The Future, On Sale: The Indian Retail Market

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Increasingly, the verve of the modern Indian economy is anchored in the growing buying power and affluence of the country’s domestic consumers. As products fly off the shelves at unprecedented rates, the Indian retail market has gained both in size—12 percent growth in 2008—and in importance—12 percent of GDP. It has become one of the hallmarks of Indian economic prowess and a harbinger of the country’s future economic success. Though it suffered a temporary slowdown in 2009, the retail market is poised to rebound strongly in 2010 and experience accelerated growth in the decade to come. This South Asia Monitor is part of the South Asia Program’s effort to provide an in-depth perspective on India’s economic future by examining the developments in a particular facet of the Indian economy.

Shape of the current retail market: At an estimated US$450 billion, the Indian retail market is one of the largest retail markets in both the developing and developed worlds. By 2015, it will more than double in size to more than US$900 billion and employ more than 62 million people, up from 40 million today. The vast majority of enterprises in today’s Indian retail sector are small mom-and-pop shops known as kiranas. Numbering about 12 million, these businesses, which typically are run by their owners and one or two assistants, supply all the basics to Indian consumers and often provide short-term credit to cash-strapped customers.

Kiranas and the ubiquitous hawkers on the streets greatly outnumber the 4.5 percent of retail businesses that fall under the label of “organized”—businesses that are registered with the government and formally adhere to tax codes. Despite its small share of the market today, organized retail is fast expanding, with sales growth nearing an impressive 40 percent per year in 2008. Organized retail is adding diversity to the kirana-dominated retail market. The proliferation of supermarkets, department stores, malls, and hypermarkets—stores selling a wide variety of both grocery and non-grocery items—is challenging the standard retail model of shops of less than 500 square feet. Between 2009 and the end of this year, more than 100 new malls and 30 million square feet of rental space are expected to open. Much of this new space will be occupied by the leading organized retail companies, such as Future Group, Reliance, Bharti, Aditya Birla, Vishal, and Tata.

2009 slowdown: Like nearly every other sector of the Indian economy, the retail sector suffered a slowdown in 2009. The repercussions of the financial crisis damaged both organized and unorganized retail growth, though organized retail was much more seriously affected. Across the board, companies were forced to scale back expansion plans and, in some cases, completely close down certain stores as consumers tightened their budgets. Pantaloon Retail, which is owned by Future Group and is India’s largest retail company, slashed expansion plans through June 2010 from 4 million to 2 million square feet and shut the doors on 103 of its shops. Vishal Retail, with Rs. 730 crore (US$160 million) in debt, closed more than two dozen of its stores and warehouses in 2009 and plans to close an additional 12 stores. The nation’s largest discount retailer, the 1,600-store Subhksha, folded entirely.

Consolidation within the domestic retail industry is a reflection of the global retail slowdown, but it is also a consequence of the dramatic expansion in organized retail stores within the last few years. Before it
collapsed in 2009, Subhiksha had expanded tenfold in just four years. In the two years before March 2009, Reliance, one of India’s largest corporations, opened more than 940 stores. Expansion occurred at such a blistering pace that many companies failed to put in place necessary back-end logistics and supply chains and relied too heavily on debt financing. Ultimately, they found themselves stretched too thin, and this compelled them to restructure and downsize once the domestic economy cooled. But growth is expected to rebound to 8 percent in 2010, and despite these setbacks, the retail sector is expected to emerge from the downturn in fair shape. With the glut of rental space owing to downsizing and continued store construction, companies will pay lower rental rates, particularly in the larger cities, where rental rates have fallen by as much as 20–30 percent.

The power of the Indian consumer: The hopeful prospects for the Indian retail sector in the coming decade lie in the evolving consumption patterns of Indian consumers. Rising income levels have left Indians with double the disposable incomes they had in 1985, which allows for the purchase of items in excess of basic necessities. This simple fact has led McKinsey to predict that the Indian consumer market will quadruple by 2025 to US$8.2 trillion in purchasing power parity (PPP) terms and become the world’s fifth-largest consumer market. Such growth will be buoyed by the expanding Indian middle class (those earning between US$4,400 and US$22,000), which by 2025 will be 583 million people strong, or 41 percent of the population.

The youth bulge in the Indian population will also bring a massive number of new consumers into the market, with higher consumption rates than their counterparts in earlier years. The population is still growing (with a growth rate of 1.34 percent in 2008) but at a decreasing rate (compared to 1.68 percent in 2000), and as the current youth cohort ages it will be replaced by a smaller population of parent-dependent children. Over time, the falling dependency rates that will result from this population shift will lead to a further freeing up of incomes for consumption.

The preferences of the Indian consumer: While the number of consumers will be a major driver of future consumption, it is the evolving consumption preferences of Indian consumers that will ultimately decide the fate of the Indian retail sector. Though they are beginning to spend more of their disposable incomes, Indian consumers are still very budget-conscious. They tend to buy in small quantities from familiar sellers and are on the lookout for the best value at the cheapest price. They tend to shop closer to home and are unwilling to travel long distances to purchase basic goods. Those preferences have created problems for organized retailers who run large-format stores and can open only in a limited number of locations and provide less personalized service.

Organized retail will get some help from Indian consumers’ increasing comfort with using credit to buy their goods. India today is home to more than 25 million credit card users, and credit card use has spread from just 10 cities in 2000 to more than 100 cities in 2009. This is a tiny percentage of the population, but a substantial increase.

Government regulation: Aside from the consumer-specific constraints on the organized retail sector, there are also a number of government constraints. While the regulatory environment in India continues to improve, there are still more than 30 requirements for the opening of a retail business. Once they have acquired signboard licenses, complied with anti-hoarding measures, and obtained all the proper permits, organized retail companies are also responsible for paying taxes on the movement of goods in and out—and sometimes even within—states.

Threat to kiranas?: A growing concern among owners and workers in the unorganized retail market is that organized retail businesses will destroy the profitability of non-organized enterprises and force them out of business. In response unorganized retailers have staged large-scale protests and demanded government action to protect their livelihoods. Still, although the unorganized share of the total retail market is certainly shrinking, kiranas have not necessarily suffered to the extent some imagine. A report by the Indian Council for Research on International Economic Relations (ICRIER) found that only 1.7 percent of stores in the unorganized market close each year and that by 2013, unorganized retail businesses will still account for 85 percent of the Indian retail market. Though businesses located near a newly opened organized retailer lost 23 percent of their sales in the first year after that new business
opened, ICRIER found that after five years, sales totals for unorganized businesses returned to their previous levels.

**Foreign presence:** For all its promise, the Indian retail sector remains one of the most protected sectors of the Indian economy. With just a few exceptions, foreign companies are largely barred from investing in the retail market. In single-brand stores, such as Adidas, Gucci, or Ikea, India allows foreign companies up to a 51 percent stake. The current government has expressed an interest in raising the cap on single-brand ownership, perhaps to as high as 74 percent, but has taken no action yet. It attempted to raise the limit to 100 percent during Prime Minister Singh’s first term, but failed in that attempt and has been cautious this time around. Multi-brand retail stores remain entirely off-limits to foreign investors.

The other means available to foreign retailers wishing to enter the Indian retail market is indirectly through the cash-and-carry wholesale business. Though they are still not able to sell directly to end consumers, companies operating under this format are able to establish connections with the domestic retail market by selling to the owners of Indian retail companies. Under current law, foreign companies operating a cash-and-carry wholesale business are allowed 100 percent ownership of their enterprise. A number of prominent international retailers have already entered or are in the process of entering the Indian retail market through this avenue. Two of the most notable are the world’s largest retailer, Walmart, which has paired with India’s Bharti Group, and the world’s third-largest retailer, British-owned Tesco, which has paired with India’s Tata Group. By operating a cash-and-carry business, these international retailers hope to put in place durable supply chains that will better position them to fully enter the Indian retail market when deregulation of the multi-brand market occurs.

**Room to grow:** While the future of Indian retail is promising for domestic Indian retailers and for foreign companies that take advantage of available opportunities, expansion of the retail sector will occur only as fast as the Indian consumer will buy. For foreign retailers especially, the key to success will be accurately reading and then adapting to Indian consumer preferences. Such a strategy will require catering to both urban and rural retail markets. Though it is only 40 percent of the current retail market, rural India’s share of retail will soon surpass 50 percent. Given that it is home to 70 percent of India’s population and that rural per capita incomes have risen by 50 percent in the last 10 years, the rural market could be a major growth opportunity.

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