Understanding Retail Challenging Issues

Making the right choices is critical in maximising the diverse opportunities of the retail sector, says **S.V. Divvaakar**

India's retail sector is on the verge of a massive boom. There exist opportunities for all formats – be it supermarkets, discount stores, cash and carry players or single brand outlets. However, in order to maximise this opportunity retailers need to make the right choice about location and pricing. This article sheds light on the experiences, challenges and trends in organised retail.

Organised retail in India is still a nascent industry. The estimated revenue turnover of USD 12 billion in 2006, accounted for less than 5 per cent of total retail consumption in India. Presently, the market is estimated to be USD 270 billion, but remains dominated by small format retail outlets. Yet, organised retail is among the fastest-growing sectors and has grown nearly 40 per cent per annum over the past three years. Further, by 2010, organised retail is projected to have revenues of USD 45 billion. Underlying this potential explosion are approximately USD 30 billion in investments from India's largest conglomerates. These include the Reliance Group, the house of Tatas, the Birla group, and Bharti, among others. Furthermore, while today organised retail formats have an estimated floor space of 100 million sq ft, spread over less than 200 malls, 100 hypermarkets,

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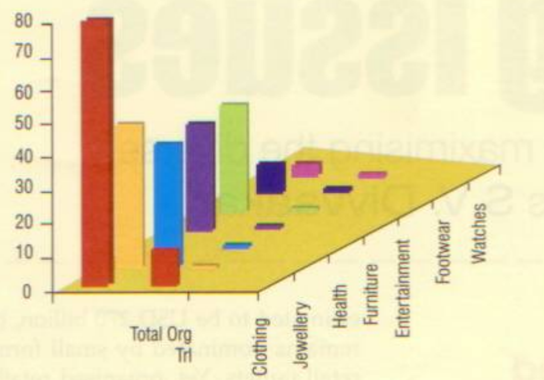
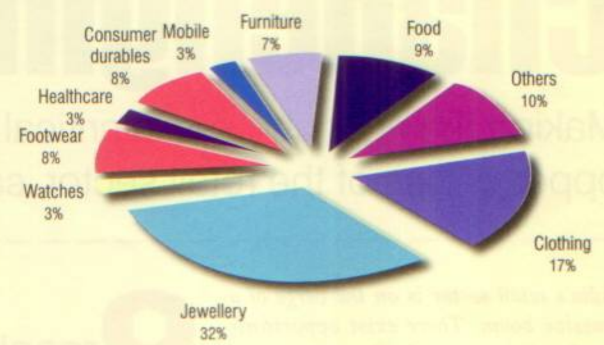
Organised Retail Share Category, Rs bn



Organised Retail Breakup by Category



500 department stores and 2000 super markets – this retail space is expected to rise five-fold by 2010. In order to avail of the opportunities that the organised retail presents, players will have to understand the challenges presented by each format.

Location is the key when a retailer is seeking to provide a convenient and elegant supermarket experience. Unfortunately, for players in this format, the ideal location has gotten impossible to procure. Rapidly changing zoning laws in major metros - and demolition drives - have often restricted the location options and thereby altered the economics of this format. One must not forget that supermarkets are a low margin high volume business and costs are important to control. Indeed, a good location is so scarce that the value proposition offered by a supermarket – its easy to access location and spacious shopping experience – is now increasingly undermined. The first reaction of certain segment of retailers has been to set up shop in what are, arguably, 'second choice' locations. This is the reason we increasingly see supermarkets amidst offices, in basements, in warehouses, and adjoining the local wholesale fruit markets, etc. Retailers must realise that in the long

Single brand outlets and foreign brands

In matching product/brand with format, exclusive single brand outlets represent the best option for foreign brands. This is especially true for high end luxury brands. Combining the two gives the retailers' four advantages:

First, the luxury retail industry thrives on its premium and exclusive evocations and not its ubiquitous-ness. The setting for such brands is more likely to be confined to hotel lounges, or ultra premium down-town real estate, with not more than three-four outlets per city. For instance, the clothing brand Zegna has indicated that there would not be more than 3 stores each in Mumbai and Delhi. As a result, these formats would not drive up real estate prices and demand, unlike the mass retail formats, which have been major buyers of commercial land in Delhi and Mumbai.

Second, given their enormous brand premium, luxury brands do not need to poach on the value chain, unlike other large format retail models, which depend on mass disintermediation from farmer to consumer, and can often involve exploitative negotiations. One hears that the sourcing strategy of India's most aggressive emerging retail chains is threateningly simple: 'your quantity, our price…' On the other hand, luxury goods marketers, by virtue of the premium prices of their wares, bring larger retailer margins per unit.

Third, luxury brand retail ventures are most likely to be dealing in proprietary luxury goods sourced internationally and not from the domestic market. For instance, Cartier accessories, (sunglasses, pens, lighters, watches) sold in any outlet worldwide, are most likely to be supplied out of global manufacturing facilities in France, Italy or Hong Kong. Therefore, they are not expected to impact domestic markets significantly, unlike experiences emerging from mass retail formats.

Fourth, FDI in single brand retail is an effective way to reduce smuggling and resultant loss of customs revenues, and also counter the problems faced due to import and sale of spurious goods, a major concern of the ultra luxury brands.

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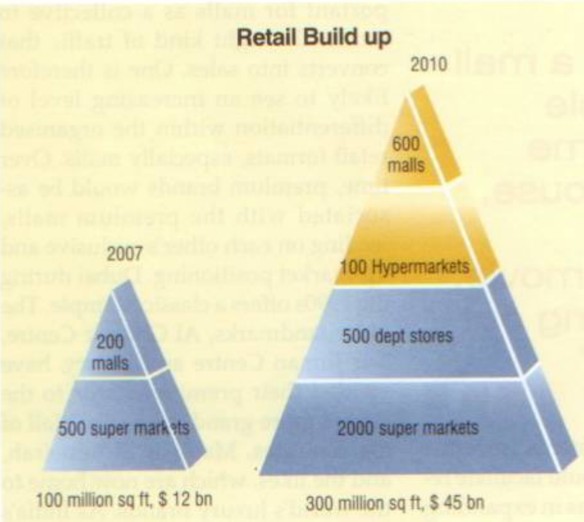

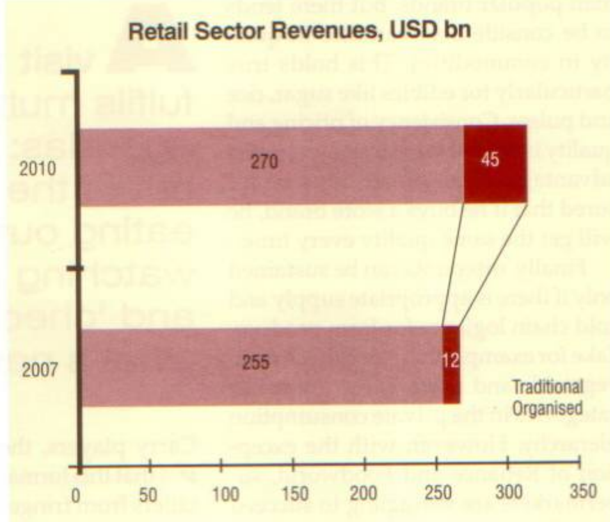

term, a second choice location will detract from the shopping experience and fail to bring in business. Instead of insisting on locating in large metros in hopes of attracting big spenders, retailers should look seriously at Tier II cities and their expanding suburbs. It is these locations that present an economically viable alternative both in terms of cost and appropriateness of location. A focus on these fringe markets, as oppose to a rush to set up in cramped big metro location need to be seriously considered.

A variant of supermarkets, discount stores such as Subhiksha and Big Bazaar have a strong magnet – price! Further, aggressive pricing, coupled with the new self-shopping experience, has enabled these brands to attract the price-conscious city consumer. No wonder, supermarkets and discount stores have done extremely well in middle-class locations. Discount stores have been particularly successful in metros in several southern states known for their 'value-shopping' culture. Discount stores are also poised to be the mainstream format for daily essentials in all new colonies and townships, and are likely to become the favorite launch grounds for new brands. Notwithstanding this success, discount stores have some disadvantages that need to be addressed for long term sustainability.

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One, currently, price discounts are restricted to few brands and fewer SKUs. And therefore it is quite likely that the discounted items may not be the preferred choices for the buyer! The price advantage also usually comes with a higher-volume compulsion! Discount stores often force larger denomination SKUs than are necessary. As a result, the average outlays are higher in discount stores, even for the most ubiquitous products. A first hand experience lends a good example. At my new swanky neighborhood supermarket, I could buy my usual shoe polish brand, but only in brown and only in sets of three, though the price was 33 per cent less than my usual corner store. Pity, I only wear black shoes! I also had to buy my preferred mouthwash brand in a 750 ml pack, and have had a problem finding place for it on my toiletries rack. The big challenge for discount stores is to change the consumer's inventory habits: the value-conscious Indian homemaker usually follows a monthly cycle for grocery lists, and tops it up weekly for stock outs. Carrying a higher inventory level than is needed for the month would need a significant inducement.

Two, store brands offer better prices

Format-wise, growth trends are estimated to be:

Format	Growth rate%	Main players
Specialty	45	Landmark, Croma, Reliance Digital, Health & Glow
Supermarket	45	Food World, Reliance Fresh, Farm Fresh, Trinetra
Hyper market	36	Bharti Wal-Mart, Big Bazaar, Spencer Hypermarket, Raheja Hyper City
Discount Store	27	Big Bazaar, Subhiksha, Metro (Cash & Carry)
Department Store	18	Westside, Shoppers Stop, Pantaloon, Lifestyle, RPG Retail

than popular brands, but there tends to be considerable variance in quality in commodities. This holds true particularly for edibles like sugar, rice and pulses. Consistency of pricing and quality is crucial to sustain a long term advantage. A consumer must be assured that if he buys a store brand, he will get the same quality every time.

Finally, discounts can be sustained only if there is appropriate supply and cold chain logistics for farm produce. Take for example the case of fresh fruit, vegetable and meat. These are major categories in the private consumption hierarchy. However, with the exception of Reliance and Foodworld, supermarkets are struggling to succeed in fresh produce retailing. At present, most supermarkets source vegetables from the city wholesale markets, the same as the conventional hawker who brings the produce to the doorstep in the morning, before the supermarket opens. Such a model cannot be sustained. Delays of supplies, differences in quality and even lack of sufficient quantities will eventually turn customers away. Thus, retailers in this segment should consider investing heavily in cold storage and supply chain infrastructure.

Untapped opportunity

Cash and Carry, a concept based on self-service and bulk buying, targeted at institutional customers - retailers, hotels, restaurants, caterers and other business professionals - is still an under developed opportunity in India. At present, the only players are large multinationals. Germany based METRO has operations in India, although Mitsubishi and a few other foreign brands have received approvals. Internationally, Cash and Carry differs from the conventional wholesaler distribution model in two aspects. One, transportation is done by the buyer and two, transactions involve no credit. These two advantages are however, redundant in most parts of India. In Tier II cities and in rural markets there has never been any credit and goods are largely collected from a warehouse by the buyer on a weekly off day in the market.

The real opportunity for Cash and Carry players, then, stems from the fact that this format would facilitate retailers from fringe areas in expanding their product range and also throughputs (from single point collection for a large range of product categories). Further, disintermediation arising from a Cash and Carry format (manufacturer- C&C chain, retailer) can also make it viable for smaller hinterland retailers to stock up appliances, electrical and electronic goods, which tend to have rather low trade margins. If the real value of Cash and Carry format is grasped then this segment is poised to be a strong contender in rural markets, particularly for second-tier brands.

A visit to a mall fulfils multiple agendas: time out of the house, eating out, watching a movie, and 'checking out what's new'

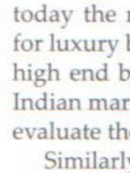
Malls are the most tangible evidence of the growth in organised retail. The question of whether they are economically sustainable as a whole or for individual shop owners remains to be answered. The simplest reason to doubt this is the very fact that foot traffic doesn't necessarily turn into ringing cash registers. Indeed, window shopping has been a long standing tradition with India's middle class, and malls have only made it a more enjoyable and comfortable experience, especially in summer.

Further, retailers must remember that even today, a large share of the Indian middle class looks forward to a visit to the mall - a visit to a mall fulfils multiple agendas: time out of the house, eating out, watching a movie, and 'checking out what's new'.

Future trends

Over the course of the next five years, it will therefore become important for malls as a collective to attract the right kind of traffic that converts into sales. One is therefore likely to see an increasing level of differentiation within the organised retail formats, especially malls. Over time, premium brands would be associated with the premium malls, feeding on each other's exclusive and up-market positioning. Dubai during the 1990s offers a classic example. The older landmarks, Al Ghurair Centre, Bur Juman Centre and Lamcy, have yielded their premium status to the newer, more grandiose malls: Mall of the Emirates, Madinat El Jumeirah, and the likes, which are now home to the world's luxury brands. As India's organised retail matures, we too shall have super deluxe malls displaying the most exclusive global brands, which would in all probability not be available in other locations (it is rare to find a brand like Rolex in more than five locations in any city). The emergence of deluxe malls would seriously challenge hotel arcades, which are today the most high profile settings for luxury brands. It is imperative for high end brands poised to enter the Indian market to pause and seriously evaluate their format and location.

Similarly, specialty retail, focusing on specific product categories – furniture, jewellery, electronic goods, etc, will also be concentrated in specialised malls. By virtue of their concentrated offerings, it will then be specialty malls that will enjoy higher mind share in their theme categories. Consumers will demand choice and these malls, perceived as brand-neutral, in comparison to standalone retailers or exclusive dealer outlets, will provide that. I creasingly, buying of products like plasma screens, refrigerators, cameras, jewellery, watches, can be expected to move to specialty malls, lured by a wider choice, assisted selection, and special price offers. ■



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