

Pulse of Indian retail market

A survey of CFOs in the Indian retail sector

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RETAILERS ASSOCIATION OF INDIA



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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.

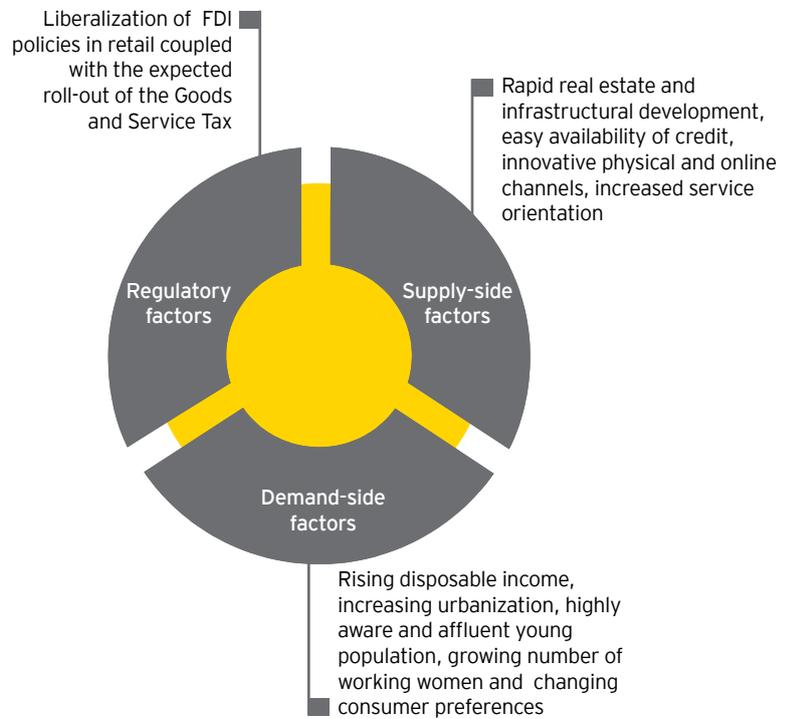
Exhibit 1: Indian retail market and organized penetration



US\$ - Retail market % Organized penetration

Source: EY research
Note: 1 US\$ = 58.6 INR

Exhibit 2: Factors driving growth in the Indian retail industry



Source: "Indian Single Brand Retail - Poised for growth," EY-RAI report, September 2013

Penetration in tier II and tier III cities, coupled with improvements in business models and operations, is expected to drive healthy double-digit growth of organized retailers in India

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

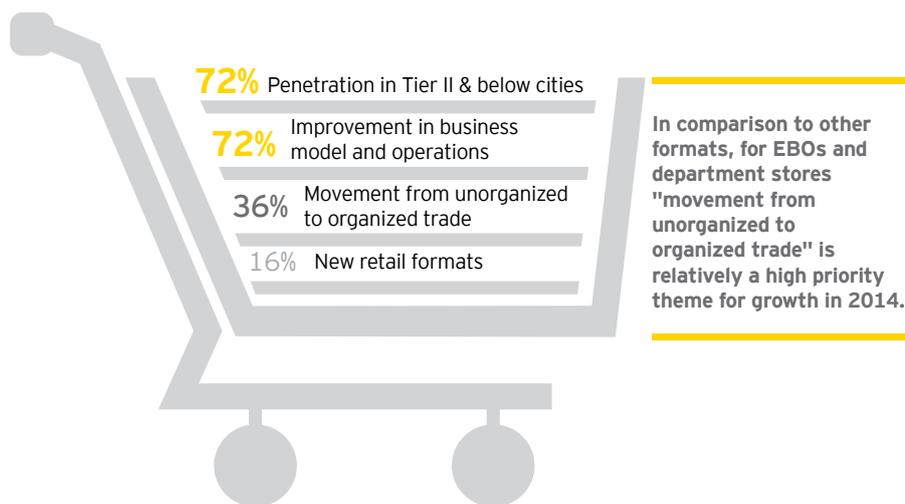
Tier-II and tier-III cities such as Jaipur, Nagpur, Ludhiana, Vadodara, Aurangabad, Kochi etc., are emerging as the new "hot spots" of consumption. Organized retailers are increasingly setting up stores in these smaller cities.

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.

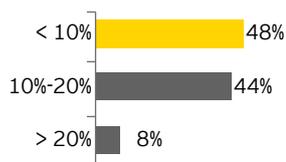
Furthermore, retailers expect that customer sentiments will improve, which will provide further impetus to the growth of the organized sector.

Exhibit 3: Top themes of growth for organized retailers



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

Exhibit 4: Expected like to like growth in current year



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 Gol seems to be working toward relaxing some aspects of the FDI policy, which could propel more international retailers to invest in the country.

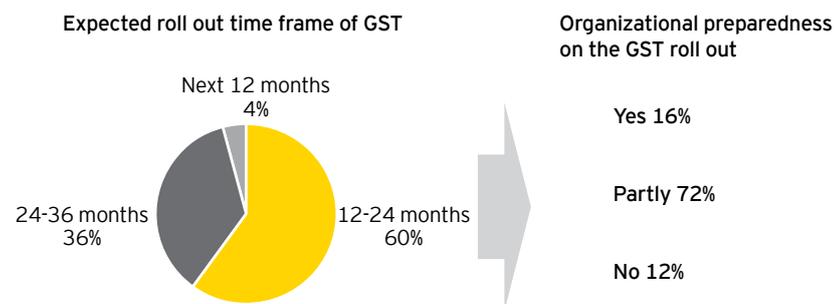
The CFOs in the Indian retail sector believe that - (a) allowing FDI in online retail, (b) clarity on provisions of sourcing, (c) revisiting and clarity on investment in back-end and (d) limiting the role of the state could be some of the changes which could shift momentum to FDI in retailing.

Gol 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.

Exhibit 5: GST roll out and preparedness



Source: EY-RAI Retail CFO Survey

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.

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

Inventory management 	High operating costs 	Working capital management 
Complex regulatory framework 	Talent retention 	Slowing revenue growth and low retail productivity 
Inflation 	Inefficiencies in the supply chain 	Achieving profitable growth 

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.

Improving productivity and driving profitability seems to be one of the top agenda for CFOs in 2014

Exhibit 7: Top priorities for retailers in 2014



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

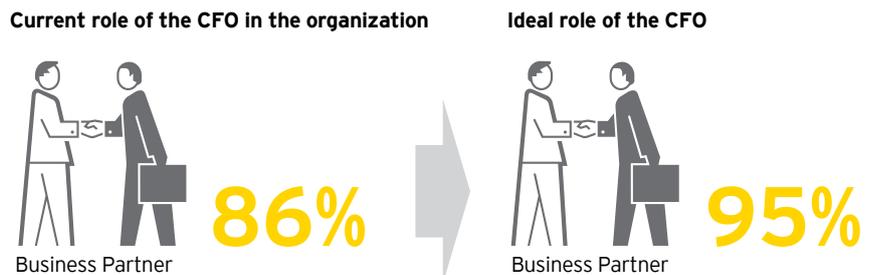
Role of a retail CFO

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



Source: EY-RAI Retail CFO Survey

Appendix

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:

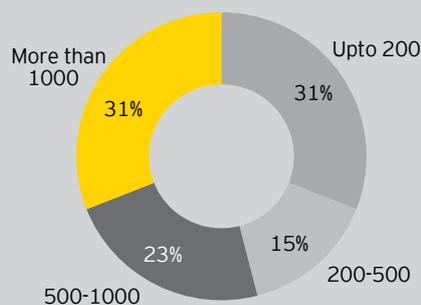
Respondents covered operate across following formats



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)



Source: EY-RAI Retail CFO Survey

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Retailers Association of India (RAI) is the unified voice of Indian retailers. RAI works with all the stakeholders for creating the right environment for the growth of the modern retail industry in India. RAI is the body that encourages, develops, facilitates and supports retailers to become modern and adopt best practices that will delight customers. RAI has a three charter aim of Retail Development, Facilitation and Propagation.

Retailers Association of India (RAI) always strives to bring best practices to the retail industry and its stakeholders. RAI's efforts center around advocacy and government representations, bringing best practices to the industry, fostering retail learning and training, creating a reservoir of information through retail research, disseminating communication through magazines, newsletter, website, etc. for the benefit of its members and the industry.