Chapter 4

Challenges for the Retail Sector in India

The challenges facing the Indian organized retail sector are various and these are stopping the Indian retail industry from reaching its full potential. The behavior pattern of the Indian consumer have undergone a major change. This have happened for the Indian consumer is earning more now, western influences, women working force is increasing, desire for luxury items and better quality. He now wants to eat, shop, and get entertained under the same roof. All these have lead the Indian organized retail sector to give more in order to satisfy the Indian customer.

The biggest challenge facing the Indian organized retail sector is the lack of retail space. With real estate prices escalating due to increase in demand from the Indian organized retail sector, it is posing a challenge to its growth. With Indian retailers having to shell out more for retail space it is effecting there overall profitability in retail.

Trained manpower shortage is a challenge facing the organized retail sector in India. The Indian retailers have difficulty in finding trained person and also have to pay more in order to retain them. This again brings down the Indian retailers profit levels.

Single-brand retail reforms approved

On January 11, 2012, India approved increased competition and innovation in single-brand retail. The reform seeks to attract investments in production and marketing, improve the availability of goods for the consumer, encourage increased sourcing of goods from India, and enhance competitiveness of Indian enterprises through access to global designs, technologies and management practices. In this announcement, India requires single-brand retailer, with greater than 51% foreign
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ownership, to source at least 30% of the value of products from Indian small industries, village and cottage industries, artisans and craftsmen.

Mikael Ohlsson, chief executive of IKEA, announced IKEA is postponing its plan to open stores in India. He claimed that IKEA’s decision reflects India’s requirements that single-brand retailers such as IKEA source 30 percent of their goods from local small and medium-sized companies. This was an obstacle to IKEA’s investment in India, and that it will take IKEA some time to source goods and develop reliable supply chains inside India. Ikea announced that it plans to double what it sources from India already for its global product range, to over $1 billion a year, within three years. IKEA in the near term, plans to focus expansion instead in China and Russia, where such restrictions do not exist.

This have made the entry of global retail giants to organized retail sector in India difficult. This is a challenge being faced by the Indian organized retail sector. But the global retail giants like Tesco, Wal-Mart, and Metro AG are entering the organized retail sector in India indirectly through franchisee agreement and cash and carry wholesale trading. Many Indian companies are also entering the Indian organized retail sector like Reliance Industries Limited, Pantaloons, and Bharti Telecoms. But they are facing stiff competition from these global retail giants. As a result discounting is becoming an accepted practice. This too bring down the profit of the Indian retailers. All these are posing as challenges facing the Indian organized retail sector.

The industry is facing a shortage of middle management level professionals. Major retailers are hiring aggressively from the similar and smaller organizations by offering better packages. They are creating various levels of management and hiring on a spree. Some of the areas such as technology, supply chain, distribution, logistics, marketing, product development and research are becoming very critical for the success of the organizations. All of these would lead to the recruitment of highly professional people who specialize in these fields. There is also a trend for hiring hotel management graduates, though now many retail schools are coming up, and Pantaloon has set up links with major business schools from where it would be selecting the right candidates.
Challenges of Retailing in India

Retailing as an industry in India has still a long way to go. To become a truly flourishing industry, retailing needs to cross the following hurdles:

• Automatic approval is not allowed for foreign investment in retail.
• Regulations restricting real estate purchases, and cumbersome local laws.
• Taxation, which favours small retail businesses.
• Absence of developed supply chain and integrated IT management.
• Lack of trained work force.
• Low skill level for retailing management.
• Intrinsic complexity of retailing – rapid price changes, constant threat of product obsolescence and low margins.

The retailers in India have to learn both the art and science of retailing by closely following how retailers in other parts of the world are organizing, managing, and coping up with new challenges in an ever-changing marketplace. Indian retailers must use innovative retail formats to enhance shopping experience, and try
to understand the regional variations in consumer attitudes to retailing. Retail marketing efforts have to improve in the country - advertising, promotions, and campaigns to attract customers; building loyalty by identifying regular shoppers and offering benefits to them; efficiently managing high-value customers; and monitoring customer needs constantly, are some of the aspects which Indian retailers need to focus upon on a more pro-active basis. Despite the presence of the basic ingredients required for growth of the retail industry in India, it still faces substantial hurdles that will retard and inhibit its growth in the future.

One of the key impediments is the lack of FDI status. This has largely limited capital investments in supply chain infrastructure, which is a key for development and growth of food retailing and has also constrained access to world-class retail practices. Multiplicity and complexity of taxes, lack of proper infrastructure and relatively high cost of real estate are the other impediments to the growth of retailing. While the industry and the government are trying to remove many of these hurdles, some of the roadblocks will remain and will continue to affect the smooth growth of this industry. Fitch believes that while the market share of organised retail will grow and become significant in the next decade, this growth would, however, not be at the same rapid pace as in other emerging markets.

<table>
<thead>
<tr>
<th>Factors</th>
<th>Description</th>
<th>Implications</th>
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<tr>
<td>Barriers to FDI</td>
<td>□ FDI not permitted in pure retailing</td>
<td>□ Absence of global players</td>
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<td></td>
<td>□ Franchisee arrangement allowed</td>
<td>□ Limited exposure to best practices</td>
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<td>Lack of Industry Status</td>
<td>□ Government does not recognize the industry</td>
<td>□ Restricted availability of finance</td>
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<td>□ Restricts growth and scaling up</td>
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<td>Structural Impediments</td>
<td>□ Lack of urbanization</td>
<td>□ Lack of awareness of Indian consumers</td>
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<td></td>
<td>□ Poor transportation infrastructure</td>
<td>□ Restricted retail growth</td>
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<td></td>
<td>□ Consumer habit of buying fresh foods</td>
<td>□ Growth of small, one-store formats, with unmatchable cost structure</td>
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<td>□ Administered pricing</td>
<td>□ Wastage of almost 20%-25% of farm produce</td>
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<td>High Cost of Real Estate</td>
<td>□ Pro-tenant rent laws</td>
<td>□ Difficult to find good real estate in terms of location and size</td>
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<td></td>
<td>□ Non-availability of government land, zoning restrictions</td>
<td>□ High land cost owing to constrained supply</td>
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<td></td>
<td>□ Lack of clear ownership titles, high stamp</td>
<td>□ Disorganized nature of transactions</td>
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<td>Supply Chain Bottlenecks</td>
<td>□ Several segments like food and apparel reserved for SSIs</td>
<td>□ Long intermediation chain</td>
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<td>□ Limited product range</td>
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<table>
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<tr>
<th>Challenges with Infrastructure and Logistics</th>
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<td>The lack of proper infrastructure and distribution channels in the country results in inefficient processes. This is a major hindrance for retailers as a non-efficient distribution channel is very difficult to handle and can result in huge losses. Infrastructure does not have a strong base in India. Urbanization and globalization are compelling companies to develop infrastructure facilities. Transportation, including railway systems, has to be more efficient. Highways have to meet global standards. Airport capacities and power supply have to be enhanced. Warehouse facilities and timely distribution are other areas of challenge. To fully utilize India's potential in retail sector, these major obstacles have to be removed.</td>
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Supply Chain Management

The retail scenario is characterized by logistical challenges, constant changes in consumer preferences and evolution of new retail formats. All this increases the challenges faced by the industry. Various strategies are to be implemented to improve core business processes, such as logistics, innovation, transparency, distribution and inventory, management of point sale (POS) data. Retail majors are under serious pressure to improve their supply chain systems and distribution channels and reach the levels of quality and service desired by the consumers.

Frauds in Retail

It is one of the primary challenges the companies would have to face. Frauds, including vendor frauds, thefts, shoplifting and inaccuracy in supervision and administration are the challenges that are difficult to handle. This is so even after the use of security techniques, such as CCTVs and POS systems. As the size of the sector would increase, this would increase the number of thefts, frauds and discrepancies in the system.

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**Lack of Adequate Infrastructure Facilities**

It is well recognized that, with its present state of physical infrastructure, India will be hard pressed to sustain 7 percent plus annual GDP growth over the medium term. Be it in power, roads, ports, airports, water, railways, urban facilities or even telecoms, the country’s infrastructure needs are enormous. There is a massive and urgent need to increase investment in these sectors. Underdeveloped supply chains, lack of strong cold chains, poor warehousing facilities, bad roads, etc. have been contributing to increased logistic costs for the retailers. Globally, the logistics cost component to the total retail price is around 5 percent, while in India it is as high as 10 percent.

In recent years, efforts have been made by the Government of India (GoI) to step-up investment in infrastructure, and particularly to catalyze greater private investment. In the Union Budget 2005, the Finance Minister reiterated the importance of infrastructure for rapid economic development and noted that, in the Government’s view, “the most glaring deficit in India is the infrastructure deficit”. In this context, he proposed to continue (and enhance) budgetary support for investment in infrastructure, including through initiatives to catalyze greater private financing of infrastructure through a proposed viability gap fund (VGF) and a special purpose vehicle (SPV). Efforts have also been made, over the years, to strengthen the policy and regulatory framework underpinning some of the key infrastructure sectors, with notable success achieved in the Tele communications sector.
Addressing Financial Sector and Related Regulatory Issues A deeper and more diversified financial sector could certainly help increase private participation in infrastructure. Developing local capital markets can play a critical role in facilitating private investment in infrastructure. Key priorities include: Facilitating equity financing.

**Improving exit policies to make it easier for investors to exit.** In this context, a key priority is for Reserve Bank of India (RBI) to introduce enabling regulations for the use of put options as an exit mechanism for investors in unlisted (privately held) companies. At present, the regulations do not allow financial investors to reach an upfront agreement with sponsors on the terms of a put option, if the sponsor company is unlisted. Greater comfort on exit would encourage financial investors to take equity in green field infrastructure projects by having some defined, low guaranteed returns. This practice is standard in many emerging markets, especially in Latin America. An additional and desirable outcome of this would be that with the entry of more financial investors in the equity market, it would broaden the investor base and with successful closing of projects it would increase investor confidence.

**Fiscal Measures that would Support Private Financing of Infrastructure and Financial Market Innovation**

While it should be noted that fiscal concessions are not necessarily desirable, per se, they might help increase returns and hence, investment. In this context:

*The Ministry of Finance (MoF)* could consider reducing the customs duty on capital goods and machinery that are critical for roads, ports, airports, power, railways, telecommunication, oil and gas pipelines and supply and distribution of...
water. This fiscal incentive would significantly reduce the cost of many infrastructure projects.

**Fragmented supply base**

The supply base is highly fragmented with a large number of intermediaries squeezing the margins of all involved, which also includes the retailer. This not only has an adverse affect on the margins but also results in cases of mishandling, theft and increased instances of shrinkage.

**Restrictions in Foreign Direct Investment**

The organized retail space was expected to receive investments to the tune of USD 25 billion over the next 4-5 years. However, significant delays in retail real estate development and opposition to organized retail have resulted in delays in investment. A large number of retailers have not been able to meet their stated expansion plans. Currently, with higher cost of funds and a slow down in demand, developers are likely to delay more projects in the near future.

- Rentals: Skyrocketing to all time high As real estate prices skyrocketed, retail rentals also touched unsustainable levels eating directly into the profit margins of retailers. Until a few months back, store rentals were 300 to 400 basis points higher than even international levels. Retail rentals in Linking Road in 15

**INDIAN RETAIL & RECESSION**

**Impact of Recession - Retail and Other sectors**

In the past few years, India’s retail journey seemed picture perfect with the most attractive ‘stops’ still unexploited and under-penetrated. Favorable demographics, steady economic growth, easy availability of credit, and large scale real estate developments were fuelling the growth of India’s approximately USD 25 billion organized retail market. The opportunity was there for all to see and India
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was the destination of choice for top global retailers. In this environment, India’s own blue chip companies like Reliance, Bharti and RPG diversified to add retail to their sector portfolio4. All things considered, it was a good time for Indian retail. This was the scenario till a few years ago. Enter the global melt down and India did not find itself completely insulated from its harsh effects. As per the Cartesian survey, almost all key industries in India have been negatively impacted by the slowdown and retail is no exception.

Dominance of Unorganized Sector

Unorganized retail is characterized by:

1) Family-run stores
2) Lack of best practices when it comes to inventory control and supply-chain management
3) Lack of standardization
4) Essentially a sector populated by anyone who has something to sell.

The Indian retail industry is divided into organized and unorganized sectors. Organized retailing refers to trading activities undertaken by licensed retailers, that is, those who are registered for sales tax, income tax, etc. These include the corporate-backed hypermarkets and retail chains, and also the privately owned large retail businesses. Unorganized retailing, on the other hand, refers to the traditional formats of low-cost retailing, for example, the local kirana shops, owner manned general stores, paan/beedi shops, convenience stores, hand cart and pavement vendors, etc.

India’s retail sector is wearing new clothes and with a three-year compounded annual growth rate of 46.64 per cent retail is the fastest growing sector in the Indian economy. Traditional markets are making way for new formats such as departmental stores, hypermarkets, supermarkets and specialty stores.
Western-style malls have begun appearing in metros and second-rung cities alike, introducing the Indian consumer to an unparalleled shopping experience.

Fig. 4.1 Sector-wise Break-up of Unorganized Retail in India

The Indian retail sector is highly fragmented with 97 per cent of its business being run by the unorganized retailers like the traditional family run stores and corner stores. The organized retail however is at a very nascent stage though attempts are being made to increase its proportion to 9-10 per cent by the year 2010 bringing in a huge opportunity for prospective new players. The sector is the largest source of employment after agriculture, and has deep penetration into rural India generating more than 10 per cent of India’s GDP.

Traditionally, the small store (*kirana*) retailing has been one of the easiest ways to generate self-employment, as it requires minimum investments in terms of land, labour and capital. These stores are not affected by the modern retailing as it is still considered very convenient to shop. In order to keep pace with the modern formats, *kiranas* have now started providing more value-added services like stocking ready to cook vegetables and other fresh produce. They also provide services like credit, phone service, home delivery etc.

**Kirana/ Grocers/ Provision Stores/ Mom-and-Pop Stores**
Semi-organized retailers like kirana (mom-and-pop stores), grocers and provision stores are characterized by the more systematic buying – from the mandis or the farmers and selling – from fixed structures. Economies of scale are not yet realized in this format, but the front end is already visibly changing with the times. These stores have presented Indian companies with the challenge of servicing them, giving rise to distribution and cashflow cycles as never seen elsewhere in Asia. The model is very antithesis of modern retail in terms of the buyer (retailer)-seller (FMCG) equations. It is not unknown for MNC leaders to link the supply of one line of products to another slower moving line of products. These retailers are not organized in the manner that they could challenge the power of the sellers, most protests have been in the form of boycotts, which really haven’t hit any company permanently.
India’s retail and logistics industry, organized and unorganized in combination, employs about 40 million Indians (3.3% of Indian population). The typical Indian retail shops are very small. Over 14 million outlets operate in the country and only 4% of them being larger than 500 sq ft (46 m²) in size. India has about 11 shop outlets for every 1000 people. Vast majority of the unorganized retail shops in India employ family members, do not have the scale to procure or transport products at high volume wholesale level, have limited to no quality control or fake-versus-authentic product screening technology and have no training on safe and hygienic storage, packaging or logistics. The unorganized retail shops source their products from a chain of middlemen who mark up the product as it moves from farmer or producer to the consumer. The unorganized retail shops typically offer no after-sales support or service. Finally, most transactions at unorganized retail shops are done with cash, with all sales being final.

While India presents a large market opportunity given the number and increasing purchasing power of consumers, there are significant challenges as well given that over 90% of trade is conducted through independent local stores. Challenges include: Geographically dispersed population, small ticket sizes, complex distribution network, little use of IT systems, limitations of mass media and existence of counterfeit goods.

Indian retail has experienced limited growth, and its spoilage of food harvest is amongst the highest in the world, because of very limited integrated cold-chain and other infrastructure. India has only 5386 stand-alone cold storages, having a total capacity of 23.6 million metric tons. However, 80 percent of this storage is used only for potatoes. The remaining infrastructure capacity is less than 1% of the annual farm output of India, and grossly inadequate during peak harvest seasons. This leads to about 30% losses in certain perishable agricultural output in India, on average, every year.
Challenges for the Retail Sector in India

Employment Problems

Total retail employment in India, both organized and unorganized, account for about 6% of Indian labor work force currently - most of which is unorganized. This about a third of levels in United States and Europe; and about half of levels in other emerging economies. A complete expansion of retail sector to levels and productivity similar to other emerging economies and developed economies such as the United States would create over 50 million jobs in India. Training and development of labor and management for higher retail productivity is expected to be a challenge.

The presence of more than one retailer for every hundred persons is indicative of the lack of economic opportunities that is forcing people into this form of self-employment, even though much of it is marginal. Because of this fragmentation, the Indian retail sector typically suffers from limited access to capital, labour and real estate options. The typical traditional retailer follows the low-cost-and-size format, functioning at a small-scale level, rarely eligible for tax and following a cheap model of operations.

Employment in Retailing:

A simple glance at the employment numbers is enough to paint a good picture of the relative sizes of these two forms of trade in India – organized trade employs roughly 5 lakh people whereas the unorganized retail trade employs nearly 3.95 crores! According to a GoI study the number of workers in retail trade in 2008 was almost 225 lakhs. Given the recent numbers indicated by other studies, this is only indicative of the magnitude of expansion the retail trade is experiencing, both due to economic expansion as well as the ‘jobless growth’ that we have seen in the past decade. It must be noted that even within the organised sector, the number of individually-owned retail outlets far outnumber the corporate backed institutions. Though these numbers translate to approximately 8% of the workforce in the country (half the normal share in developed countries) there are far more retailers in
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India than other countries in absolute numbers, because of the demographic profile and the preponderance of youth, India’s workforce is proportionately much larger.

Cultural and Regional Differences

Regional Differences

India’s retail sector is highly segregated by geography. Historically, retailers were primarily located in Southern India; however, in recent years the Western and Northern areas of India have developed and more retailers have expanded their stores to these two regions. California agricultural products are more likely to penetrate the more developed regions of India (South, West and North) where organized retailers are expanding and consumers are more likely to know about imported offerings and more able to afford them.

Southern India: Historically, most organized retail has been concentrated in Southern India due to better distribution technology, cheaper real estate, and a greater degree of Western influence in the region. Importantly, the Southern region offers more organized transportation systems and cold storage facilities. This infrastructure provides reliable delivery and minimizes product deterioration and damage. As a result, modern retail began here and it continues to be one of the leading regions for organized retail.

Western India: Due to favorable consumer characteristics and higher incomes, many retail chains have recently expanded to Western and Northern India. Western India has the highest per capita income in India and the strongest consumer product awareness. Residents in the West receive the highest level of education and are well traveled (internationally) compared to other regions. Mumbai, one of the major cities and the financial capital of India, is located in West India.

Northern India: Northern India is another region influenced by Western culture. The growing population in Northern India has been a key factor in the significant
growth of organized retailers in the region. The North is considered an emerging retail market for international brands and national retailers and is one of the leading regions in organized retailing. The capital of India, Delhi, is located in North India.

**Eastern India:** The Eastern region of India is still highly underdeveloped and will not likely be a potential market for California products in the short term. The East has the lowest average per capita income (Rs. 10,315 or US$264) across India. Due to financial barriers, most consumers do not have the means to purchase imported products and shop almost exclusively in unorganized retail outlets.