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Gold at the end of the rainbow...

Pic: Shaju John

Despite the recent downturn in consumer spending in the country, the fundamentals of organised retailing such as increased consumer purchasing power remain strong.

THE prophets of doom are at work. The much-hyped retail bubble is set to burst, they say, and despite all that has been said about the bright future of organised retailing in India, current reality seems to suggest that profitability for Indian retailers is the elusive pot of gold.

So, has the 'great Indian retail dream' gone sour? When will Indian retailers begin to see black on their financials? Even before 9/11, there was little cheer with most retailers reporting flat or declining comparable sales and the post-WTC scenario looks even bleaker.

True, consumers in India, as also in most other countries, are being increasingly cautious about how and where they spend their money. Yet, such recent downturns in consumer spending notwithstanding, the fundamentals of organised retailing remain strong and can be enumerated as:

1. Sustained uptrend in consumer purchasing power.

2. Evolving expectations from shopping - choice, value, service, experience and convenience.

3. Extension of consumer brand seeking (promise, trust, comfort, image) from products to stores.

4. Potential to deliver superior value through supply chain savings.

Having said that, there certainly are several obstacles to the organised retail sector, which affects its profitability prospects - low consumer spending and traditionally lower retail margins relative to most international markets, operational and infrastructure bottlenecks which limit pace of growth and so on. Various retail formats and models are evolving, all of which seek to circumvent and overcome these challenges in different ways.

Several business models and hypotheses are currently being tested in India - from the consumer adoption of large hypermarkets such as RPG's Giant and Pantaloons' Big Bazaar, to the scalability of regional successes such as the FoodWorld

Pic: Bijoy Ghosh

In a country such as India, a single winning retail format is unlikely to emerge, at least for some time to come.

supermarkets and Subhiksha's discount stores. It is clear that in a country with consumer diversity on the scale that it is in India, a single winner format is unlikely to emerge and several models will succeed in catering to different consumer segments, and even cater to the different needs of the same consumers. Conversely, not all the formats that will develop will succeed and some will clearly have to shut shop.

On the subject of when Indian retailers will become profitable, the distinction between profitability at the store level and at the business level must be made. To achieve operating breakeven at the store level or 'four wall (4W) profitability' is relatively quick, and typically ranges between three and nine months for small footprint stores (1,000-5,000 sq ft), and 12-24 months for large formats (20,000-30,000+ sq ft).

For a single large format clothing store, for instance, the level of sales to achieve 4W breakeven may be as much as 40-50 per cent of the target sales at maturity, i.e. the 'target' level of throughput for a store beyond which annual sales increase can be expected to be fairly modest. It may take 12 months to achieve the breakeven level of sales, even for a reasonably well performing store, and a large format store can take up to five years to reach maturity. (The accompanying table illustrates the contribution towards business level profitability from a single store as it evolves from start-up to maturity.)

Prior to attaining 4W breakeven, each new store requires financial support to meet operating expenses. Post breakeven, each store begins to contribute towards the business' profitability.

Besides the large investments in the stores, the retailer is required to make substantial, phased investments in establishing infrastructure including IT (information technology) systems, distribution centres, supplier development and to support roll-out. These costs typically build up in advance of sales increases through multiple stores.

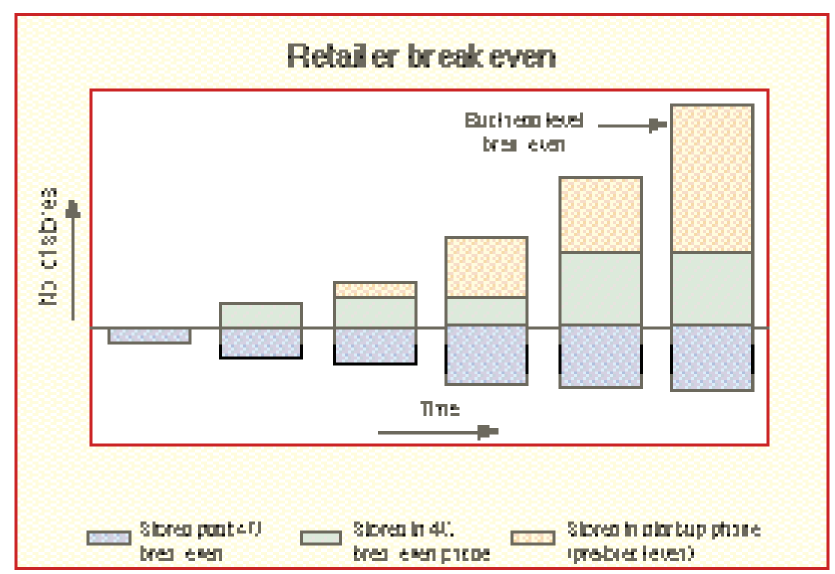
A start-up retailer can adopt either of two roll-out strategies in the initial years. It may choose to limit the pace of roll-out and achieve breakeven for each store before adding new stores, or to roll-out aggressively and thereby build the scale to benefit from supply chain efficiencies. In the case of the former, the business can turn profitable reasonably quickly and then possibly remain profitable. However, it may risk losing opportunities in new markets to more aggressive competitors.

A retailer pursuing an aggressive roll-out strategy targets attaining a higher gross margin through consolidation of volumes for multiple stores, thereby reducing the time to achieve breakeven for subsequent stores. This also enables the retailer to spread fixed back-end costs over a larger number of stores.

Typically, for a retailer pursuing aggressive roll-out, there will be more stores in the start-up phase and too few past 4W breakeven, which are contributing to offset back-end expenses, and the overall business profitability will be low. The chart illustrates how business level breakeven follows individual stores' 4W breakeven, and can vary with the pace of roll-out.

The challenge during the roll-out phase lies in managing the store portfolio so as to have more stores in the post-4W breakeven stage than in the start-up phase, which, combined with the need for rapid roll-out for market and supply efficiencies, implies that retailers must focus on expediting 4W breakeven for each store.

Also, retailers targeting early business level breakeven will plan phasing of back-end investments and expenses in conjunction with the roll-out plan and the time taken for indi-



In the early years, retailers can either choose to opt for an aggressive roll-out strategy by setting up several stores simultaneously, or add one store at a time, waiting for each one to be profitable before setting up the next.

Four Wall profitability for large clothing store

	Start-up	Breakeven	Maturity
Sales	100.0	100.0	100.0
Gross margin	28.0	28.5	30.0
Operating expenses			
- Fixed	28.1	17.9	9.4
- Variable	6.0	5.0	4.0
Store operating profit (loss)	(6.1)	5.6	16.6
Depreciation & Interest	8.0	5.6	3.5
PBT	(14.1)	0.0	13.1

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vidual stores to attain 4W profitability.

Thus, even while adopting an aggressive roll-out strategy, retailers need to focus on the following:

- Minimise fixed costs, both at stores and head office, by exploiting possibilities of partly variable occupancy costs, part-time staffing and reducing interest burden through phasing of back-end expenses.
- Carefully plan roll-out and develop formats which are scalable, to address the potential of each relevant market. This means some customisation of the store size and assortment to match the expected throughput without diluting the value proposition to the customer. Too large a store in a low potential market loads the store's fixed expenses and requires too much stock to fill the store, much of which will be candidates for markdowns. This, of course, will substantially prolong the time taken to reach 4W breakeven. Also, given that in the early roll-out stages, a retailer would have only a few stores and therefore a longer time to breakeven in even one or two stores can substantially impact the time for the business to turn profitable.
- Develop the capability (and the discipline) to facilitate exit from unprofitable store locations. Just as a retailer can make incorrect decisions in the merchandise it buys and requires strategies to exit those lines, decisions on store sizes and locations too can be incorrect, though with much higher stakes. Retailers need to consider possibilities of a quicker and lower cost exit from these locations which can significantly impact business profitability.

In the current Indian context, it must be kept in mind that Indian organised retail developments is a very recent phenomenon. With a few exceptions, most of the 'first generation' organised retailers have made an entry or commenced their roll-out, only in the last three-five years as the table shows.

Therefore, it is realistically too early to expect even the first generation organised retailers to deliver significant profits. Over the next 12-24 months, however, one can reasonably expect most of these businesses to turn profitable as more stores reach maturity to offset the additional back-end and new store expenses.

Also, to be fair to the pioneers, these companies are still developing competencies in understanding their customers, managing the supply chain and developing their store brands. These competencies have to be largely developed locally and clearly the inadequate availability of skilled resources - both frontline and managerial - is a huge impediment to this process.

A retailer commencing operations in a new city or even in a new location within a city, requires understanding of local preferences and behaviour to be able to present an efficient assortment, which implies going through several customer purchase cycles. In the case of a category such as clothing, this may take at least two-three seasons before the retailer can effectively gauge the pulse of local consumers and tailor its assortment to meet local needs, even if it has undertaken extensive research prior to commencing operations.

Of course, even while improving its assortment, the retailer must work at strengthening the store brand, enhancing customer acquisition and retention and managing supply relationships. Also, retailers must attain a certain scale to be able to effectively partner with suppliers, and then it takes a while before the benefits of the partnership manifest themselves in bottomline results. Having said this, retailers must develop the process capability and infrastructure even as they roll-out, and failure to do so will manifest itself in huge inventories, high markdowns and dissatisfied customers on a much larger scale, as some of the first generation retailers are now painfully aware.

Individually, many of the first generation retailers have demonstrated strong growth and fairly respectable performances on various operational performance measures. While globally retail performance is strongly linked to the performance of the overall economy – so too in India – tighter consumer spending may dampen the immediate profitability prospects of our retailers. However, the long-term potential for retailing in India remains strong, though recent events have certainly served to inject some realism into the expectations from our retailers. ■

(The author is Associate Director, KSA Technopak.)

Open for business (Year of start up for first generation organised retailers)

Shoppers' Stop	Clothing, Accessories, Home goods	1995-96*
FoodWorld	Food, Grocery	1996
Subhiksha	Food, Grocery, Pharma	1997
Globus	Clothing, Accessories	1998-99
Westside	Clothing, Accessories, Home goods	1998*
Planet M	Music	1998
Arcus	Building, Home improvement	20000

** year of roll-out*

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