it an uncut big round pizza, as per the original plan, was not well received. Thus, the pizza was

cut and served in four pieces." FIT has also enabled Yum! to identify market gaps. For example, KFC launched Sparklers (from the KFC's Krushers range) since this was identified as a product that could help get many vegetarians, traditionally not KFC-goers, into the brand's fold. It was also introduced in India keeping climatic conditions in mind and the price points for first-time users. Also, consumer patterns were observed at pubs and bars to help hone in on new product offerings.ⁱⁱⁱ

by assessing purchase behaviour, transaction history, frequency of purchase, value of purchase, etc. The hub works closely with the company's creative agency to fine-tune communication for India and global markets. "The traditional way of doing marketing was taking up precious dollars and the idea to decentralise the function took root... We will be launching a master brand campaign across the globe soon.

The guidelines for creative work, tactics for local adoption, brochures, direct mailers, microsites, websites--everything will be done from here. The local markets can then take the prototype and adapt it to the local market before rolling it out," said Ajay Kaul, executive director, marketing services worldwide, Lenovo. The hub manages over 5,000 marketing jobs from all over the world.^{iv}

Category: Premium fashion jewellery

Swarovski: Providing Indian consumers with stylish jewellery

Sector snapshot

India's gems and jewellery sector is growing at a CAGR of 15 to 20% per annum...

India is one of the largest consumers of gold. Traditionally, Indians have always believed gold to be a sound investment. Weddings and festivals saw gold jewellery that was not worn every day, given its ornate nature.

Indians celebrate numerous festivals through the year and consider them an auspicious time to purchase gold and jewellery. Since gold and jewellery are the most popular festival gifts, retailers in India are embarking upon promotional activities to maximise revenues during this time.

While for most consumers jewellery is considered an investment Indian women today are demanding jewellery made from a mix of metals (silver, white gold, platinum) and semi-precious stones. They want to wear lighter jewellery, every day, which is also easier on the pocket!

...and is exhibiting strong growth potential in the premium and fashion jewellery segment.

Indian women want jewellery they can wear to luncheons, dinners, soirees, etc. The emphasis is on style, modernity, global appeal, quality, and brand.

Several factors are enabling Indian women to not think twice before spending hundreds of rupees on premium jewellery:

- GDP growth and an increasing number of women entering the workforce are enabling Indian women to spend on premium jewellery.
- Indian women are travelling abroad, reading international fashion magazines, looking at global fashion online and choosing more contemporary products to reflect a more modern lifestyle.
- The increased adoption of western wear has fuelled demand for trendy jewellery. These accessories complement western apparel and are appropriate to wear to many personal and professional settings.

Company profile

Swarovski: Enabling Indian women to access modern, fashion accessories

Growth rates for Swarovski's Indian operations...

Swarovski has two business units: crystal figurines and premium fashion jewellery. Here, we focus on Swarovski's jewellery business.

Swarovski entered India in 2000 and took a few years to understand the market and help Indian consumers learn about its fashion-focussed jewellery. From 2008 onwards, sales per square foot have been growing strongly and are at par with growth rates in selected Asia Pacific markets. Global and regional leadership are focussed on growing the Indian market.

... are in excess of its global growth rates!.

Given that the Indian business is growing at a healthy rate, Swarovski has two main goals:

- Increase its store network (i.e., distribution presence)
- Build brand awareness (i.e., become the top-of-mind choice for Indian women looking for premium fashion jewellery)

Offering the best value proposition is the key to long-term success.

**Understand the
Indian consumer**

Creating and offering the best value proposition is key to pleasing and understanding the Indian consumer. The best value proposition in fashion jewellery does not necessarily mean the lowest price. Consumers define value according to different parameters:

- Styling and design
- Quality
- Fashion
- Customer service
- The buying experience

Swarovski has conducted local market analysis to understand what appeals to the Indian consumer. For example, clip-on earrings that sell well in western markets do not sell in India because consumers here have pierced ears. For its Indian consumers, Swarovski selects the most suitable products from its global range. Swarovski believes that it is important to be flexible to adapt to the nuances of the Indian market.

**Localise the
product**

Localisation is important but will be done with time once Swarovski has increased its distribution strength and brand awareness in India. To localise, Swarovski will need to have a certain critical mass of sale. This will naturally occur as the market grows and as consumers gravitate toward more chic accessories. Swarovski in China has a localised range.

Swarovski will soon offer localised jewellery for Indian woman, devoid of religious intonations, so as to keep the global appeal of the brand. That said, this localised jewellery will have an ethnic twist to appeal to Indian women who are both modern but also like to celebrate their culture.

Source: Discussions with senior management at Swarovski, PwC analysis

Sector snippets

Some supply chain issues include the following:

- Presence of multiple intermediaries
- Absence of suitable infrastructure
- Lack of integration with suppliers
- Increased demand from consumers
- Reducing shrinkage
- Preventing and managing stock-outs

#3

Mastering supply chain to drive competitive advantage

According to PwC's thought leadership report *Strategic Issues for Retail CEOs*, "Mastering supply chain dynamics is critical for the growth of modern trade." Supply chains will also become essential due to the following:

- Regional variances exist in demand patterns. These result in differences in goods distributed to cities and rural areas.
- Value-conscious consumers demand lower prices. This requires retailers to be agile in moving goods efficiently and quickly through the supply chain.
- Supply chains help retailers create strong customer value propositions, such as being cost-effective, providing fresh and better product assortments and having a better reach.

India is a large and fragmented country. Further, the absence of strong infrastructure and logistics makes it difficult to reach consumers in urban, semi-urban and rural India. With the Indian government investing in state highways, logistics costs are bound to reduce. Studies suggest that logistics costs are between 10 to 12% of total GDP.

Challenges

Today, efficient management of logistics and the supply chain is not just important for survival, but a necessity for retailers to gain a competitive advantage. Looking at the rapidly evolving retail sector, it is essential to develop robust supply chains. The following supply chain issues affect retailers:

- **Inappropriate planning and forecasting:** In the race for operational excellence, optimal demand and supply forecasting determine the winners. Sub-optimal forecasting, which does not take into account seasonality, promotions and factors leading to sudden increase in demand, often lead to issues like stock-outs. High inventory levels, due to improper forecasting, also exist in the Indian retail sector.
- **Purchase, logistics and distribution:** India's large geographical distances, fragmented nature of transporters and poor transport infrastructure development are the reasons behind high lead times and transportation costs.

Also, due to the diverse location of suppliers and the presence of several large intermediaries, product costs increase artificially. This results in decreased margins for retailers. A large number of retailers lack the ability to effectively manage the less than truck load (LTL) sized shipments. Besides, the benefits of aggregation and appropriate route planning have not been fully exploited by Indian retailers. By consolidating or aggregating the goods to be distributed to various distribution centres, retailers can reduce the number of times a merchandise is handled, thereby reducing the likelihood of freight damage.

The absence of long-term relationships with transporters during peak season on spot rates also leads to an increase in product costs.

- **Store replenishment:** At times, retailers store inventory at several locations to shorten the lead time in reaching stores. With multiple distribution centres stocking the same items, difference in inventory is observed and store replenishment arrives from different centres.
- **Underdeveloped infrastructure:** Issues such as lack of good roads, communication infrastructure, electricity and water shortages and a limited number of ports impede the development of a pan-India network. Besides, the lack of a robust cold chain system also results in high wastage levels. The rugged Indian terrain and use of old vehicles by transporters further increases inefficiencies^{vii}.
- **Inconsistent tax rates:** Although the Indian government is trying to regulate it, the tax structure is heavily impeded by differential tax rates. Also, due to large geographical distances, suppliers need to operate a regional network and nation-wide redistribution centres, which in turn increase the size of supply chain. It is important to shorten this chain to save time and money. Once the tax structures are standardised, operations will be streamlined and retailers will be able to reduce costs^{viii}.



- **Skills shortage:** This gap exists in varying degrees in India's retail sector. There are very few supply chain management professionals with significant experience in the country. Retail professionals need to keep pace with the rapidly evolving retail management processes and operations, demanding customers, etc. The absence of structured skill development initiatives, lack of attraction for new recruits arising from poor working conditions in warehouses, lack of incentives and benefits, and the emergence of attractive alternate career options also aggravate the issue.
- **Technology implementation and usage:** It is a challenge for organisations to achieve their business goals due to inefficient implementation of IT systems in vendor management, merchandising and inventory management, supply chain management, warehouse management, business intelligence, customer relationship management, stores management, etc. Further, forecasting demand becomes difficult in the absence of proper knowledge and skills among users to feed data into the various IT systems, to retrieve historical data, analyse and create meaningful results. This, in turn, results in stock-outs, low inventory turns and a high pilferage rate. Proper and efficient usage of the IT systems will help derive meaningful results out of the available data. This will create efficiencies across the value chain and help meet the critical demand and supply issue, thereby benefitting all stakeholders^{ix}.

Gaining the competitive edge

Creating efficient supply chains and achieving competitive advantage for retailers is a function of the following:

- **Integrating vendor-managed inventory (VMI) programmes with**

planning and forecasting processes:

In VMI programmes, the vendor, or supplier, takes complete responsibility of maintaining the inventory at the buyer's, or retailer's, premises. The vendor's representatives are also present at the supplier's premises to help gather important information regarding market trends. VMI programmes also help reduce problems of stock-outs and excess inventory at the buyer's premises. Creation of a collaborative VMI and replenishment programmes aid in enhancing planning efficiency, maintaining appropriate levels of inventories, risk-sharing for unsold inventory between vendors and buyers and providing better customer service.

- **Integrating components of the value chain:** It is important for participants in the value chain to integrate activities and work together. Manufacturers should work in close association with service providers, distributors, wholesalers and retailers. Indian retailers can follow examples set by global retailers who have embarked upon backward integration and have developed captive logistics, transports and warehouse capabilities^x.
- **Using a multimodal transport network:** Currently, a majority of the goods in India are transported through the extensive road network. A multimodal transportation network involving a combination of roads, rail, air and water needs to be explored. This can help overcome some of the bottlenecks experienced during road transportation^{xi}.
- **Encouraging skill development:** Considering modern trade emerged in the 90s, the organised retail sector in India is relatively young. Retail talent is still developing and some large retailers are establishing training academies for

hiring new recruits. Retailers also need to invest in training and development of their employees in areas of vendor management, merchandising and inventory management, supply chain management, warehouse management, business intelligence, customer relationship management and store management^{xii}.

- **Using innovative techniques in retail logistics:** Voice-based technologies have been created to increase the efficiency of the logistics and supply chains across industries. These solutions are being used by retailers in warehouses and sales-floors. They aid in monitoring real-time sales, collecting data inventory, tracking schedule changes, meeting requests, improving worker productivity, etc.
- **Utilising technology:** Modern logistics and supply chain management are not limited to the flow of merchandise in packed boxes and packets but are dependent on the flow of information. Monitoring and controlling appropriate and authentic information can enable retailers to match demand and supply. Companies should invest in technology to store and retrieve key data for successful forecasting. The need of the hour is to adopt best-in-class IT systems across the retail value chain such as merchandise, financial planning and forecasting systems, vendor and merchandise management systems, warehouse management systems, logistics and channel management systems, customer relationship managements systems, RFID, etc. These are also essential in generating efficiencies for retailers^{xiii}.



IT optimisation

IT optimisation and effectiveness is an area most retailers need to focus on. As the retail market evolves and becomes more crowded, supply chain systems and IT optimisation will be key to remaining agile, reducing costs and being successful in the long term. In India, the use of IT is confined to the organised sector, a small proportion of the retail industry. In general, mid-sized players are only using point-of-sale (POS) and basic systems like stores software, SKU software, etc. However, small modern retailers have hardly made investments in IT infrastructure.

Barcode scanning was the first major technology application adopted by Indian retailers that ushered in a new level of automation to front-end point-of-sale processes. Using scanning technologies made cashiers more productive, reduced the number of errors at the register and made the inventory and buying trends more visible and accurate. India's retail sector has undergone several technology evolutions to enable retailers to increase efficiency,

improve customer service and become more competitive. India's retail sector, today, is advanced in its adoption of basic IT systems and infrastructure like ERP, networks etc. Medium and large retailers are in the process of establishing robust transaction systems including suitable POS systems, merchandise management systems, CRM systems, and radio-frequency identification (RFID) technology to avoid pilferage.

In today's competitive market, modern trade participants are relying more on IT solutions to manage the rapidly changing business scenarios and rising customer demand. Huge investments are being made in updating IT infrastructure. According to Cisco India, "Of the total investments made by Indian retail companies, approximately

4 to 10% is invested in IT and within this, approximately 30 to 40% is meant for networking infrastructure."^{xiv}

Most Indian retailers need to use advanced IT products and solutions like replenishment planning, world-class supply chain and logistics management systems, business intelligence and analytics systems, warehouse management systems, etc. The growth of the Indian economy is bringing about several changes in consumer demand and purchase patterns. The Indian retail market is difficult to predict, consumers are evolving, retailers are expanding operations, further driving the need for IT adoption.

Technology components required by retailers

Retail Business Processes	Supporting IT Infrastructure					Decision Support	
Planning and Forecasting	Financial Planning and Forecasting	Merchandise Planning and Forecasting			Supply Chain Management		Business Intelligence Solutions and Analytics
Purchase	Vendor Management	Purchase Order Management	Merchandise Management	Item Cataloging Management			
Logistics	Distribution Centre Management	Logistics Management	Channel Management	RFID Technology			
Storage	Warehouse Management	Returns Management	Replenishment Management				
	Inventory Management	Dispatch Management	Stock Transfer Management				
Sales	Point of Sale Solutions	E-commerce Solutions					
Support Systems	Knowledge Management				MIS		
	Financial Management	Human Resource Management		Loyalty Programs, Schemes and Promotions	Legal and Contracts Management		
Customer Relationship	Customer Relationship Management						

Source: PwC analysis

Some of the key innovations that have occurred in India's retail sector include the following:

RFID technology

- It enables organisations to become more efficient in tracking goods and assets, optimising inventory levels and improving asset visibility.
- It can be used for customer identification by issuing smart cards embedded with smart chips. These RFID-enabled cards provide information such as buying preferences, shopping behaviour, etc.
- There are privacy concerns related to the use of RFID which must be addressed to fully utilise the potential of the technology.

Case study

The use of this technology helped enhance Wills Lifestyle's existing processes such as reducing time-to-market, managing material efficiently and bringing more accuracy in books as compared to physical inventory. The chain's apparel products used to slow down when they reached the warehouses. Each day that a box of clothing remained shelved in the warehouse, was a day less on display and worth 10 hours less in making a sale. With traditional manual practices, there was only so much that the retailer could do to reduce its time-to-market cycles. Looking to streamline operations, the chain identified RFID as the solution that could increase the company's responsiveness. Today, it takes the company between 20 to 30 seconds to inventory 30 to 35 garments (about one box) compared to the five and eight minutes it took earlier. Currently, on a given day, each worker can handle between 2,000 and 3,000 garments from the earlier 300 to 400.^{xv}

Open source security solutions

These solutions enable retailers to secure their applications and improve operational efficiency and agility.

Case study

Trent improved its security with a more flexible and cost-efficient open source solution. Since then, the retailer has brought in new functionalities to their POS system and increased the speed of deployment. This has improved their time-to-market and enabled them to adopt new functionalities across stores, ahead of their competition. For instance, when the company's marketing team rolled out a new customer loyalty programme, the IT team made a simple change to its POS and the programme was deployed across 42 stores in just two days. This was a tremendous improvement given that it used to take 20 days to roll out a new release across stores. Over a timeframe of four to five years, the retailer's operating expenses were reduced by 40%. With the deployment of the open source project, the retail team increased its operational agility and security infrastructure.^{xvi}

Cloud computing

For retailers seeking to gain greater results using minimal resources, cloud computing is like a miracle. It allows retailers to invest less in maintaining, monitoring and updating shared working documents, email and operational data. It enables them instead to focus resources on store portals, social media, digital marketing, etc. Retailers have been quick to realise the benefits that cloud offers.

Cloud computing enables retailers to efficiently manage seasonal and unexpected demand and weather-disastrous events. In a typical IT environment, retailers need to scale fixed data centre resources prior to demand spikes. This leads to wasted capacity and increased costs. Even worse, it can mean an under-supply, with network outages and crashed servers. However, by taking advantage of cloud computing, retailers can adjust to this dynamic demand. With cloud computing, retailers only have to pay for the level of service they need, without the costs of unused or under supply capacity.

Lastly, cloud computing transforms how retail employees collaborate and share information. By implementing a hosted intranet with messaging, online meeting and social networking tools that span time zones and geographies, employees can collaborate more effectively, whether in the field, at headquarters or with a supplier. Cloud computing improves information flow and enables retailers to spend more time interacting with consumers.

Case study

The leisure chain Oxford Bookstore increased its revenue by INR 3.4 crore by using the SaaS ERP. Prior to this, issues like excess purchases, over-stocked SKUs and slow-moving inventory plagued the retailer. There were significant inefficiencies with the POS function and since the inventory management system was not integrated with the POS system, the company lacked control over its inventory. With dispersed retail operations and increased volume of transactions, the main challenge was to find a way to regulate processes and manage transactions. The company decided to implement a SaaS-based ERP to resolve the challenges. Today, the ERP-SaaS project has centralised the entire product titles across all branches into a single directory controlled by the ERP. The ERP also covers the company's payroll, accounting needs and web tools. The investment of INR 1.08 crore in the ERP-SaaS increased footfalls by 25% and bill size by 20%. Profits were spectacular on the e-platform too. Online sales increased by 100% and revenues grew by 50%. Other aspects of managing the business, like operating a CRM system, loyalty programmes and discount schemes, have become easier.^{xvii}

Innovations used by retailers globally

- **Mobile POS:** This technology enables consumers to purchase goods while putting them in a shopping cart. The customer is spared the hassle of standing in long queues.
- **Digital signage:** Static signboards have not proved beneficial in terms of helping a customer track a product. Digital signboards integrated with an automated tracking system are expected to make this tracking easier.
- **Intelligent database:** Today, with technology advancements, a detailed database of customers can be made available online, to help the retailer understand a particular customer's buying characteristics and preferences.

Indian and global IT service providers are working on a range of other retail innovations such as hi-tech store solutions, mobility solutions, shopping assistants, etc. that will ease daily operations and provide retailers the much needed competitive advantage.

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Looking ahead

The Indian retail sector is evolving rapidly and those who enter the market now can learn about local dynamics, develop market insights and establish leadership positions





Patience, deep pockets, localisation and market evolution

Now is the right time to enter and establish operations in India's booming retail sector. Domestic and global retailers who have already entered the Indian market are learning about consumer wants, preferences and needs. This is an important education for retailers and brands looking to establish leadership positions. We provide an insight into the four key areas of focus for the coming decade:

#1

Understanding consumers needs, preferences and wants

- Consumers vary by region, state, city and street. It is critical to understand local market dynamics and ensure that product assortments at the store level can meet these needs.
- Creating localised products will help drive purchases and increase sales.
- Data derived from loyalty programmes will help retailers understand consumer behaviour.

#2

Operating stores efficiently and profitably

Mastering supply chain systems

- Operating stores and managing operations will lead to cost competitiveness. Passing on the best prices to consumers include the following:
 - Finding the right merchandise mix for stores by catchment area
 - Using IT to optimise systems
 - Incorporating logistics, warehousing, transport and cold chain
 - Reducing shrinkage
 - Securing the right retail real estate

#3

Serving value-aware consumers

- Indians are not always looking for a bargain. Recognising this, retailers and brands need to offer value in quality, style and price.
- Offering a comprehensive range of food and non-food private labels will address this demand-supply gap in the market. Private labels will also become more sophisticated in their look-and-feel. Retailers will use their private label portfolios as a means of differentiating and standing out in the market.

#4

Evolving with the market

- With the emergence of modern trade in the 90s, India's retail ecosystem is evolving rapidly. Good customer service policies, loyalty programmes and promotional offers will be a significant part of the retail landscape.
- The sector will eventually liberalise and when it does, several benefits will flow to stakeholders (consumers, unorganised trade, farmers, producers, the exchequer, etc.). When the sector opens further, we expect to see some consolidation as market dynamics take over to create a more competitive marketplace.

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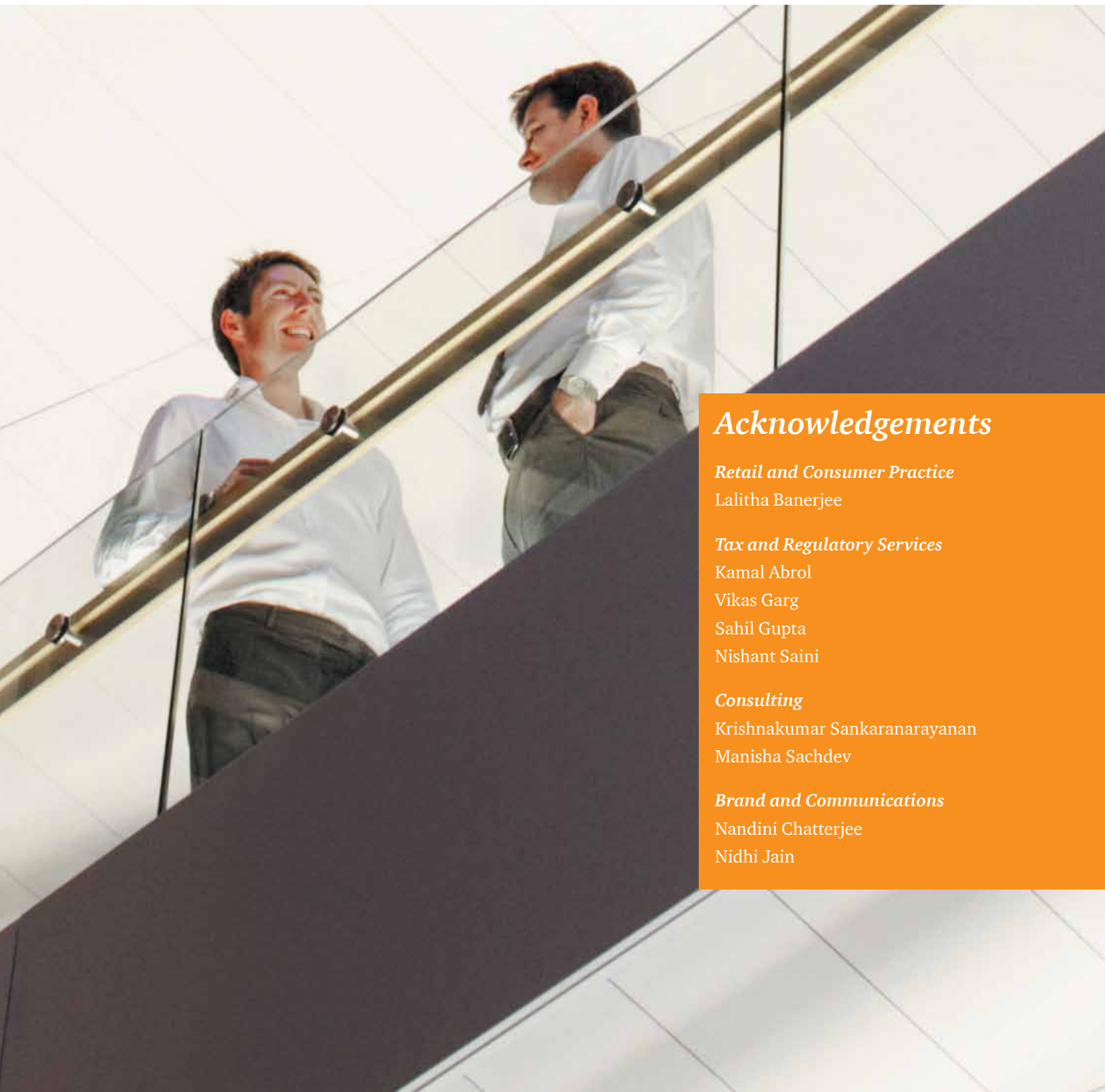
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