Wal-Mart changes the game in India

Looming entry of world's biggest retailer will herald a new era of retailing in India, but there will be a backlash.

By Eric Johnson

It might be a little far-fetched to think of a Paul Revere-type character riding through the streets of Mumbai or Delhi and yelling, “Wal-Mart is coming! Wal-Mart is coming!”

Then again, in a country where political outcry is a national pastime, nothing is that far-fetched.

In any case, Wal-Mart is coming to India, and on the surface, it appears to be the perfect union of low-cost retailer and bargain-hunting consumer.

But the move of the world's biggest retailer into the world's second-biggest market of potential consumers is set against a backdrop of looming backlash.

As with other markets that Wal-Mart has tried to enter, there are those who don't think the mega-retailer's presence would be beneficial for the rising Indian economy. But then there are those who argue that Wal-Mart could herald a new era of retailing in India, one that would drive down costs for other retailers and bring a new level of supply chain and logistics sophistication to a country lagging behind other Asian markets.
shops — a familiar refrain the world over.

India’s own retail powerhouses are publicly welcoming “healthy competition,” but are wondering how Wal-Mart’s global influence will affect their sales figures. And vendors, who have largely held the upper hand over retailers in India, are loathe to see Wal-Mart’s “squeeze the suppliers” strategy implemented in the subcontinent.

Of course, Wal-Mart’s entry into India can’t be taken out of the context of the retail boom in India that was under way whether the Waltons empire spread to the land of masala or not.

“What’s abut to happen in retail in India is nothing short of an amazing story,” said Mumbai-based Kenneth Glenn, vice president of South Asia for APL. “When you talk about Reliance, Tata, the Birla Group, their investment plans are nothing short of mind-boggling.”

That is to say, the retailing story in India didn’t begin last November.

**Attitudes Changing.** Devangshu Dutta, chief executive officer of Third Eyesight, a retail supply chain consulting firm near New Delhi, said that in the decades after Indian independence (1947), consumerism was looked down upon. That has changed.

“There’s a huge shift in the consumer market,” he said. “The target audiences forecast in 2002 might only be one-eighth of what it will be in 2010. That is a huge impact on which companies come in to India, and which brands are available.”

Part of that trend is a youthful, urban population that has grown up amidst billboards offering international brands. Where their parents had to go abroad and stuff a foreign product in their suitcase, they can now go to a nearby mall and choose which foreign product they like best.

“Tis a generation coming into the workforce now that has grown up in an era of choice in retail,” he said. “The retail boom hasn’t happened yet, but it will.”

As with many aspects of the Indian economy, it lags behind China by about 10 years in terms of the maturity of its retail sector. And that’s why foreign firms are lining up to accept 50:50 joint ventures that they wouldn’t even consider in other markets.

“Most of the big companies — I’m referring to the global 20 — they would prefer to have control because they want their brand to interact with the customer,” Dutta said about the entry of the world’s biggest retailers into India. “If you look at China 10 to 12 years ago, they were in the same place. What China did is allow retailers to come in once the domestic retailers grew big enough to compete.”

What foreign retailers — large and small — are doing is staking a claim in some part of India. The idea is to build brand recognition and trust so that when the market matures their name will be one upon which the Indian consumer leans.

Of course, that strategy involves risk, potential loss, and a steep learning curve. Aside from the logistical differences between setting up a supply chain in India versus other countries — even developing ones — it’s getting pretty expensive to do business in India’s cities.

“Real estate costs are too high,” Dutta said. “They must be brought down or the retail model cannot exist. As a percentage of cost, real estate is too high for retailers to be viable, much less successful. Most retailers coming into India are paying high rates just to get a presence in front of the customer.”

Of course, high real estate costs affects everyone equally, and international retailers are often in a better position to absorb those costs than the mom-and-pop shops that exist.

“The price of urban real estate means it has to be filled by modern retail, not mom-and-pop shops,” Dutta said.

**So Long, Mom And Pop?** The transition of consumers who are accustomed to relying on corner shops and open markets to air-conditioned stores where a whole shopping list can be tackled might be a stumbling block for retailers.

In a sense, India’s business mentality is founded on the outdoor bazaar. As one logistics official put it when talking about bargaining with his doctor over the price of Lasik surgery, “in India, you negotiate over everything.”

And some aren’t convinced that Wal-Mart, and others, will have such a universal effect on smaller shops.

“Organized retail in India is less than 10 percent” of the entire retail market, said Vijay Nair, supply chain manager with retailer Hypercity. “Even if the hyper markets come up, they cannot force the mom-and-pop stores out. But you can’t say the mom-and-pop stores won’t be affected. Take areas where...”

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Kenneth Glenn
vice president of South Asia, APL

**What’s about to happen in retail in India is nothing short of an amazing story.**
the retailers come in. The mom-and-pop stores will find it hard to compete.”

Or as Dutta puts it, “There are lots of lobbies against organized retail, but there are lots of lobbies for organized retail as well.”

In spring, his consultancy company conducted a survey to gauge the potential acceptance of organized retail presence in India. He spoke about the results at the Retail Supply Chain Summit held by the India Supply Chain Council in May.

Among the findings in the survey, which polled a cross-section of retailers, manufacturers and distributors:

- Retailers and suppliers alike believe organized retailing will be good for the supply chain in India.
- Organized retailing is helping supply chains gain importance with most businesses, keeping suppliers on their toes.
- Modern retailing is good from a manufacturer’s point of view, but not from an intermediary’s perspective.
- Suppliers are seeing 10 percent to 25 percent higher sales figures per square foot in organized retailing compared to traditional retailing, most of which comes from better replenishment. (Dutta said the actual sales increase could be 35 percent to 40 percent higher.)
- Thirty-five percent of respondents said they have different internal structures to deal with organized retailers. “Those with different structures tend to be large companies and brands which have experience in other countries,” Dutta said.
- About three-quarters of the companies who have developed different structures to deal with retailers have done so within the last three years.

Dutta offered an example of how traditional Indian retailing differs from modern organized retailing.

“In the traditional retailing scenario, a box of 10 pairs of underwear might be broken up by a distributor, with two going to a wholesaler, two to a semi-wholesaler, and one each for six stores,” he said. “With organized retailing, the whole box of 10 goes to the retailer, who breaks it down themselves.”

In his view, the Indian market is ripe for the kind of practices that are common in the West.

“The market is still wide open for a lot of basic stuff—things you would take for granted in a developing country, like bar coding,” Dutta said. “There’s an inherent need for more structure.”

And he isn’t stretching things. Most stores—even those selling the most famous of brands—still handwrite receipts and file them away in boxes, where they are later checked by another employee.

“Smaller retailers are realizing they have to adapt,” Dutta said. “More stores have air conditioning, for instance, than five years ago.”

Ripe For Change. One area where retailing might thrive is in food sales. If India’s vast and varied agriculture industry could be harnessed within efficient supply chains, it would drive down costs for consumers and open up spending for other items.

“More than 50 percent of Indian spending is on food,” Dutta said. “If cost is taken out of the agriculture supply chain, that has a huge impact on the economy. One could imagine it would free up even more development of special economic zones. “Foreign companies expect India to be as open as other countries, but the coalition government means there are going to be divergent views on the entry of foreign companies,” Dutta said.

The government coalition he speaks of is a pact between the Congress Party, which has paved the way for foreign investment, and the Communist Party, which fervently protects the rights of Indian workers and usually rejects any large scale foreign investment. Propped up by votes from the Communist Party, Congress won national elections in 2004 despite being a minority winner. In other words, it’s a perfect example of politics making strange bedfellows.

But as other speakers at the India Supply Chain Council’s conference said, once consumers get used to the organized retailing way of life, it will be difficult to keep the retailers away.

“As soon as foreign retailers get organized and get into the market, you will see a domestic change in retailing,” said Max Henry, founder and CEO of the India Supply Chain Council. “Things will change because people will get a taste of how things can be different. It won’t necessarily wipe out the Big Bazaars (one of India’s biggest low-cost retailers), but it will bring about a change from Big Bazaar because they know the customer will have different expectations.”

No Fear. Current retailers in India have shown no fear when it comes to Wal-Mart’s entry, mostly because they have confidence and experience in the Indian market. But Wal-Mart or not, a shakeout is likely, and it will most probably come down to which retailers have their supply chains in order.

“There are retailers who have taken the route of ‘we need to get as many stores open as possible to beat our competition to the market,’” Dutta said. “And then there are retailers who are doing that, but are also making sure the systems are in place behind that.”

Reliance, the Wal-Mart Bharti venture and the TataS are all major retailers that have taken a “measured approach,” he said.

And Dutta gave three reasons why organized retail will succeed in India, despite Wal-Mart’s failures in nations like Germany and Korea.

“First, domestic retailers are already succeeding,” he said. “Maybe they don’t have the best practices in a global sense, but they do things pretty darn well.”

“Second, Indian companies are in a position to challenge these companies and provide them with local expertise, not just blindly follow what the company says. And third, these foreign retailers have been to...
China already, so the lessons learned will be there."

One problem is that there are not many foreign success stories in India with which international retailers can comfort themselves.

"McDonald's, for instance, has had to work with its suppliers to develop a supply chain from scratch here," Dutta said. "Together on less than 30 seconds means you need to have a consistent supply chain. But other than McDonald's, there's no widely discussed example of the beneficial impact of organized retail in recent years."

Perhaps the biggest change in the dynamics of retailing will occur in the interchange between retailers and suppliers. With suppliers and distributors holding sway over retailers— even some of the country's biggest— will that change once Wal-Mart comes and others follow?

Dutta said it's not that simple.

"There's a change in the supply side as well," he said. "With increased product development, there's a diversity of products, including fashion, electronics, food and organics brands available today. You could also have large retailers use smaller suppliers to make private labels to compete with larger suppliers' brands, so it won't just be a consolidation of suppliers due to pressure from retailers. It could be a fragmentation of suppliers and that's not what people are saying now."

Either way, suppliers are not likely to take the potential growth of retailers in India lightly.

"You take a company like Hindustan Lever, a company that has been a giant in (fast moving consumer goods) in India," Dutta said. "They see a larger percentage of their volume moving through retailers, and they are starting to empower smaller retailers so they don't fall into the same pattern as in Europe and the U.S."

"The predominant fear people have is that there will be too much consolidation," he continued. "I think given the dynamic nature of the Indian economy, it's difficult to tell who really is going to be a leader. You can't just stand up and say I will invest $5 billion and be a leader. Retail is an organic industry by nature. Each customer who enters your store is alternatively a chance to increase or decrease your share of the market."

**Distribution of power**

Manufacturers, retailers sound off on rise of Indian retail, including how distributors impact what is sold.

Of all the kinks to be worked out in the India retail supply chain, perhaps the most important is also the most simple: who will hold the power?

For years, suppliers and distributors have held sway over a retail sector that could be described as nothing less than comprehensively fragmented. The lack of pure retailer clout put the power in the hands of huge manufacturers of fast moving consumer goods.

Just as significant, the lack of sourcing sophistication of shops in India meant distributors gained a disproportionate share of power of their own.

The delivery patterns of these distributors, and what they choose to stock and distribute, influences greatly what is on a store shelf on a certain day, despite whatever strategy a retailer or manufacturer might devise.

That's leading some to question how any arrangement will change in the face of what most predict will be a retailing revolution, which was the main source of discussion at the Retail Supply Chain Summit, held in Delhi in May by the India Supply Chain Council.

"In the past two years, we have seen the emergence of organized retail in India," said Deepak Gupta, director of product supply for Proctor & Gamble. "In the next two years, we will see an explosion."

P&G, like most big suppliers, has enjoyed the upper hand in India for years. But Gupta said manufacturers only succeed when the outlets selling their items succeed. So manufacturers do care about the success of retailers, but do big retailers feel the same way about their vendors?

"Retailers and manufacturers only succeed when the cost is right," Gupta said. "This is where the conflict often comes between retailers and manufacturers. But manufacturers often provide good enough margins, it's more often the operating costs of retailers that erode margins."

Gupta said that because of inefficient supply chains and India, stores are forced to sell old products at a discounted price, which doesn't benefit the seller or consumer. He said manufacturers have to become more efficient at managing this, particularly in light of the increased power retailers may come to enjoy in India.

"Clearing remittances through price discounts is counter-productive," Gupta said. "You saddle your customer with old products just as new and better products are released. Better is to match replenishment with sale velocity, so that shorter inventory cycles reduce remittances."

Gupta said it's typical for 50 percent of a manufacturer's SKU's to contribute to the bottom 5 percent of that company's profits and sales.

"These have to be managed better," he said.

The Indian retail sector is valued at $280 billion (compared to $475 billion in China) and has been growing roughly 30 percent annually the last four years. The apparel industry in India is worth $55 billion alone, with about $36 billion sold in the domestic market and $19 billion exported.

"The long supply chain for fashion is shrinking fast," said Ravi Vaidyanathan, vice president operations for textile manufacturer Orient Craft. "The life cycle from raw material to shelf is shrinking, so that export number will rise."

Unlike fast moving consumer goods vendors, who mostly hold sway over their retail outlets, apparel manufacturers are quite fragmented.

"Most apparel vendors are small operations," Vaidyanathan said. "We don't have steadfast norms here. No one bothers to regulate what percent of a garment is actually polyester, or cotton, or rayon. The retail apparel industry here should work better with export-oriented manufacturers who have to deal with a very difficult pricing environment. Manufacturers need to provide services for that collaboration, whether it be warehousing or distribution. Such tie-ups enable us to join hands with retailers."

The problem is, retailers in India tend to not have the leverage their counterparts in the West enjoy. That leads to situations where neither partner is taking control of the relationship, leading to inefficiency, said Vijay Nair, a supply chain manager with Hypercyn, an offshoot of Shoppers Stop, one of India's biggest retail chains.

"Retailers in India don't hold clout in collaborations," Nair said. "There's no direct supply from the manufacturers — it's all with distributors. So we're subject to the whims and fancies of the distributors. We might get more inventory than the stores want. Old product lines get dumped right before new product is launched."

But Gupta, of P&G, said it's up to individual supply chain partners to make their specific partnerships work.

"My only advice to retailers is to push back on the manufacturers," Gupta said. "I understand that you don't always have the clout, but you have to stand up. Keep pushing back on us and you'll be surprised.