



“The content and thesis of this groundbreaking 2006 white paper has been featured multiple times by the Wall Street Journal, Economic Times of India, CNN and Fortune magazine.”

Retail Nirvana – Indian Style

by Love Goel

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India finally opened up retailing, its largest industry, to partial Foreign Direct Investment (FDI) in early 2006. U.S. President George Bush was there in February urging further deregulation. India's \$286 billion retail industry is several times the size of its much ballyhooed IT, software and outsourcing sectors combined. Moreover, the retail sector there is highly fragmented with only 3% of it organized, and the remaining 97% comprised of 12 million mom-and-pop shops. During the next decade, analysts estimate India's organized retail sector will grow by 30% annually; and the broader retail sector will at least mirror annual GDP growth rates of 5-10%. Not surprisingly, it is impossible to swing a cricket bat in India without hitting teams of foreign retailers and consultants like Wal-Mart, Carrefour, McKinsey and AT Kearney who are studying the retail opportunity. This emerging, high-growth retail market is simultaneously fraught with unprecedented opportunity and tremendous risk. Foreign retailers may find their risk exacerbated by a retail model that has worked well for them in the west. Just like the telecom sector where India jumped two generations, and now has twice as many cell phones as landline phones, the retail sector also could fast forward to a new model that is more satisfying for customers and more profitable for retailers.

In addition to broad macroeconomic trends, five factors make India very attractive for foreign retailers and investors:

- Consumer clamor for organized retailing: Hundreds of malls and dozens of store concepts have sprung up across India and are overflowing with crowds of Indian consumers. On a February 2006 trip to India, I found malls on Valentine's Day packed with middle and upper-middle class families and young people shopping, eating and socializing – like a scene out of *Miracle on 34th Street*. Indian malls, everyday, seem as crowded and festive as Christmas Eve on 5th Avenue.
- Consumer willingness to spend money with organized retailers: India's middle class is known for having one of the highest savings rates in the world but their willingness to spend those savings has been suspect.

Over the past few years, though, India's new, affluent middle class has demonstrated that it will pay for a cleaner and more fun shopping environment, broader merchandise selection, better service, pricing transparency, convenience, reliability and customer-friendly returns, refunds and exchange policies. The rising numbers of consumers who have credit cards - quadrupled in the past three years - are also more likely to spend on retail.

- Indian retailers are weak: The handful of home-grown retailers like Pantaloon, Trent and Shoppers Stop have made tremendous strides but need to do a much better job with product quality and selection, pricing, in-store displays, staffing, customer service, advertising and brand consistency. That explains why there is no discernible brand loyalty yet among Indian consumers.
- Negligible local retail talent: For obvious reasons, India does not have a strong bench of retail executives - talented or otherwise. It will take some time before executives from other consumer sectors will be able to repurpose themselves to lead successful retail enterprises.
- Government support for FDI in retail: Last, but not least, in countries like India and China where governments highly regulate business, their policies play a key role in shaping sectors. The Indian government has already seen merit in opening up the retail sector, albeit only single-brand retailers can open stores. Speculation is rife that all retail formats will be open to FDI in the next 12-18 months.

Two trends in this country make India even more attractive for U.S. and European retailers, suppliers and investors:

- They are running out of good growth opportunities locally due to intense competition for choice real estate and customer wallet share across

categories. The Indian retail market has enough room for everyone to grow profitably at least for the next decade or two.

- Suppliers also might discover the Indian retail market to be an attractive, high-margin destination where they can bypass the traditional “retail” channel because no western retail brands are established in India yet. Fashion, apparel, shoe and electronics companies like Levi’s, Nike, Reebok, Bose and Sony already have set up stores and are doing brisk business.

India, because of its large population, has a history of offering huge opportunities when it opens up sectors to foreign companies. More often than not, best-in-class American consumer companies like Coke, P&G and Kellogg have fared poorly at least initially in India. It is crucial to understand that Indian consumers are quite different from the largely homogeneous group of customers we are used to marketing, selling and serving in America. In India, there are 18 official languages with a new dialect spoken every few miles. Each of India’s 28 states has its own culture, customs, cuisine, shopping habits and clothing styles that make it challenging to realize the scale advantages we expect in American retailing. Most importantly, it is wise to consider that “organized” retailing is less than 10 years old in India compared to several hundred years in the U.S. or Europe -- where consumer preferences and behaviors are more predictable, though they have been dramatically changing during the past decade.

Indian consumers are in the thick of figuring out what, why, how, for how much and from whom they want to shop. Retailers, therefore must test various formats, categories, channels, price points, merchandise assortments, service levels, promotions, advertising and marketing strategies before committing large amounts capital to any single retail model. The governing principle in such an environment is to test the market in a capital-efficient and disciplined manner while being opportunistic and responsive to the marketplace. Those who over-invest early run the risk of investing in the wrong formats,

channels or categories -- and not only losing money in the process but also, even more dangerous, eroding credibility and brand equity that can hurt them in the long run.

The optimal model to test the Indian retail market is a multi-channel, direct-to-consumer model -- eschewing high real estate costs for physical stores in favor of low-cost channels that have very high penetration among India's rapidly growing middle class. These 350-400 million people are the beneficiaries of India's decade-long telecom and media revolution. The average middle-class family there is likely to have more television channels than we do, receive more advertising and conduct more commerce on their sophisticated cell phones than we do, and are among the largest internet populations in the world. Therefore the TV, internet, mobile phone and catalog can be powerful channels for customer acquisition, selling and customer service. In contrast to store-based retailers, the direct-to-consumer, multi-channel platform can be used to efficiently personalize offerings, price points and service levels with much more precision for India's diverse customer base; and to build deeper and more profitable customer relationships. In addition, these channels address some of the pet peeves of Indian shoppers -- congested roads and impossible-to-find parking. Retailers can complement these low-cost, direct-to-consumer channels with small physical stores in high-traffic urban locations like South Extension (Delhi) or Colaba (Mumbai). Instead of using stores as warehouses in India's pricey real estate market, these stores would offer a location to visualize and experience the brand, touch and feel products, and provide superior customer service. A much larger inventory assortment can be warehoused in nearby industrial belts like Gurgaon or Thane for one-fifth to one-tenth of the cost. Orders from store, catalog, phone, TV or internet then could be delivered to people's homes or offices within hours much more efficiently than Amazon or Barnes & Noble do in Manhattan. Why? Because of a reliable pre-existing courier network, and because Indian cities are far more densely packed than Manhattan or Western European cities which are ideally suited for internet, TV or catalog shopping fulfillment. There is no dearth of high-quality, low-cost call centers to take orders and

provide customer service. In all fairness, there are a few categories like groceries where this retailing model might not be efficient because of the way Indians shop.

This multi-channel, direct-to-consumer strategy has three practical advantages:

- reduces significantly the single biggest capital expense to test retail concepts in India (keep in mind plum real estate in Mumbai and Delhi tends to be pricier than in Manhattan or LA);
- overcomes current FDI regulation that only allows single-brand foreign retailers to operate stores in India. Nothing prevents multi-brand retailers like JC Penney, Target, Best Buy or Home Depot from selling through other channels like web, phone, TV or catalog and having physical stores for branding and product display; and
- diminishes simultaneous exposure to retail and real estate which tend to underperform at the same time in economic cycles.

Strategic partnerships with India's world-class television, phone, printing, call center, warehousing and courier companies will be key to the success of any foreign retailer both in keeping costs down as well as accelerating time to market. In fact, with the elimination of global textile quotas and shrinking international freight costs, this platform could be used not only to serve Indian consumers but also conceivably to sell directly to U.S. customers thus bypassing American retailers.

In conclusion, India represents retail nirvana - the single best international retail opportunity - to American companies and investors.

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