India

ECONOMIC OVERVIEW

Over the past decade, India has witnessed stable economic growth due to the progressive liberalization of government policies, an increase in direct investment, enhanced global competitiveness, investment in infrastructure development and growth in domestic as well as export demand for Indian goods and services.

While unemployment and poverty remain key challenges, the outlook for long-term economic growth for India remains positive.

GDP AND CPI

The Indian economy grew at an impressive rate of 8.1% in 2003-2004 compared with 4.3% in the previous year. A key driver of this growth was the recovery in agriculture and allied services, which registered declines in the previous year. The compounded annual economic growth rate for the last five years (1999-2004) stands at 5.6%.

Key economic indicators	1999-00	2000-01	2001-02	2002-03	2003-04
GDP growth (%)	6.0	4.4	5.6	4.3	8.1
CPI (%)	3.4	3.7	4.3	4.0	4.6

Source: Reserve Bank of India

The proportion of GDP represented by the services sector has risen steadily from 47.5% in 1992-1993 to 56.1% in 2003-2004. Services have thus emerged as the principal driver of growth in the Indian economy. Information technology (IT) and IT-enabled services (outsourcing) have played a key role in positioning India as a global services destination, a trend that is expected to continue and grow at a rapid rate. On the other hand, the proportion of GDP derived from agriculture and allied activities has declined from 31.5% in 1992-1993 to 22.2% in 2003-2004. Manufacturing has remained broadly unchanged, representing 21%-22%.

Area ('000 sq km): 3,300
(US 9,600 – EMU 2,500 – World 133,700)

Capital: New Delhi

Population (million): 1,055
(US 288.4 – EMU 305.5 – World 6,200)

GDP (USD billion): 510.2
(US 10,400 – EMU 6,600 – World 32,300)

GNI per capita (USD): 478
(US 35,400 – EMU 20,320 – World 5,120)

Currency: Indian Rupee (INR)

Languages: Hindi, English, regional languages

Main religions: Hindu, Muslim and Christian

Government type: Federal Republic

India

Agriculture, industry and services are estimated to have registered growth of 9.1%, 6.6% and 8.2% respectively in 2003-2004. The growth recorded in these three key sectors surpassed the previous year's rate.

Economic growth has been accompanied by moderate inflation of 4.0% over the last five years. At 4.6%, the CPI for the year 2003-2004 was marginally higher than the previous year.

UNEMPLOYMENT

Given the large population base and the relatively low GDP per capita, unemployment and poverty remain key challenges to future development, particularly as agriculture remains key to providing employment to the rural working population. Estimates put unemployment at 8.8% in 2001-2002.

ECONOMIC FORECASTS

GDP growth projections of 6.5% to 7.5% in 2004-2005 corroborate the expectation of continued growth in services, industry and infrastructure. However, the contribution from agriculture is expected to fall in relation to the high comparison base set this year. Inflation is expected to rise marginally in the near term due to the increase in international oil/energy prices.

Unemployment is expected to rise from the present level of 9.2% to around 9.8% by 2006-2007 on the back of labor force growth estimated at 1.8% per annum and employment growth of 1.7% per annum estimated by the Planning Commission.

REGULATORY ENVIRONMENT

FOREIGN DIRECT INVESTMENT

Foreign investment is governed by the Indian government's Foreign Direct Investment (FDI) policy and the Foreign Exchange Management Act, 1999 (FEMA). Foreign investment is permitted in virtually all sectors, except those falling under strategic concerns that are not eligible for automatic route investment. The FDI policy is formulated by the Indian government and implemented by:

- The Reserve Bank of India for cases falling within the parameters of the automatic route (i.e. without requiring prior approval); and
- The Foreign Investment Promotion Board (FIPB) for all other cases.

The FIPB is an empowered board of the Government of India consisting of members of various central government ministries. The government is proposing to set up an Investment Commission with the objective of engaging, discussing and inviting foreign businesses to invest into India.

Prior to 1997, while FDI policy recommended specific FIPB approval in trading, the FIPB also considered and approved, on a case-by-case basis, applications for the retail-trading segment. For instance, Foodworld, which is a 51:49 joint venture between RPG group and Dairy Farm International of Hong Kong, was established during this period and is one of the leading food retailers in India.

Since then, the policy has undergone change and the current FDI scheme in India permits retail-trading, subject to FIPB approval, in the following cases only:

- Hi-tech items/items requiring specialized after sales service
- Social sector items
- Medical and diagnostic items
- Items sourced from the Indian small sector (manufactured with technology provided by the foreign collaborators)
- 2 year test marketing (simultaneous commencement of investment in manufacturing facility required)

Foreign-owned Indian companies cannot own and operate retail outlets, other than for those items identified above. However, on a specific approval basis, 100% FDI may be permitted in the case of trading companies carrying out the following activities:

- Export trading
- Bulk imports with sales either through custom bonded warehouses or high seas sales
- Cash and carry wholesale trading

- Sales substantially to group companies

With respect to e-commerce activities, up to 100% foreign direct investment is permitted subject to the condition that companies listed abroad divest 26% of their equity in favor of the Indian public in 5 years. Furthermore, these companies are only allowed to engage in business-to-business (B2B) e-commerce and not in retail-trading, inter-alia. This implies that existing restrictions on FDI in domestic trading would be applicable to e-commerce as well.

Given that the retail sector is presently dispersed, widespread, labor intensive and largely disorganized, the Indian government has been debating on whether to lift restrictions on FDI. As the new government takes shape, it remains unclear as to whether this sector will be opened.

PROPERTY / REAL ESTATE REGULATIONS

Real estate for retail sector

The retail boom currently being witnessed in India is likely to have a significant impact on the commercial real estate sector. Presently, most major Indian cities have sizeable retail construction projects underway. In the past, real estate costs have been high in India. However, the scales of supply and demand have recently tipped in favor of a rationalization of property prices across the country.

In most cities it is difficult to find suitable properties in central and downtown locations for large format retail stores. This is primarily because private holdings are fragmented and the auctioning of large government-owned vacant plots is rare. This has led to a shift towards the suburbs of metropolitan cities. There has been a spurt of shopping malls in these areas, such as Gurgaon and Noida near Delhi and Bandra Kurla Complex and Navi Mumbai near Mumbai. While most Indian players have ready and easy access to prime real estate locations, foreign companies have to depend upon shopping malls and rentals for their outlets.

Property regulations

As discussed above, there is a shortage of retail space in central and downtown locations and rents are high for what is available. These shortages are compounded by the following problems:

- Very high stamp duties on transfer of property - varies from state to state (12.5% in Gujarat and 8% in Delhi).
- Urban Land Ceiling Act and Rent Control Acts have distorted property markets in cities, leading to exceptionally high property prices.
- Presence of strong pro-tenancy laws makes it difficult to evict tenants. This problem is compounded by lack of clarity over titles to ownership.
- Land use conversion is time consuming and complex.
- Time consuming legal process for property disputes.
- City urban planning projected smaller commercial plots and this, together with rigid building and zoning laws make it difficult for procurement of retail space.
- Non-residents are not allowed to own property except if they are of Indian origin. Foreign-owned Indian companies can own property for business purposes.
- Foreign investment in real estate business is prohibited except for integrated township development, wherein 100% FDI is allowed with prior government approval.

OTHER REGULATIONS

Domestic taxation system

Sales tax rates differ across the various Indian states making supply chain management a challenging task for organised retailers. Inter-state sales attracts Central Sales Tax while for some categories of products, certain states levy import duties, namely entry tax on entry of goods into their territory. Simultaneously, states levy export duties when goods are moved for sale outside state border. Sales tax evasion by small retailers to offer lower prices/ fetch higher margins is also commonplace in local markets. In addition to state taxes, certain local authorities (e.g. municipal corporations etc.) may levy Octroi (local entry taxes).

The Government has proposed Value Added Tax (VAT) to streamline the domestic commercial taxation system. The implementation and rollout of a VAT regime remains in discussion stage. However, in its latest budget, the Government announced that VAT would be introduced from April 1, 2005. VAT would have a very strong bearing on the consumer and retail sector. Currently most of the retail traders are not

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liable to pay tax, as the first seller is paying the tax. Henceforth the retailers would be comprehensively brought into the VAT regime. In order to implement VAT successfully, the Government will be encouraged to further develop the organized retail sector in India.

Imports

Customs or import duties are levied by the central government on goods imported into India based on predefined nomenclature. Duty is levied on the transaction value of the imported goods at the rate of duty specified in the Customs Tariff Act, 1975.

The central government has reduced the peak rate of basic customs duty chargeable on goods imported into India to 20% with effect from January 9, 2004, down from 40% previously. Based on the tariff description, the following duty slabs for basic customs duty have been notified by the government: 20%, 15%, 10% and 5%. In some cases, certain goods are fully or partially exempt from levy of customs duty.

Most consumer goods generally attract a peak rate of basic customs duty of 20%. An additional customs duty can also be levied on such items at the rate of 16%.

India, being one of the founder members of the World Trade Organization (WTO), has agreed to bind its customs tariff to the rates specified in the Schedule of Concessions in accordance with Article II of the WTO Agreement. These commitments restrict India from raising its tariff levels beyond the limit specified in the Schedule of Concessions. Further, India has gradually removed Quantitative Restrictions (QRs) in accordance with the commitments made to the WTO.

Recent reductions in various customs duty rates below the bound rates indicate continued efforts of the Indian government to rationalize and align duty rates in accordance with the rates prevailing in South-East Asian countries. With the implementation of WTO norms and further removal of restrictions from the import regime, the retailing sector outlook appears bright.

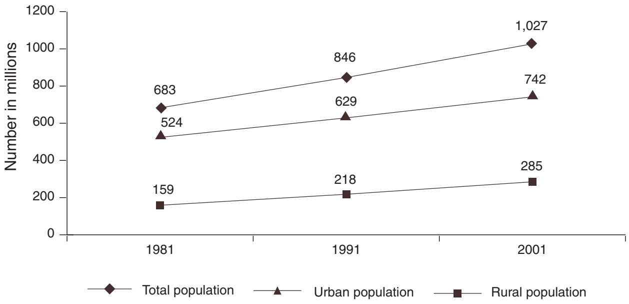
DEMOGRAPHICS AND CONSUMER BEHAVIOR

POPULATION

Population evolution

India's population estimated at 1,055 million (2003) is expected to grow by 1.7% this year. Growing urbanization is a key trend in the country, with rural population growth averaging to 17.9% and urban growth at 30.7% for the period 1991 to 2001.

Key statistics with regard to population growth and the urban and rural split are set out below.



Source: Statistical Outline of India 2003-2004

Over 70% of the urban population is estimated to reside in Class I cities (population of over one million). This is largely as a result of increased employment opportunities in cities as well as a preference among the younger generation to move away from agriculture.

Growth of population and urbanization	1981	1991	2001
Population growth (decennial %)	24.7	23.8	21.3
Urban population as a % of total	23.3	25.7	27.8
% of urban population in class I cities	60.4	65.2	73.7

Source: Statistical Outline of India 2003 - 2004

Population by age group

One of the important demographic trends in recent times is the changing age profile. India is increasingly being acknowledged as a "young" nation, with about 35% of its population less than 14 years of age. The median age of India's population is 24 years. Youth are generally early adopters of most modern products and concepts. Given the higher aspirations and "willingness to change" of the younger age group, India's age profile offers high market potential for consumer goods.

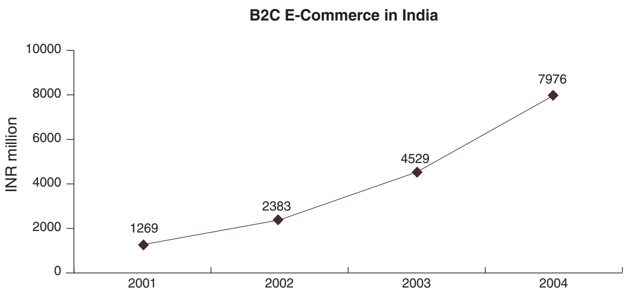
However, in the long term, this factor represents a challenge as rapidly growing numbers of ageing consumers will have more discretionary income but will spend less on goods and more on healthcare and other services as well as saving for retirement. Set out below is the forecast of the age profile over the next 12 years.

Ageing population	2001	2006 (projected)	2011 (projected)	2016 (projected)
0-14 years (%)	35.6	32.5	29.7	27.1
15-59 years (%)	58.2	60.4	62.5	64.0
60 and above (%)	6.3	7	7.9	8.9

Statistical Outline of India (2003-2004)

INCOME / BUYING POWER

The per capita income has been witnessing steady growth in the last few years and as seen from the chart, has almost doubled in this period. This trend is likely to continue in the near future as the economy continues to grow.



Source: Statistical Outline of India 2003-2004

As seen from the mapping of India's income classes below, the consuming class and climbers class segments offer tremendous opportunity to the retailers. The number of households in these categories combined is expected to grow by 38.8% over the period 2005-2006. The lower income categories are projected to decline by 10.7%, while the very rich category is projected to double. Retailers will have to focus on the consumption patterns of the middle class to map their future strategies, as this upward push will lead to greatly increased purchasing power.

Classification (annual household income)	Number of households (Millions)		
	1994-95	1999-00	2005-06 (projected)
Very rich (Above INR 215,000)	1	3	6
Consuming (INR 45,000- 215,000)	29	55	75
Climbers (INR 22,000-45,000)	48	66	78
Aspirants (INR 16,000-22,000)	48	32	33
Destitutes (Less than INR 16,000)	35	24	17

Source: The Marketing Whitebook (2003-04)

CONSUMER BEHAVIOR

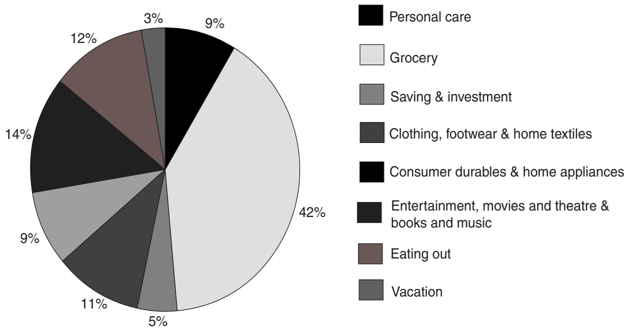
Rapid advances witnessed by India in areas like education, communication, information technology and transportation have created a sense of freedom in the minds of people. These advances have led to a paradigm shift in the way Indian consumers behave today. Consumers are seeking convenience at their doorstep for regular purchases, but are willing to travel to exclusive destinations for valuable items. With Indian consumers maturing to self-service formats, reliance on salesmen is on the decline.

Urban consumer spending

Consumer spending is estimated to have grown at an average rate of 11.5% p.a. over the past decade. The average Indian spent INR14,396 in 2001-2002. A review of urban consumer spending in 2001 and 2002 reflects that the expenditure on 'lifestyle' items such as vacation, eating out, etc. has increased while that on savings and investments is on a decline. Groceries were the single largest expense, accounting for nearly 42% of total expenditure. Eating out followed this, which accounted for 12%.

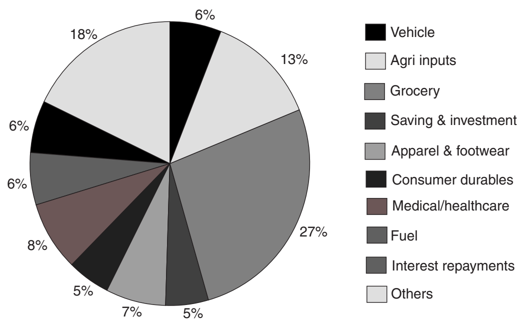
Urban Consumer Spending

2002



Source: The Marketing Whitebook (2003-2004)

Rural Spending



Source: The Marketing Whitebook (2003-2004)

Rural consumer spending

A rural customer is fundamentally very different from the urban consumer. About 70%-80% of rural consumers are farmers; as a result the rural spending basket differs from urban spending, as it not only consists of personal and household items but also occupational expenditure like fertilizers, seeds, pesticides and so on.

Lifestyles / Shopping habits

Global travel and media have exposed Indians to the "western" lifestyle. Discretionary spending increased by 15% in 2002-2003. Fast moving products/ services include mobile phones, movies, entertainment, eating out and consumer durables. Opening up of the economy has led to an increase in the product choice available and modern retailers are experimenting with ways to deliver an international shopping experience to the consumer.

Brand / Price sensitivity

Urban consumers today are relatively less price sensitive than a few years earlier. Some of the key factors behind this change are growing number of double-income households, a decrease in the average size of the family and higher media exposure. With the rise in disposable income level, the consumer is willing to spend more on personal needs and indulgences, leading to a propensity to consume rather than save.

RETAIL & CONSUMER SECTOR PERFORMANCE

MAJOR CONSUMER GOODS PLAYERS

The Indian CPG sector has a fair mix of domestic and international players, with Hindustan Lever (subsidiary of Unilever), a conglomerate offering a diversified consumer products portfolio (including soaps, detergents, shampoos, cosmetics, food, tea and coffee), a clear market leader. ITC (part of the BAT Group), India's largest cigarette manufacturer, which owns diversified holdings in hotels, apparel and food, ranks second.

Top 10 consumer goods companies

Rank	Company name	Category of products	Net sales (INR million)	Year
1	Hindustan Lever	Personal care, detergents, food	101,244	Dec-03
2	ITC	Tobacco, food, apparel	64,704	Mar-04
3	Videocon International	Electronics	36,015	Sep-03

Rank	Company name	Category of products	Net sales (INR million)	Year
4	Ruchi Soya Industries	Soya products, edible oils	35,787	Mar-04
5	Gujarat Co-operative Milk Marketing Federation	Dairy products, chocolates, food, ice cream	28,820	Mar-04
6	Nestle India	Dairy products, chocolates, food, confectionary, coffee	22,798	Dec-03
7	Nirma	Personal care, detergents	22,087	Mar-04
8	Indian Rayon	Textiles, apparel	15,738	Mar-04
9	Philips India	Electronics	15,664	Dec-03
10	Arvind Mills	Textiles, apparel	13,911	Mar-04

Source: PricewaterhouseCoopers

Although Indian people are using more consumer products than ever before, they are paying less for them. While sales rose in volume last year, they fell in value due to a huge decline in prices triggered by intense price wars among existing big players. Furthermore several local companies with cost-effective structures captured potential customers by introducing strong brands in their regions. *"Reasonable products at affordable prices"* is emerging as the consumer goods company's route to success.

The dynamic rural market is attracting more and more companies, undertaking specific initiatives, such as customizing, merchandize, localizing communication and promotion activities and carrying out region-specific research to target the rural consumer. Companies, like Hindustan Lever and Arvind Mills are among the pioneers in successfully identifying the potential of the rural market.

MAJOR RETAIL PLAYERS

Retail sales

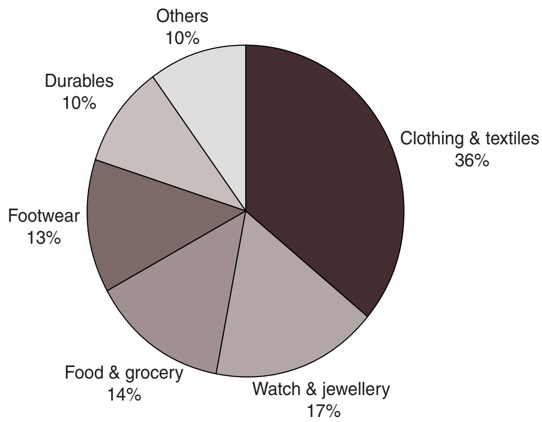
The Indian retail industry, consisting of over 15 million outlets, is estimated to provide employment to over 18 million people. The retail market pegged at USD180 billion has been growing at a steady rate of over 5% per year and accounts for around 10% of the country's GDP. Currently, the sector is highly fragmented and dominated by small, individually-owned businesses (unorganized sector). Organized retailing is estimated to represent USD3.6 billion, accounting for only 2% of the overall market. The top ten cities account for 96% of total organized retail, of which the top six cater to 82%.

The organized retail industry is expected to be worth about USD6.7 billion by 2005, representing 6% of the total retail market against 1% in 1999. This growth is likely to be driven by increasing incomes, growing exposure to overseas markets, availability of credit cards, increased 'lifestyle spending' and higher mobility. The top six cities are expected to account for 66% of the organized retail market in the future. It is estimated that at the current rate of projected addition of retail space, an investment of INR 5 to 7 billion annually will be made on retail real estate and supporting infrastructure.

The key players in the organized retail sector are Shoppers Stop, Pantaloon, RPG Group (Foodworld), and DS Group. A popular medium of entry for foreign companies has been through franchising arrangements with local entities. Several global brands such as Marks and Spencers, Tommy Hilfiger and Nike have entered through this kind of arrangement.

Breakdown of the organized retail market by sector is estimated as follows:

Organized retail in India



Source: The Marketing Whitebook (2003-2004)

India

Food retail channels

Hypermarkets

Hypermarkets in India are still in the nascent stage, however, a few established retailers have ventured into this format.

Company name	Group name	Number of outlets	Net sales 2003-2004 (INR million)	Future plans
Big Bazaar	Pantaloon Retail	9	2,300	22 stores by 2005
Giant	RPG Group	2	900	21 new stores by 2007

Source: PricewaterhouseCoopers

Supermarkets

Till recently, 'Kiranas' or the neighborhood grocery store was the only choice available to the consumer, especially in urban areas. This is slowly giving way to international retail formats with the emergence of global standard supermarkets. Supermarket sales grew by 30% in 2003.

Company name	Parent company	Number of outlets	2003-04 Net sales (INR million)	Future plans
Food World	RPG (51%) & Dairy Farm (49%)	93	3,519	NA
Nilgiris	Nilgiris	30	2,550	20 new outlets in the next three years
Food Bazaar by	Pantaloon Retail	12	1,650	30 stores 2005

Source: PricewaterhouseCoopers

Discount stores

Discount store formats are primarily used for grocery and household products since consumers are price sensitive in this segment. Facing stiff competition from small grocery stores, retailers are forced to match the prices offered by them.

Company name	Group name	Number of outlets	2003-04 Net sales (INR million)	Future plans
Subhiksha	Viswapriya Group	143	2,350	55 new stores by 2005
Margin Free Markets	Independent retailer	300	540	N/A

Source: PricewaterhouseCoopers

Cash & Carry

The window of cash and carry wholesale trading has emerged as one of the preferred modes for entry into Indian trading sector by many foreign investors. For instance, Metro Group of Germany has set up a wholesale cash and carry complex.

Company name	Group name	Number of outlets	2003-04 Net sales (INR million)	Future plans
Metro Cash & Carry in	Germany's Metro Group	2	650	Wait and watch for any relevant changes regulation

Source: PricewaterhouseCoopers

Non food retail channels

Department stores

The number of department stores has grown by 24% per annum over the past five years. Department store sales have grown even more rapidly – by about 34% annually over the period 1999-2003. The upper-middle and the high-income classes predominantly frequent these stores. Most department stores stock a range of branded goods such as apparel, cosmetics and perfumes to cater to the customers' growing appetite for such goods.

Company name	Group name	Number of outlets	2003-04 Net sales (INR million)	Future plans
Shoppers Stop	K Raheja Group-Real Estate	14	4,040	11 new stores by 2005. Venture into food retailing

Company name	Group name	Number of outlets	2003-04 Net sales (INR million)	Future plans
Westside	Trent Ltd.	15	1,555	6 new stores by 2005. Venture into food retailing
LifeStyle	Landmark Group	7	2400	13 new stores by 2006
Globus	R Raheja Group-Real Estate	7	1,100	8 new stores by 2005
Pantaloon	Pantaloon Retail	16	2,500	21 stores by 2005
Ebony	DS Group	8	820	2 more stores by 2005

Source: PricewaterhouseCoopers

Specialist retailing

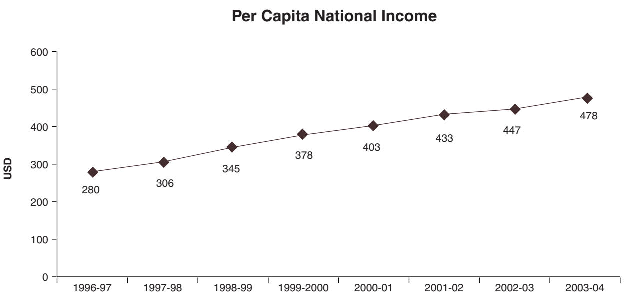
In India, manufacturers who have set up their own outlets to cater to customers directly dominate the specialist retail sector. Key lifestyle outlets, especially in sectors like jewelry, home furnishings and entertainment, will continue to be driven forward by growing incomes.

Company name	Group name	Format	Number of outlets	2003-04 Sales (INR million)	Future plans
Music World	RPG Group	Music retailers	125	600	14 new stores by 2005
Tanishq	TATA	Jewelry retailers	65	3,900	75 stores by 2005
Health & Glow	RPG Group	Pharma retailers	24	282	3 new stores by 2005
Crossword	Shoppers' Stop (51%); ICICI Ventures (49%)	Book retailers	18	370	28 stores and a turnover of 680 million by 2005

Source: PricewaterhouseCoopers

E-commerce

E-commerce in India has almost doubled in size in the last few years, despite of relatively low Internet penetration of 1.5%. The number of Internet users grew from 5 million in 2000 to 16.6 million by the end of 2002, a rise of 232% over a span of just two years. In 2003-2004 B2C turnover was up by 76% from the previous year.



Source: The Marketing Whitebook (2003-2004)

Most of this growth came from travel-related services, as Indian airline companies and Indian Railways introduced online reservations. Sahara and Indian Airlines reservations, alone account for half the transaction values on Indiatimes, a leading online retailer.

E-commerce in India is still in its infancy. With the number of Internet users increasing every year and credit card transactions on the rise, there is a huge potential for Internet retailing in the country.

RETAIL & CONSUMER CHALLENGES, OPPORTUNITIES AND EMERGING TRENDS

The unique characteristics of the Indian economy represent key challenges for the marketers. An understanding of these characteristics is necessary to unleash the vast potential of the Indian market.

CHALLENGES

Differences between urban-rural consumers

The rural Indian consumer is economically, socially and psycho graphically very different from his urban counterpart. Urban growth in the CPG sector is spread over a diverse basket of goods like low priced mobiles, cheap financed consumer goods and new entertainment options. Rural spending and demand is fuelled by good monsoons resulting in disposable income that is spent on medicines, fertilizers and interest repayments.

Cultural preferences and tastes that differ from the "global economy"

Given the strong and diverse cultures in India, multinational firms have to develop and customize products specifically for the Indian market. For instance, Domino's has introduced pizzas with Indian cuisine toppings, and over one third of its revenues are attributed to such additions.

Extensive distribution network

The Indian market is dominated by over 12-15 million small "mom and pop" retail outlets, of which about 65% are in rural areas. Accessing these outlets is one of the biggest challenges facing the CPG companies who need to either set up their own extensive distribution networks or enter into strategic alliances.

Fragmented market

The Indian market continues to have a strong presence in the unorganized sector, primarily due to limited entry barriers, exemptions and reservations of certain items for the small-scale sector and problems encountered by large players in reaching out to rural areas.

High capital requirement

Size and scale drives efficiencies on procurement and lower logistics costs, that in turn delivers better value to customers. Capital infusion and constant expansion are the order of the day and is lacking in the Indian retail space. Retailing efficiency is derived from effective sourcing, economies of scale and implementation of logistics and therefore calls for high investment in these areas.

Real estate and infrastructure

These two basic requirements for setting up retail stores are in shortage in the country. Acquiring large retail space in downtown and central locations of large Indian cities is very expensive. Lack of secondary infrastructure also affects the logistics and supply chain management of retail companies.

Managing channel conflicts

With cash registers equipped with bar-code scanners, retailers can now automatically manage the flow of products and transmit stock replenishment orders to the vendors. The lack of sophisticated analytical capabilities providing an integrated view of the supply chain continues to be a challenge. In addition to this, retailers are now setting up their own distribution networks to handle inbound logistics and are directly tying up with key suppliers for their sourcing. Some manufacturers / suppliers are forward integrating to alternate channels with both exclusive brand outlets and multi-brand outlets. However, these developments are giving rise to conflicts with the distribution infrastructure that suppliers have built over the years.

OPPORTUNITIES

Third party manufacturing

This is a commonly adopted practice in India and allows flexibility in production, inventory planning and control of labor costs, besides offering logistics solutions that enable companies to cater to a large market. CPG companies have traditionally relied on outsourcing of manufacturing to small-scale producers. Recently there has been a noticeable reverse trend from third party manufacturing to own manufacturing. MRP (i.e. Maximum Retail Price) based taxation and a host of incentives given by some Indian states such as Himachal Pradesh and Uttaranchal have encouraged companies to set up own facilities in these regions. Companies such as Hindustan Lever and Britannia, seeking taxation benefits in excise duty and direct tax, have announced plans to set up facilities in these states.

Packaged food / Agricultural products

Given the recent Government concessions announced in the agriculture and food sector, there is tremendous opportunity in the packaged food segment as well as in contract farming for both organized food retailers and food manufacturing companies. These concessions include - credit schemes for farmers, infrastructure schemes in rural areas, tractors at lower prices, extension of contract farming law to more States and provision of tax holidays to new agri-processing units.

Introduction of private labels

A surprising number of consumers have accepted private label brands in a country where small, individual stores selling no name goods have dominated. Private labels act as margin generators and create a dimension for differentiation for the retailer. In the long run they increase the retailer's bargaining power with established brand suppliers. This has proved to be a competitive advantage in providing scalability for delivery, lower inventory costs and store positioning for several retailers.

Mergers and acquisitions

India, with its vast consumer class, is now emerging as a focus country for several large multinationals in the retail and CPG sector. Multinationals are now exploring options to either enter the country or strengthen their existing presence in India. With its unique characteristics of strong local cultures and traditions, local brands, extensive coverage, differing regional pallettes and preferences, price consciousness etc., several multinationals have shown a preference for acquisition of local brands. Some of the large Indian groups have also identified acquisitions as the preferred growth strategy in this sector.

In the retail space, organized retailers would have to scale up operations quickly and smartly, both to achieve faster top line growth along with reasonable bottom-line performance. Consolidation is therefore likely to happen, leading to the emergence of 3-4 strong national players along-with 5-6 regional players as clear winners in each retail format within the next 2-3 years.

The sheer size of the market will make the world look at India with keen interest sooner or later. Indian retailers therefore have a 2-3 year window to scale up, consolidate and strengthen their brands to either forge partnerships with foreign players or to compete with them independently.

New specialty retail formats

There is huge need gap in categories such as car accessories, over-sized apparel, clothing for new born babies, maternity wear, footwear, branded jewelry, branded office products, etc. Indian / foreign retailers can distinguish themselves by entering these focused specialty retail formats.

EMERGING TRENDS

Sourcing

The CPG industry is following the IT outsourcing trend. Indian subsidiaries of global CPG players have proved themselves in terms of quality and production capabilities. This has led several international companies to source from India. For example, Hindustan Lever the subsidiary of Unilever exports a wide range of products like soaps, detergents, oral care and skin care products to other Unilever subsidiaries. A new Export Orientated Unit is being set up by Hindustan Lever in Pune, to cater to the needs of this business. Unilever is also setting up a global sourcing office in India to buy products and raw materials from low-cost locations for its subsidiaries across the world. India is moving towards embracing global patent and trademark standards that will facilitate outsourcing by CPG companies.

With quotas in textiles sector also being relaxed, global retailers are increasingly focusing their sourcing efforts (both apparel and non-apparel) from India. Wal-Mart has announced it will increase its annual sourcing from India from current USD0.5 billion to USD5 billion. This trend is likely to be followed by most big retailers.

Forward integration / Alternate channels

In a bid to close the distance between the company and the end consumer by cutting down the distribution channel, some manufacturers of consumer goods are establishing company-owned stores and service formats and exploring the store-in-store concept to enhance margins and increase customer value.

Rapid expansion and format migration

After making years of investments in customer acquisition, setting up of systems / processes and consequent operational losses, many leading retailers have passed their “learning” phase and are getting into the consolidation/aggressive rollout phase. Today, few of them are making modest money out of the business. This provides confidence to the investors to infuse much needed capital in the business, and will lead to further expansion, innovation and format migration. For example the department store chain, Shoppers Stop, will soon have its Initial Public Offering (IPO) and use all the funds raised, for rapid expansion in existing format and roll-out of grocery stores. Other leading retailers such as Trent (Westside) and Landmark Group (LifeStyle) are also considering new formats in home improvement and hypermarkets.

Region specific formats

With organized retail penetrating into Class II towns, retailers have started differentiating and experimenting with store sizes and formats. For example, in the departmental store format, while most Class A cities and metros have large stores of 50,000+ square foot in size, stores in Class II towns have stabilized in the 25,000-35,000 square foot range.

Development of discount formats

Large discount formats, or hypermarkets, aiming at retail consolidation by providing a single point of contact between brand-owners and customers, are now emerging as major competitors to both unorganized and organized retailers. Penetration of organized retailing into the lower income brackets and consumer demand for increased value-for-money has improved the prospects of these formats. Big Bazaar, promoted by Pantaloon, and Giant, promoted by the RPG group, provide two examples of this trend.

Convenience stores at gas stations

India is now showing signs of aligning with global trends in petro-retailing with increasing sales coming from non-fuel related products. With deregulation, private players entering this sector force existing petro-retailers to review their business models. Dealer and company owned convenience stores at service stations are on the rise. State run oil giants have entered into joint ventures with FMCG companies and food retailers to sell food and groceries at select markets.

Malls potential

Over 300 large malls will come up by the end of 2006. The urban Indian consumer prefers ‘All-under-one-roof’ shopping destination together with eating-out and entertainment venues. This creates excellent development potential for malls. With the shortage of retail space making an excellent potential for development of malls. As there is a shortage of retail space in central locations, most of these malls are being set up in the suburbs of large metropolitan cities. In addition, foreign retailers are restricted from investing in property and thus have to depend on malls for their outlets.

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