



Organizing for organized retail in India

How consumer products companies
can thrive in a changing market place

Organizing for organized retail

With a population approaching 1.2bn¹ and rapid GDP growth, India is on track to become the world's fifth largest consumer market by 2025.² And as consumer demands are evolving and becoming ever more sophisticated, so companies are finding that they have to offer increasing choice in terms of both products and retail formats.



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One significant consequence of this is the emergence of organized or ‘modern’ retail. This is born out of changing lifestyles in this disparate society, in which the huge rural market makes up about 70% of households and relies largely on traditional outlets (with limited choice, small display areas and little self service), whereas the growing urban middle-class is demanding luxury goods and Western-style organized retail outlets like ‘one stop shops’.

“While organized retail may only represent about 5% of the Indian market at present, in the long term we expect to see it accounting for 35-40% of the market,” says Pinakiranjan Mishra, Leader, Retail & Consumer Products. “This suggests organized retail will become a key battleground for market share and profitability in years to come, so those Consumer Products companies determined to succeed in India will need to ensure they are ready for the challenges and opportunities that it represents.”

A challenging environment

Even though India has been named the most sought after market for retailers seeking to expand overseas, setting up shop there carries all the same risks you'd expect to see in any rapidly developing market, including regulatory constraints, changing consumption patterns, competition from local players, and rising interest from Private Equity (PE) firms.

Some challenges are particularly pertinent to organized retailers and the consumer products companies that supply them. For example, volatile commodity and raw material prices are a key issue, and with fluctuating inflation in India there has been significant pressure to bear on margins. But this is one cloud that may have a silver lining, as the credit crunch hits home consumers are flocking to large grocery retailers for discounts, promotions and relatively stable prices.

As 2009 unfolds and the global economic outlook looks less certain, there is a slowdown in the overall economy. After years of rapid expansion plans, retailers are rethinking their aggressive pace of growth. Some of the pullback is due to the weak economic conditions, but it is also a matter of right-sizing operations as retailers learn more about what is working in a given situation.

¹ www.stats.oecd.org (deep link is: <http://stats.oecd.org/wbos/viewhtml.aspx?queryname=490&querytype=view&lang=en>). This is data from the Organization for Economic Co-Operation and Development.

² Jackie Range, “Asia's 200 Most-Admired Companies – India – Reader Survey: Bharti Airtel, ICICI Bank top list of innovators in India – Mobile-phone operator mixes borrowed ideas with new ones; private-sector lender brings services to the poor in rural areas,” *The Wall Street Journal Asia*, 11 July 2008, via Dow Jones Factiva, (c) 2008 Dow Jones & Company.

To achieve profitable growth over the longer term, supply chains need to be transformed into efficient and agile networks that can handle larger volumes, expand reach, and balance costs.



The other big issue is the lower margins that can be achieved compared to traditional retail. “Consumer products companies may be unwilling to give up the level of margins they are used to,” says Howard Martin, Global Sector Leader, Consumer Products, “but equally they cannot afford to miss out on the long-term opportunities that organized retail offers. As it expands it will create volume growth opportunities, which in turn should enable companies to achieve the economies that go with that increased scale.”

Four ways to win

Consumer products companies can improve the opportunities that organized retail represents in various ways, including anticipating change and being flexible; using local materials and resources; leveraging innovative technologies to gain first-mover advantage; matching size to need; and focusing on corporate responsibility to counter image pressures.

But we think that the real path to success lies in focusing on just four things. Get these right, and you should be well placed to compete in this dynamic market:

1. Improve your supply chain

Consumer products must develop stronger and more agile supply chains to succeed. India brings with it a host a supply chain issues, including a limited use of IT, a lack of third-party logistics providers, little infrastructure sharing among retailers, and gaps in the storage and transportation networks. Inadequate road infrastructure is a particularly big issue; as the majority of all Indian transportation is through roads and nearly half of all villages are connected only by roads.

Tackling the supply chain is crucial as inefficient supply chains are contributing to the massive problem of ‘out of stocks’ – and consequential lost sales – that is afflicting Indian retail across the board. Supply chains also need to be able to adapt to the changes that organized retail brings, such as shifting distribution patterns and shorter times-to-market.

To achieve profitable growth over the longer term, supply chains need to be transformed into efficient and agile networks that can handle larger volumes, expand reach, and balance costs – and suppliers and organized retailers will need to work together to build the necessary capabilities to achieve this. One long-term solution might even lie in consumer products companies acquiring smaller Indian retailers in order to gain a distribution infrastructure.

Getting it right

In 2000, Unilever set up the Shakti program to help the communities in which it was operating, as well as improving its own supply chain and distribution network. The program involves women becoming sales distributors for the company’s soaps and shampoos, something for which they receive training in selling, commercial knowledge and bookkeeping. So far, it has been successfully rolled out in India, Sri Lanka and Bangladesh and helped more than 50,000 women into employment.³ It also makes strong business sense: it has enabled Unilever to reach thousands of remote Indian villages, and reports suggest Shakti distributors now account for 15% of the company’s sales in rural India.⁴

2. Collaborate with organized retailers

The power struggle so frequently seen between organized retailers and consumer products companies is just getting started in India. Large retailers like Wal-Mart and Carrefour have landed (with around 7-8 additional major retailers looking to enter the market imminently) and are starting to use their global clout to negotiate down prices as suppliers are not offering the types of margin that can be achieved elsewhere.

³ <http://www.unilever.com/ourvalues/environment-society/case-studies/economic-development/india-creating-rural-entrepreneurs.asp>

⁴ “Strong partnership key to success in bottom of the pyramid innovation,” Economic Intelligence Unit – Executive Briefing, 5 September 2008, via Dow Jones Factiva, (c) 2008 Economic Intelligence Unit.

One way to achieve increased understanding is through working closely with non-governmental organizations (NGOs) and governments on projects which are both commercial and beneficial to local communities, as such bodies can provide invaluable local insight.



As this is not viable over the long term, suppliers have already begun to focus on cutting costs so that they can offer more competitively-priced products.

Despite such negotiations, unlike markets such as the US and Western Europe – where retailers are increasingly wielding massive power over their suppliers – there is an interesting interdependence evident in the Indian market. For example, while retailers have been known to boycott even the most high-profile supplier's products if prices don't come down or supply or quality is erratic, this can backfire badly. Many products in India are very local in nature, and consumers are relatively brand-loyal, so if a retailer doesn't stock the right products it affects footfall. Boycotting can also work both ways, and certain large consumer products companies have stopped supplying retailers due to non-payment for products.

All of this means that consumer products companies and retailers should put their customers first and work together to encourage a more collaborative way of working. Retailers and consumer products companies should come together on the consumer offer – getting the product and price right, as well as improving supply chain dynamics. This may prove particularly important in light of the growth of private label in India – it now accounts for around 15-20%⁵ of the top line of many large Indian retailers, or considerably more in some cases – so consumer products firms face fierce competition for retailers' wallet share.

3. Focus on the rural market

The rural market must become an essential area of focus for organized retail (it already is for traditional retailers) due its sheer size and growth potential, so consumer products companies must make sure they devote sufficient and appropriate resources to it.

India's rural market is one where needs tend to be practical and price sensitive. And even though companies have to be aware that consumers at the bottom of the pyramid tend not to have predictable income (which affects purchasing dynamics) the rural market has been shown to be surprisingly loyal – so if companies get it right they could really reap the rewards. This is particularly true as changes in the rural economy – such as people moving from working in agriculture into manufacturing, which pays better – are likely to lead to a rural economic boom.

In order to earn and keep brand loyalty in the rural market, product design will need to go beyond ideas like smaller sizes (such as single use sachets) to creating genuinely new products that appeal to this group. This requires a deep understanding of the market and an appetite for innovation, posing a challenge for both consumer products companies and retailers as there is still a lack of shared understanding about the ever-changing Indian market and the types of consumers that make it up.

One way to achieve increased understanding is through working closely with non-governmental organizations (NGOs) and governments on projects which are both commercial and beneficial to local communities as such bodies can provide invaluable local insight. Perhaps the best example of this is the Shakti program as it was launched in partnership with NGOs, banks and government.

Getting it right

Colgate is an example of a company that has successfully targeted the rural market, without falling into the 'one size fits all' trap. When it was looking to launch its toothpaste, it carried out research that showed that 66% of rural households still used non-toothpaste products like ash, charcoal and tobacco to clean their teeth. As a result, Colgate launched 'Colgate Toothpowder' instead, a completely new product it had developed to emulate the cleaning method the target market was used to. The toothpowder rapidly became a strong seller and helped make Colgate one of India's leading oral care brands.⁶

⁵ "Little room for private labels as big durables brands slash prices," *The Economic Times, India*, 5 March 2008, via Dow Jones Factiva, (c)2008, The Economic Times, India.

⁶ http://www.colgate.co.in/app/Colgate/IN/Corp/PressRoom/Product.cvsp?newsArticle=News_030400



India's geographic spread and diversity mean that traditional retail will always have a significant role to play in reaching India's less accessible, largely rural consumers, as well as providing an alternative to the formats organized retail has to offer.

4. Don't forget traditional retail!

Despite the emergence of organized retail and its projected growth, consumer products firms must not neglect traditional retail. India's geographic spread and diversity mean that traditional retail will always have a significant role to play in reaching India's less accessible, largely rural consumers, as well as providing an alternative to the formats organized retail has to offer. After all, the small size of most traditional retailers means they are agile and have low running costs, enabling them to compete with organized retailers by offering a range of value-added services such as credit arrangements and same-day home delivery.

That doesn't mean things won't change. Approaches to traditional retail will also need to evolve because organized retail will start having a 'halo effect' as it introduces new ideas, processes, products and services to the market. Traditional retailers will learn from this and enhance their business practices accordingly.

All of this means that consumer products companies will need to monitor developments and innovations in both organized and traditional retail and ensure that they have a multi-faceted strategy that applies effectively to both.

How we can help

We work with organizations in a variety of ways to make sure they're in good shape to enter and operate successfully in the Indian market over the long term. We offer services including:

- ▶ entry strategy and business planning
- ▶ partner search and funding advisory
- ▶ supply chain transformation
- ▶ tax-efficient supply chain management
- ▶ strategic cost reduction
- ▶ marketing and advertising risk services
- ▶ contract risk services
- ▶ standard operating procedure (SOP) manuals
- ▶ ERP advisory services

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Whether it's squeezed margins, brand erosion, business complexity or new regulatory requirements, today's consumer products companies must think differently in order to prosper. Ernst & Young's Global Consumer Products Center brings together a worldwide team of professionals to help you achieve your potential – a team with deep technical experience in providing assurance, tax, transaction and advisory services. The Center works to anticipate market trends, identify the implications and develop points of view on relevant industry issues. Ultimately it enables us to help you meet their goals and compete more effectively. It's how Ernst & Young makes a difference.

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