

Winds of change

Retail reforms in India

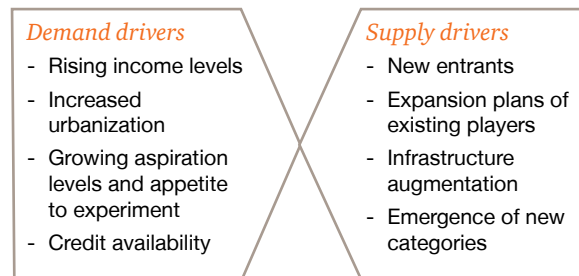
This paper sets out the opportunities for foreign and domestic retailers in India, a summary of the applicable foreign direct investment regulations and how PwC can help you.

India's exciting retail sector

With India poised to become the fifth largest consumer market globally by 2020, the country has become integral to the growth plans of all global retailers and brands. Strong macroeconomic fundamentals and India's demographic advantages (e.g., a 350-million strong middle class, a large youth population where 50% are under 25, rising income and aspiration levels, etc.) also support the structural growth of India's retail sector.

Statistics	
Market Size	USD 500-520 billion
Organized Retail Penetration	6 - 8%
5 year CAGR (organized retail)	19-20%

Low organised retail penetration (ORP) suggests that strong growth potential exists for modern trade players!



The retail market is therefore expected to reach USD 1.3 trillion to 1.5 trillion by 2020. Organised retail is expected to grow at a CAGR of 15 to 20%, outperforming the overall retail sales growth of 12 to 14% from 2009 to 2014.

Select key retailers in India include AV Birla Retail, Bharti-Wal-Mart, the Future Group, the K Raheja Group, the Landmark Group, Louis Vuitton, Marks&Spencer, Metro, Mont Blanc, Reliance Retail, Swarovski, Tata-Tesco.

Growth across categories

India's retail sector offers growth opportunities across most major categories

Organized Retail Penetration and Key Trends Across Categories				
Retail Category	Category Share as a % of Total Market ¹	ORP (%)	Approx. Gross Margin (%)	Key Trends
Food & beverage	69-70 ²	2-3	3-14	Large market and low ORP presents robust opportunities
Clothing & textile	11-13	17-20	35-50	High margins, increased preference for branded apparel
Consumer durables	4-5	15-20	10-20	Wide range of price points and good-after sales service are key differentiators
Home décor & furnishing	3	5-6	40-50	Housing boom and increasing aspiration levels are driving demand
Beauty, personal care & jewellery	8-10	6-10%	20-40	Growth driven by new product launches, consumers' aspirations and expansion plans of organized players
Footwear	2	16-17	25-35	Lifestyle brands are increasing their product offerings and formats
Others	3-4	9-30	10-15	Pharmacy retail, stationery retailers, etc.
	100	Source: PwC analysis		

¹ Based on data from Ministry of Statistics and Program Implementation

² Includes tobacco products

Changing regulatory scenario

On 20 September 2012, the government has notified two significant regulations that would go a long way in development of Indian retail sector. One, permitting FDI in multi brand retail trading and two, simplifying the rules for single brand retail trading to make it more business friendly. The contours of these new regulations are set out below:

Multi brand retail trading

FDI was not permitted in multi-brand retail trading in India, so far. The new policy will allow up to 51% FDI with prior government approval, subject to the following key conditions:

- Minimum investment by foreign investor of USD 100 million
- At least 50% of total FDI to be invested in 'back-end infrastructure' within three years of first tranche
- At least 30% of the value of procurement of manufactured and processed products to be sourced from Indian 'small industries' (those that have a total investment in plant and machinery not exceeding USD 1 million). For convenience of initial roll-outs, the sourcing compliance requirement for first 5 years has been averaged. After this period, it will be annual compliance.

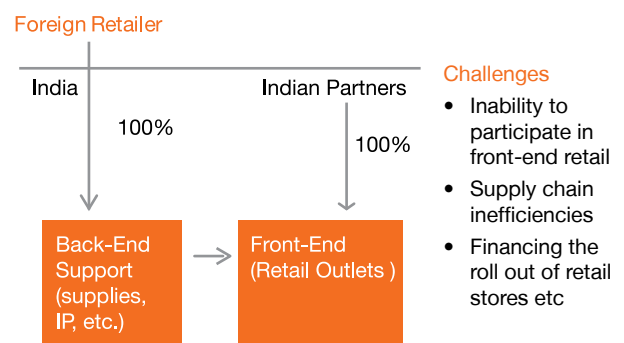
Stores will be set up only in cities with a population of more than one million as per the last census. Stores can be set up only in those states that are notified by the government as having agreed or agreeing in future to allow FDI in multi-brand retail trading. States that have been currently notified include Andhra Pradesh, Assam, Delhi, Haryana, Jammu and Kashmir, Maharashtra, Manipur, Rajasthan, Uttarakhand, Daman and Diu and Dadra and Nagar Haveli (union territories). Given this, Mumbai, Pune, Delhi, Nagpur, Hyderabad and Jaipur are some of the cities where retail stores will currently be permissible.

The policy further clarifies that companies with FDI cannot undertake multi-brand retail trading through e-commerce.

A high-level group, under the Minister of Consumer Affairs, may be constituted to examine the issues concerning internal trade. This group is expected to make recommendations for reforms accordingly.

What it means for you

- If you are a foreign retailer entering or expanding in the Indian market, you will need an Indian joint venture partner, to evolve strategy around store location, back-end infrastructure and procurement contracts and to obtain necessary regulatory approvals both at the centre and state levels. The process of set-up (i.e. market analysis through to store opening) can take a minimum of 18 months for any new entrant.
- If you are an Indian retailer, existing operations will need to be restructured to meet policy conditions for a potential FDI partnership.
- Typically, players in the multi-brand space have been operating through the following structure.



Given the policy announcement, the above structure needs to be re-worked for better operational efficiency and value consolidation. The new structure will need to be growth-oriented, tax-efficient and regulatory-compliant.

Single brand retail trading

The earlier FDI policy on this segment of the retail trading window allowed 100% FDI, with government approval, subject to the following key conditions:

- Products should be only of a single brand.
- Products should be of international brand.
- Products should be branded during manufacture.
- The investor should be the brand owner.
- Thirty per cent should be mandatorily sourced from small enterprises of the value of goods sold.

The last condition was not applicable in case the FDI was capped to 51%.

Realising the difficulty in complying with the sourcing condition, considering single-brand retail players typically deal with speciality and hi-tech products, the government has now enabled 30% sourcing to be undertaken from anywhere in India. Only a preference has been stipulated to use small and medium enterprises for sourcing. For convenience of initial roll-outs, the sourcing compliance requirement for first 5 years has been averaged. After this period, it will be annual compliance.

Additionally, the sourcing commitment will now be counted on the basis of the value of goods 'purchased' as against the earlier value of goods 'sold'.

The policy now also permits a person other than a brand owner (e.g. licensee/ franchisee) to invest into a single-brand retail company on a territorial exclusivity basis.

It further clarifies that companies with FDI cannot undertake single-brand retail trading through e-commerce.

The FDI policy on single-brand retail trading, stands accordingly modified.

What it means for you

- If you are an international brand entering India and do not wish to have an Indian joint venture partner, then you need to evolve a sourcing strategy along with your Indian market retail strategy and obtain necessary government approvals.
- You may also be looking at acquiring your existing licensee or franchisee in India. Therefore you will need to additionally undertake due diligence, valuation and evolve a transaction structure.
- If you already have an existing joint venture in India, you may be looking at exiting the Indian joint venture partner and hold your Indian retail operations in entirety. You will need to address issues relating to sourcing strategy, exit valuation, tax structuring and obtain necessary government approvals.
- You may be a homegrown international brand looking at realising value in your existing retail business or raising new funds to drive your future growth.

How we can help

PwC in India has a specialised Retail and Consumer sector team with expertise ranging from strategy, corporate finance, mergers and acquisitions, tax and government regulations, and is well geared to support clients.

- Market opportunity assessment, strategy development, preparing and validating India business plan
- Identification of acquisition targets, JV partners, buyers, due diligence and valuation
- Structuring and restructuring the model for the retail business in compliance with FDI regulations (including sourcing strategy, store split strategy – FDI and non FDI compliant, etc), tax regulations and transfer pricing policy
- Structuring of investments into India for tax efficiency and regulatory compliance including funding options, repatriation strategies, etc
- Obtaining necessary government approvals and clarifications and other implementation assistance
- Provision of post deal services (related to business strategy, finance function, operations, HR, IT, process, reporting and MIS rationalisation)

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