

Investment Outlook for Indian Retailers



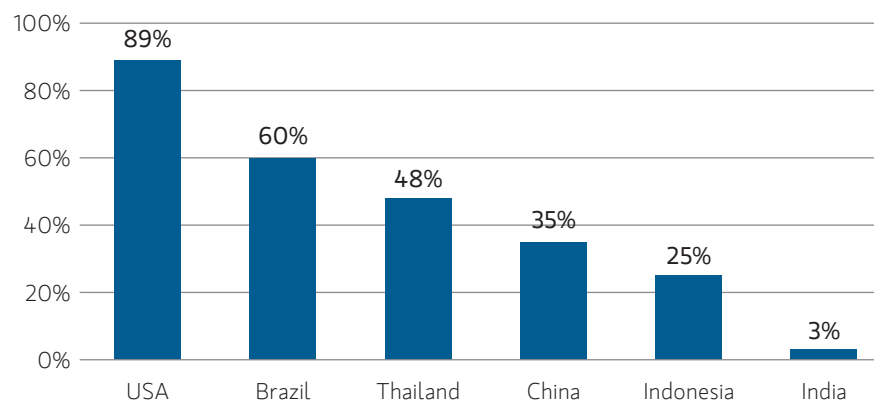
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The retailing space in India offers a sizable investment opportunity given growing discretionary spending, low market penetration and growing consumer aspirations, all set against an unorganized, unlicensed backdrop that continues to evolve (especially in grocery—see *Display 1*). However, it won't be easy to determine winners given the consumer's value mindset and the operational challenges of dealing with cultural diversity and geographical complexity. In the end we believe only a resilient few will emerge from the detritus, but they will be the ones to generate disproportionate higher returns.

DISPLAY 1

India's Grocery Retailing Has a lot of Runway to Takeoff

Organized market share in grocery retailing (%)



Source: Goldman Sachs 2020.

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Yes, There Are Challenges in the Indian Retail Market...

The retail landscape in India is littered with potentially incendiary landmines. The high cost of capital, regulatory challenges, an extremely value-conscious customer, all coupled with the inability to charge above the Maximum Retail Price (MRP) despite high retailing costs. In the end, only the very efficient retailers can survive; in fact, the longevity of efficient retailers in India is often quite underappreciated by investors.

On one side there is that value-conscious and culturally diverse customer. On the other, limited availability of quality retail spaces, trained human resources and reliable suppliers, all driving the cost of doing business to almost untenable heights. The constraint imposed by the MRP regulations limit the ability of retailers to price products differently in economically different locations (think rural vs. urban). Given the vast number of local and regional sensibilities, every retailer must maneuver his inventories to remain attractive to a large and diverse, but growing, consumer base.

We believe this presents an opportunity for businesses that can offer the right product and a superior in-store experience, to the right consumer, most importantly at fair price. This is an endgame that takes many, many years to achieve in India, something that cannot be accomplished overnight. We find that patience is a rare—but critical—commodity in the current Indian retail environment.

... But Opportunities Abound

Consumption is a complex topic in a diverse consumer market like India, and the currently high valuations of India consumer stocks make the discussion even more complicated. With an ongoing market consolidation, we see a strong

“In India, an aspirational but value-conscious consumer, mixed with expensive rents and limited pool of trained staff, can be a noxious combination that is best remedied by a high turnover, low margin business.”

—Vishal Gupta

polarization in consumer stock returns over the next decade. Below are some observations from our recent India trip:

1. DIGITIZATION IS HAVING AN IMPACT: The ever-evolving digitization of India has had an appreciable effect on consumer tastes and preferences. To start, younger generations are savvier and want more goods and services. In contrast to older generations, the young are using credit to meet their consumption aspirations. In addition, the proliferation of ecommerce has made products more readily available and has also served to drive demand in the traditional “bricks and mortar” channel as well.

2. THERE IS A SHIFT FROM MULTI-BRAND OUTLETS TO EXCLUSIVE-BRAND OUTLETS: Many retail national brands are now aggressively expanding their brand outlets. National retailers are growing faster than regional players who aren't able adapt their product offering and retail experience to changing consumer aspirations. This growing proliferation of organized direct retail has also driven the shift from traditional distribution. In addition, a better buying experience is also driving better demand.

3. NEW STORES WITH WELL-KNOWN BRANDS ARE CROPPING UP EVERYWHERE: Successful retail companies are expanding rapidly across the country, whether via the franchise or in-house

model. Key brands are becoming well-known by the Indian consumer, who can often get a better selection of goods at better prices than at the smaller, local “mom and pop” stores.

Case Studies

CASE STUDY 1: TRENT

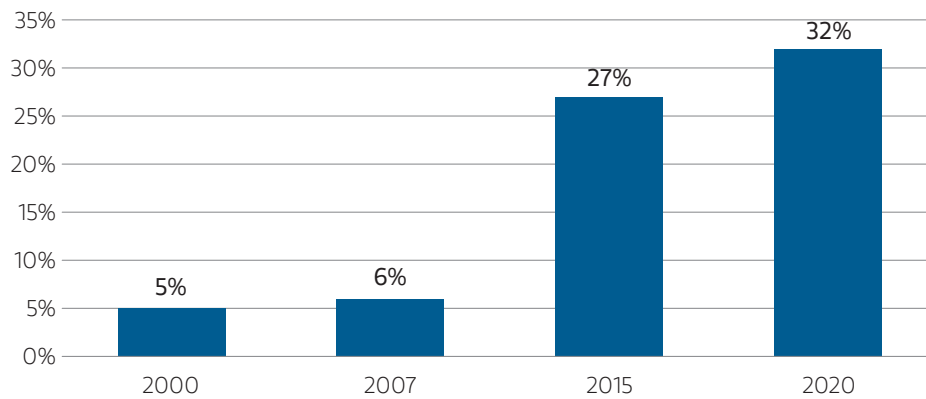
Trent is one of the leading players in the branded retail industry in India, offering trendy apparel and other lifestyle products at attractive prices. Its flagship brands Westside and Zudio (value) sell only in-house labels which helps keep their prices sharp. Apparel retailing in India is currently \$60 billion, growing at compound annual growth rate of 10-12%, meaning a significant opportunity for Trent, as branded apparel is still only 25% of this growing market.

Trent is trying to lower prices while looking to improve their sales/sq ft, a critical metric in generating improved operating margins. As such, the Trent customer gets sharp pricing and fresh styles every week, all in a relaxing environment created through music and a unique “look and feel.”

It took Trent nearly two decades to effectively integrate their supply chain, logistics, front-end retailing and unique product line. The firm is ideally expanding beyond their flagship, Westside, currently building stores for their Zudio, Utsa, Samoh and Misbu brands.

DISPLAY 2**India's Organized Jewelry Brands Are Steadily Growing**

Share of organized jewellery brands in India (%)



Source: Goldman Sachs 2020.

CASE STUDY 2: TITAN

Titan is the fifth largest integrated own-brand watch manufacturer in the world, but over the past couple of decades has transformed itself into a jewelry company, pioneering experiential retail across India. Jewelry, an integral part of Indian family tradition as both a store of value and statement of fashion, is a category where the organized (licensed) brands are quickly gaining traction (*Display 2*). Titan developed a brand proposition of trust, design and a superior retailing experience to entice consumers away from their local “mom and pop” jeweler.

Titan predominantly uses the franchisee model, as nearly 70% of its network is franchised. The franchisee model is smart for the business as it delegates the day-to-day operations management and employee relations to the franchisee, so that the company can focus primarily on the product and their brand. The franchisees also provide insightful input on the nuances of the local markets which the company then incorporates into its product line.

One example of this is the Tanishq, a jewelry brand and division of Titan with 410 retail stores in more than 240

cities across India. Tanishq segments their customer base by community to develop an end-to-end understanding of the area and local tastes.

Tanishq emphasizes design, elegance and finely finished products. Their designs are acknowledged to be unique, allowing for a slight pricing premium relative to the market. The combination of pricing, and superior products and retail store experience serve to strengthen the value proposition of the brand. Moreover, in 2015 the company lowered prices on entry-level items, which expanded their market and embellished its value proposition. It also cut the price premium on gold to further improve its price effectiveness. Newer formats like Caratlane and Mia are targeting new consumers in the jewelry segment.

CASE STUDY 3: AVENUE SUPERMARTS LTD.

D*Mart is a one-stop supermarket chain owned by Avenue Supermarts that offers a wide range of basic home and personal products. Their core objective is to offer customers good products at great value. D*Mart opened its first store in 2002 and today has a well-established presence across 330 stores in India.

In general, we believe the longevity of retailers is underappreciated in India and the markets. Unlike in the West, the high cost of capital and rents, regulatory challenges, minimum wages, value-conscious customers and an inability to charge more than the MRP means only very efficient retailers can survive in India, especially in the grocery business. Survivors can look to reap the benefits of growing consumption, real estate/labor reforms and the evolution of higher margin discretionary categories such as “fresh foods.”

D*Mart’s leadership in supply chain logistics, unique store culture and focus on efficiency makes it the strongest candidate to lead grocery retail in India. While competitors focused on private labels, ambience and increased offerings, D*Mart focused on rightsizing their product line and offering prices ~5% below their competition, passing on their efficiencies to their customers. Stores have convenience-store intimacy, but are large and able to stock higher gross margin items in the homecare, apparel and kitchenware categories. This layout appeals to value- and quick-service customers alike.

D*Mart’s ability to deliver quality products with ultra-efficient procurement methods and control over SKUs is a critical element of their business model. Of note, D*Mart focuses on bulk at every step of the process—bulk procurement, bulk goods movement and a bulk buying consumer behavior. A focus on bulk creates capacity to serve more customers per shopping day. A customer buying bulk quantities once or twice a month is significantly better for the climate than 10 or so quick deliveries a week of lower cost items at the doorstep.

In Summary

Indian retail is not a single, homogeneous market but an array of hundreds of smaller markets with differing local tastes. While cultural nuances remain of paramount importance today, consumer preferences are converging rapidly. Consumers are starting to identify favorite brands, while retailers generally focus more on pull strategies (branding, experience), rather than push strategies (price cuts, deals) to develop loyal customers.

In our minds, the keys to success are relatively simple:

- **DEVELOP SUPERIOR PRODUCTS WITH THE RIGHT VALUE PROPOSITION** – rely on unique designs, the use of new materials and be an early mover introducing new sub-categories. Customer perception of value has to be strong.
- **INVEST IN PRODUCT MERCHANDISING** – create consumer pull rather than push, devoting resources to product merchandising and freshness of the inventory, more so than short-term deals.
- **CREATE A BETTER IN-STORE EXPERIENCE** – develop Exclusive Brand Outlets (EBOs) and customer experience centers.
- **CURB SALES FORCE ATTRITION** – keep a line open for senior management, with local channel partners. A trained work force drives much better store efficiencies and customer experience.
- **INVEST HEAVILY IN TECH AND SUPPLY CHAIN MANAGEMENT** – digitize channel management, namely product ordering, inventory management and incentive settlements.

Companies who can do all this efficiently should be able to increase market share in both existing and adjacent categories. It won't be easy for investors to determine long-term winners given the challenges outlined throughout the paper, but it is worth repeating that only a resilient few will emerge—and they will be the ones to generate disproportionately higher returns.

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