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Case study: Development of the retail sector in India

India may be a long, slow path for Metro

Metro's progress still slow - No licence for fresh fruit and veg - Procurement difficulties. India's retail system fears foreign intrusion. By Sabine Hedewig-Mohr

India. The two new Metro C+C stores opened in Bangalore, in south-western India in 2003, were worth only a minor reference in Metro's plans for global expansion: it is just another country in its international store portfolio. What began in China and Japan is now India.

The 6,500 sqm store is pretty much like any other Metro C+C store, anywhere. The high-rack shelving is the same, so are the blue signs hanging on the racks, in fact it's just an average Metro C+C, Junior type.

Well it would be normal if it were not for the lamb carcasses waiting for their buyers, the vast array of shoes, the huge 50 kilo sacks of rice or the missing fruit and vegetables.

Religion plays an important role

Something else that makes it stand out is the statue of the elephant god Ganesh, complete with a garland of jasmine flowers, standing at the entrance. Smaller versions hang in the country's many taxis and rickshaws, a mode of transport that is part of the way of life of the store's management team, most of whom are from India.

India is not like the fast tigers Singapore or Thailand, neither is it like the artful dragon China which is happy enough to let foreign investors into the country, profits from their expertise and then keeps its fingers on more than half of their capital.

In fact India should perhaps be likened to an elephant, well-tempered, rumbling, friendly to strangers, but one which is likely to follow three steps forward with two in the exact opposite direction.

A strictly regulated democracy

The Indian continent has a population of more than 1 billion, and will have overtaken China as the world's most populous country by the year 2050. 70 per cent of the population lives in rural areas, but 27 of its cities each hold more than 1 million people. 30 per cent of the population lives in the poorest of circumstances, and between 150 and 200 million people make up the middle class.

India is also the biggest democratic country in the world, but its market economy is restrained by a tight corset of rules and regulations. For instance, its protectionist system tightly regulates which foreign consumer goods can be produced in the country, and which not.

Retail prices are controlled by printing the recommended retail price on the product packets. Most of these regulations are designed to protect domestic companies from foreign investors, only Indians, for instance, are allowed to own property and land.

Foreign IT sector strong

India is a country with enormous potential, one that has only really been "discovered" by a handful of companies, mainly in the IT sector. The German software house SAP recently decided to create 3,000 jobs in India. But, when it comes to retailing, on the other hand, India is also still a developing country.

98 per cent of the country's shops are small, and owner-operated. The retail sector achieves an estimated turnover of USD 260 billion each year. Modern, western style retailing is found mainly in the country's southern states, in the states Kerala, Karnataka and Tamil Nadu.

Low rents in the south

This emphasis on the south has to do with rents. According to the property specialists Jones LaSalle Research, rents in Mumbai and New Delhi are higher than in Los Angeles. In Bangalore, Chennai and Hyderabad, on the other hand, rents are about a third of what they are in Mumbai.

Interestingly enough, there are only two Indian retailers who earn as much as the EUR 100 million achieved by an average well-run western hypermarket.

Major international retailers have already taken their first steps on the Indian continent. Wal-Mart has had an office here for quite a while, Tesco has an outsourcing project running there which includes the further development of its Retek software.

The French retailer Casino is also interested, as is the British drugstore multiple Boots. The convenience retailer 7Eleven is also said to be negotiating the set-up of operations. All these groups have said they are interested, but things have not been taken any further. Metro is the only one to actually be operating. Carrefour withdrew from India in March 2004.

Laws protect domestic retailers

There is a very different reason behind this lack of foreign retail investment in India. A law, in existence since 1997, stops foreign retailers from setting up shop. The law was implemented by the Indian government as it feared the anger of the country's 10 million retailers.

Retailing is the country's second biggest employer, after the agricultural sector, and achieves 10 per cent of the nation's GDP. But it has become obvious that without foreign investment the sector is doomed to stagnation.

There are only very few foreign retailers who have managed to get a foot in the door. Hong Kong-based Dairy Farm and the South African retailer Shoprite had the courage to set up shop in India before 1997 and were able to remain when the law was introduced.

Some always find a way in

The Canadian shoe retailer Bata and Italian textile group Benetton have production facilities in the country and were therefore allowed to set up shop as well. Nike, Hugo Boss, Tommy Hilfiger, Swarovski and Marks & Spencer managed to get around the complicated laws by finding local franchise partners for their brands.

Metro was allowed to set up shop as a wholesaler, not as a retailer. The group took its first exploratory steps already back in 1995, withdrew, and then returned in 1999. Two first Junior C+C store were opened in the autumn of 2003 in Bangalore, in southern India. The venture cost the group an investment of USD 35 million.

Government promises behind location decision

The decision to open in Bangalore was based on several, good, reasons. First of all, the government of the state of Karnataka indicated that it was planning to scrap the retailing hurdles. Second, Bangalore has become India's Silicone Valley, where a wide range of international IT companies are making use of the highly-qualified specialists earning wages that are low by international standards.

Several manufacturing companies have already started production in the area and Bangalore is proud of its title "City of Pubs": in short, there is plenty of potential for Metro.

But now, one year on, Metro is still having teething problems. One of these is as old as the cash + carry sector itself, and is one of the most difficult to refute. Metro is reckoned to be selling not only to dealers, but also to end-consumers for their private consumption.

Domestic retailers fear Metro's power

The protests in India have been particularly hefty. Retailers were up in arms, the media became embroiled in the matter, and the public authorities were drawn into the fracas.

They have reacted by drawing up a strict criteria list of who is ably to shop at Metro, and who not. Apart from an official traders licence, till receipts have to be above 1,000 Rupees (20 Euro). Products are sold only in bulk or in multiples.

Anybody wishing to buy spirits at wholesaler prices has to have an additional retail licence for this product group and not even Metro's own staff are allowed to shop in the store.

No fruit and vegetables, no strong growth

Another problem that Metro India faces, and one that is much more difficult to resolve, is the fact that it is not allowed to sell fresh fruit and vegetables in Bangalore. This really is a major hurdle for a company that would like to provide its customers with everything they need, under one roof.

The store's huge Fruit and Vegetable section offers huge sacks of dried fruit and nuts. Here Metro's size is a disadvantage. Another Indian law states that fruit and vegetables can only be sold wholesale at the city's 2,700 sqm special market. In a nutshell, Metro isn't licensed to sell fruit and vegetables in India.

The government in Karnataka said three years ago that it wanted to change this ruling, and Metro is still waiting.

Time has always been money

This waiting is costing the company turnover, it was 30 per cent below expectations in its first year. Food turnover accounted only for 42 of total turnover instead of the 65 per cent that was planned. It is missing out on all those restaurant customers who specialise in vegetarian food.

Despite al these difficulties, Metro still sees its activities in India as positive. And it has figures to back this up. The two stores average about 1,400 customers a day and the average till receipt is 4,500 Rupees (about EUR 90), well above the minimum turnover required and above all expectations. Metro has become Bangalore's biggest wholesaler in the suitcase, shoe, school requisites and towel sectors.

Import tariffs prohibitive

One of the difficulties that all retailers face in a new market is one that also Metro has come up against. This is procurement. Import tariffs are very high and this means that 95 per cent of all goods sold in its stores have to be sourced in India and this confronts Metro with a quality problem.

There is nothing that could be termed a supply chain for chilled produce and even if there are chiller systems in operation, these have to contend with power cuts on a daily basis.

Major problems with quality

Some of the agricultural products pass through anything up to six middlemen, only very few producers or dealers know anything about making sure that the quality produced is also maintained along the supply chain. And the result? Huge losses from rotting produce and falling quality.

This is hardly something that India, a country with a population of more than 1 billion and a growth rate of between 6 and 7 per cent per year can afford. What is more to the point, this is something that a major food wholesaler such as Metro cannot afford.

Metro provides education

This is why the company has initiated programmes to educate producers and improve the supply chain. Some of these programmes are being carried out with the help of public institutions, others with the backing of the German development bank KfW.

Shepherds and fishermen, for instance, are being taught to grade and pack their goods according to their quality. This initiative seems to have impressed the governments of several other Indian states. Metro C+C director Thomas Hübner visited the state of Punjab in July in

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the course of which he signed a letter of intent stating that Metro would be opening one of its stores in this region and that it would source produce for the store on a regional level, maybe even for its international operations.

Produce from India goes worldwide

The New Delhi-based Metro Buying Group profits from the experiences and contacts of its C+C division whose job it is to source products that will benefit Metro worldwide.

That India is one of the world's biggest agricultural countries is something that the government has come to realise, just as it has realised that an inefficient supply chain and low qualities are a hindrance to country out to improve its experts.

Kamal Nath, Minister for Trade and Industry, has recently initiated a programme designed to strengthen India's position as an exporting nation, by supporting the retailers. In fact Nath is setting his sights beyond mere exports, he is also considering the idea of opening the country to foreign retail groups.

Foreign expertise

Their expertise would serve to improve the infrastructure of warehouses and transport logistics which would, in end effect, serve to improve the quality of produce all the way from the farm to the fork.

And, in the end, this would then serve the "initiator" of the movement: Metro would then no longer be battling alone against laws and bureaucracy, the company of groups such as Wal-Mart and others wouldn't be far behind.

India's Top Retailers: A Ranking

Retailing in India

The Margin Free Market co-operative is India's biggest retailing group although it only operates in Kerala. M+M Planet Retail estimates that the group achieves a turnover of about EUR 248 million. Its 320 stores, mostly very small and very simple, are operated by franchisees. It only costs 100,000 Rupees, about EUR 2,000, to buy into this highly successful system. About 12 new stores are opened each month.

Dairy Farm, a Hong Kong-based group, has a joint-venture with the Indian Spencer & Co. Ltd group. Its 91 Foodworld stores make it the biggest supermarket operation in Bangalore and Chennai. The stores have an average retail area of 500 sqm and offer 5,000 lines, including 150 own labels. Many of the stores also have a little café and snackbar attached.

Spencer Giant Hypermarkets, with 5,000 sqm retail space and 25,000 lines, are found only in Hyderabad and Mumbai, 17 new stores are planned for 2005.

The 100 per cent Indian Subhiksha group, began its operations in Chennai, then moved to

Bangalore and is now planning further expansion in the direction of Mumbay and New Delhi. The group has also be said to be considering the acquisition of smaller competitors. The concept consists of 137 fairly small neighbourhood type shops.

Nilgris, also 100 per cent Indian, has been around since 1905, the first supermarket was opened in 1971. The group operates six of its own stores as well as 21 operated by franchisees. 50 per cent of the lines sold are own labels, produced by the company itself. The group also has an internet shop.

Metro is already in 5th position after only 3 months of operation in 2003, 17 more stores are already being planned, with a projected overall turnover of EUR 1 billion.

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