Dear reader,

Ernst & Young LLP and Retailers Association of India (RAI) are delighted to present our report, *Pulse of the Indian retail market*.

The report not only collates responses from the survey with 25 retail CFOs, but also provides an overview of the prevailing trends in the Indian retail market. The objective of the survey was to map the views and concerns of CFOs on the performance of organized retailers in the Indian market.

This report sets the tone for the Indian retail sector in 2014, highlighting the growth opportunities, challenges and concerns and priorities for the sector, particularly from the lens of a retail CFO.

We hope that this report proves to be helpful in contextualizing expectations from the organized retail sector in 2014.

**Foreword**

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Abbreviations

CFO Chief financial officer or equivalent
CAGR Compounded annual growth rate
EBO Exclusive brand outlets
FDI Foreign direct investment
GOI Government of India
GST Goods & Services Tax
MBRT Multi brand retail trading
SBRT Single brand retail trading
VAT Value Added Tax
Executive summary

Consumerism in India is witnessing unprecedented growth driven by favorable demographics, a young and working population, rising income levels, urbanization and growing brand orientation. This, in turn, is reflected in India's retail market, which in 2013, was estimated at US$520 billion and is expected to grow at a CAGR of 13% to reach around US$950 billion by 2018. Organized retail penetration, currently estimated at 7.5%, is expected to clock a 19-20% p.a. growth to reach 10% by 2018. Penetration in tier-II and III cities, improvement in business models and operations, coupled with movement from unorganized to organized trade are expected to play an integral role in driving this growth. Furthermore, the liberalization of FDI policy is expected to propel foray of global retailers, which will further fuel the growth of organized retail in India.

However, this growth in organized retail has been achieved at a significant cost. The wave of organized retail started more than a decade ago. However, most players have struggled to achieve the desired level of profitability and returns. Despite high investment of time and capital during this long gestation period, the return from the retail business continues to be a major concern.

In 2014, leading retailers are putting financial goal of profitability on the top of their agenda. At store level, the retailers are focusing on improving store profitability further through productivity enhancement and better inventory management. At corporate level, the retailers are keeping major costs such as supply chain and manpower in line with the revenue to ensure profitable growth of the business.

In a nutshell, a retail CFO’s mantra for 2014 seems to be balancing growth and profitability.

Top agenda points on the plate of a CFO of a Indian retail business

- Focus on growth through expansion in Tier II and below cities
- Improve store operations and supply chain
- Better working capital management
- Play a partner role to the CEO of business
- Balance growth and profitability
Thriving Indian retail market

Indian retail market is expected to grow at a CAGR of 13% till 2018

Globally, India is among the top 10 retail markets. In 2013, the Indian retail sector was estimated at US$520 billion and was among the largest employers in the country. By 2018, the Indian retail sector is likely to grow at a CAGR of 13% to reach a size of US$950 billion.

Organized retail market in India is burgeoning and is expected to grow at CAGR of 19-20% over the next 5 years

The Indian retail sector is set to grow rapidly with a gradual shift toward organized retailing formats. Organized retail penetration is expected to increase from 7.5% in 2013 to 10% in 2018 at a robust CAGR of 19-20% during the same period. This will be driven by a combination of demand, supply and regulatory factors, which are expected to be the growth engines of the Indian consumer and retail market.

Exhibit 1: Indian retail market and organized penetration

<table>
<thead>
<tr>
<th>2013</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>US$ 520 bn</td>
<td>US$ 950 bn</td>
</tr>
<tr>
<td>7.5%</td>
<td>10%</td>
</tr>
</tbody>
</table>

US$ - Retail market % Organized penetration

Source: EY research
Note: 1 US$ = 58.6 INR
Exhibit 2: Factors driving growth in the Indian retail industry

Liberalization of FDI policies in retail coupled with the expected roll-out of the Goods and Service Tax

Rapid real estate and infrastructural development, easy availability of credit, innovative physical and online channels, increased service orientation

Rising disposable income, increasing urbanization, highly aware and affluent young population, growing number of working women and changing consumer preferences

Penetration in tier II and III cities and improvement in business models and operations will be the top themes of growth for the organized sector

Tier-II and tier-III cities such as Jaipur, Nagpur, Ludhiana, Vadodara, Aurangabad, Kochi etc., are emerging as the new “hot spots” of consumption. Organized retailers are increasingly setting up stores in these smaller cities.

There is increasing focus on profitable growth in the sector. Most retailers seem to be focusing on transformation of existing operations rather than introducing new formats. Moreover, retailers are expecting existing formats to deliver a like-to-like growth of around 10% this year.

In a nutshell, leading retailers seem to driving the dual themes of expansion and internal improvement for sustainable growth.

Furthermore, retailers expect that customer sentiments will improve, which will provide further impetus to the growth of the organized sector.

Exhibit 3: Top themes of growth for organized retailers

- 72% Penetration in Tier II & below cities
- 72% Improvement in business model and operations
- 36% Movement from unorganized to organized trade
- 16% New retail formats

In comparison to other formats, for EBOs and department stores "movement from unorganized to organized trade" is relatively a high priority theme for growth in 2014.

Source: EY-RAI Retail CFO Survey (% of respondents which have selected the above option)

Exhibit 4: Expected like to like growth in current year

- < 10%: 48%
- 10%-20%: 44%
- > 20%: 8%

Source: EY-RAI Retail CFO Survey
Policy reforms in Indian retail

The Government of India, through its reforms in FDI for retailing seems to be repositioning the Indian retail sector on the global map of investments.

India categorizes retail trading into single brand retail trading (SBRT) and multi-brand retail trading (MBRT). Currently, FDI under SBRT is permitted to the extent of 100% and FDI under MBRT is permitted to the extent of 51% with select conditions and Government approval.

While the FDI policy for SBRT has received favorable response, the FDI policy for MBRT has been slow to gain the traction among international retailers. Given this, the GoI seems to be working toward relaxing some aspects of the FDI policy, which could propel more international retailers to invest in the country.

The CFOs in the Indian retail sector believe that – (a) allowing FDI in online retail, (b) clarity on provisions of sourcing, (c) revisiting and clarity on investment in back-end and (d) limiting the role of the state could be some of the changes which could shift momentum to FDI in retailing.

GoI has proposed Goods & Services Tax (GST). Once implemented it will simplify the supply chain and bring down price/cost.

The GST, originally proposed to be introduced with effect from April 2010, is yet to be rolled out. Difference in opinion among states, insistence of states on commitment of the federal government to compensate for possible revenue losses, coverage of specific products, procedural delays together with consensus on the Constitutional Amendment Bill are some of the key factors delaying the introduction of GST in the country.
Given these issues, CFOs in the Indian retail sector don’t expect GST to be rolled out in 2014 and therefore, seem to have put the preparation for GST on the back burner.

Gradual liberalization of FDI policy for retailing in India has increasingly propelled global retailers to evaluate a foray in the Indian market. Furthermore liberalization/ modifications in the policy could result in speeding up the process of setting up and expansion of operations in India.

Exhibit 5: GST roll out and preparedness

<table>
<thead>
<tr>
<th>Expected roll out time frame of GST</th>
<th>Organizational preparedness on the GST roll out</th>
</tr>
</thead>
<tbody>
<tr>
<td>Next 12 months</td>
<td>Yes 16%</td>
</tr>
<tr>
<td>24-36 months</td>
<td>Partly 72%</td>
</tr>
<tr>
<td>12-24 months</td>
<td>No 12%</td>
</tr>
</tbody>
</table>

Source: EY-RAI Retail CFO Survey
Top concerns and focus areas for 2014

Achieving profitable growth and inventory management seem to be the top concerns of a retail CFO in 2014

Organized retailers in India have experienced rapid growth over the last decade. However, this growth has been achieved at a significant cost. Despite considerable investment of time and capital during this gestation period, the returns from the business are a concern. Going forward, the organized retail sector is expected to grow at significant rate of 19-20% p.a. given that it is critical that the business starts generating positive cash flows and is self sustaining.

Inventory management is a top concern for CFOs. This is largely driven by the vagaries in the Indian supply chain such as low fill rates, long lead times and ordering cycles and lack of process orientation. These result in high inventory holding, low turns and high investment in stock.

Exhibit 6: Top concerns for retailers in 2014

Source: EY-RAI Retail CFO Survey
Profit and revenue enhancement feature as the top agenda for CFOs in 2014

In light of the various opportunities and challenges posed by the Indian retail sector, retailers are increasingly focusing on balancing expansion with profitability.

At the store level, top two focus areas in 2014 for retailers are — driving revenue growth and inventory management. Furthermore, cost rationalization features as the third-most important area.

- **Revenue enhancement**: The focus is on improving productivity from the existing resources such as space, people etc. Retailers are focusing on levers of customer service and talent retention to improve their productivity.

- **Inventory management**: Retailers are focusing on optimizing inventory turns, investment in inventory and drive freshness in stores.

- **Cost rationalization**: Retailers are continuing their efforts to keep store costs in check. Some cost rationalization initiatives adopted by leading retailers in the recent past are (a) revenue-sharing agreements to protect the downside on rent, (b) increasing use of power-saving equipment/fit-outs to save utilities cost, (c) staffing promoters and contract employees to reduce manpower costs etc.

At a company level, profitability features as the top priority for retailers. This is largely expected to be driven by improving supply chain, efficient buying and merchandizing and keeping other corporate costs in line with the scale of business.

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**Exhibit 7: Top priorities for retailers in 2014**

<table>
<thead>
<tr>
<th>Top focus areas (company level)</th>
<th>Top focus areas (store level)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proficiency (bottomline) 88%</td>
<td>Revenue enhancement (productivity &amp; sales) 80%</td>
</tr>
<tr>
<td>Revenue (topline) 64%</td>
<td>Inventory management 72%</td>
</tr>
<tr>
<td>Improve supply chain 60%</td>
<td>Cost rationalization (efficiency) 52%</td>
</tr>
<tr>
<td>Improve customer service 48%</td>
<td>Talent retention 48%</td>
</tr>
</tbody>
</table>

For department stores improving customer service seems to be a bigger focus area than improving supply chain.

For hyper markets, department stores and speciality stores talent retention seems to be a joint 3rd most important focus area at store level.

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Source: EY-RAI Retail CFO Survey (% of respondents which have selected the above option)
CFOs are increasingly taking up the role of a business partner and take/facilitate strategic decision making

The role of CFOs is not just limited to the traditional mandate of day-to-day accounts, compliance, providing financial insights and analysis, managing investor relations etc. The role of CFOs is undergoing a change as they are required to be more versatile in their approach and act like business partners in the retail organization. CFOs are now increasingly required to work in conjunction with the top management to develop and support organizational and expansion strategies, identify strategic M&A initiatives and make holistic business decisions, along with managing compliance, investor relations and other operational matters.

Currently, most retail CFOs seem to be playing the role of a business partner and this trend is expected to continue going forward.

Exhibit 8: Current and expected role of a retail CFO

<table>
<thead>
<tr>
<th>Current role of the CFO in the organization</th>
<th>Ideal role of the CFO</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business Partner</td>
<td>86%</td>
</tr>
<tr>
<td>Business Partner</td>
<td>95%</td>
</tr>
</tbody>
</table>

Source: EY-RAI Retail CFO Survey
Conclusion

Although Indian retail presents several growth opportunities, achieving this growth profitably has been a major concern for leading Indian retailers. Retailers have conducted an in-depth evaluation of their business to identify key cost and revenue levers for financial performance improvement.

There is a growing emphasis within retail organizations to assess the impact of major business decisions on cost and revenue levers, given that top agenda of retailers is to improve profitability. Furthermore, the finance department is well equipped to connect the financial impact of business decisions with the company’s strategy. Therefore, the role of a CFO is increasingly shifting from custodian/store keeper of financial information to a business partner.
About the report

For the purpose of this study, EY in collaboration with Retailers Association of India (RAI) conducted a survey of 25 senior executives in the Finance department of prominent retailers in India. The responses collected have been analyzed to map the upcoming trends in the Indian retail market.

Profile of respondents

The survey respondents represented prominent retailing organizations present in India. These retailers manage multiple formats and brief representation of the same is given below:

Respondents covered operate across following formats

- 36% Hypermarkets
- 24% Department stores
- 12% Supermarkets
- 34% Speciality formats
- 42% EBOs
- 34% Others

Source: EY-RAI Retail CFO Survey (Note: Some retail companies operate multiple formats)

The survey was conducted across representatives of retailing companies varying in turnover (size). A snapshot of mix of respondents, based on revenue of their companies is given below:

Size of the firm (Net sales in INR crores)

- More than 1000: 31%
- 500-1000: 23%
- 200-500: 15%
- Upto 200: 31%

Source: EY-RAI Retail CFO Survey
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