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Retail's Coming Face-off

One wants to be India's Wal-Mart and the other is (Bharti-) Wal-Mart. With both set to battle, the Rs 14,00,000-crore retail market will never be the same again. But how will the retail wars play out?

By R. Sridharan and Krishna Gopalan

Sunil Bharti Mittal *Chairman & MD, Bharti Enterprises*

Mukesh Ambani *Chairman & MD, Reliance Industries*

Expectedly, Indian retail industry's most-awaited news came with a bang. It was a Monday morning and as India Inc.'s Who's-Who, including Bharti Enterprises' Sunil Mittal, made a beeline to the India Economic Summit, World Economic Forum's India gabfest, the New Delhi-headquartered Bharti dropped a bomb. In a short press release, whose matter-of-fact tone was in stark contrast to the significance of the development, the company announced that it had signed a Memorandum of Understanding (MoU) with the Bentonville (Arkansas, us)-based retail behemoth, Wal-Mart. "(Bharti and Wal-Mart) share the same commitment to building relationships with producers in order to provide great quality at reasonable prices to consumers every day," the world at large was told. The press release had begun going out around 10.30 that morning, and by the time Mittal arrived at the summit's venue (Taj Palace Hotel, New Delhi), the media had worked itself into a frenzy. And Mittal, who had also been talking to France's Carrefour and Britain's Tesco, was only too happy to oblige. "It's a partnership of equals. Big investments are in the pipeline," he told BT and other reporters at the summit. Later, at the same event, Reliance Industries' Mukesh Ambani, who plans to invest Rs 25,000 in his own retail venture, Reliance Retail, welcomed thedevelopment, saying there was enough space in the industry for six to seven large players.

Don't let the corporate propriety fool you. What the industry has in the making is an epic retail battle. Pitted against each other are two equally strong and ambitious (see A Battle of Equals) players. One wants to be India's Wal-Mart and other, well, is Wal-Mart. Therefore, this fight won't be about winning a few customers here and there; rather, it will be about supremacy-of one Indian company, which has never believed in being #2 in anything, trying to live up to its own expectations, and of another retailer, whose global revenues are as big as India's entire retail market, fighting tooth and nail for the most attractive retail destination in the world at a time when its own topline (for November) has declined for the first time in 10 years, and it is pulling out of key global markets such as Germany and South Korea. In other words, this fight will be about a Rs 14,40,000-crore market, where just about 3 per cent share belongs to organised players and which is growing at 8 per cent annually. "There's no doubt that the two players are equally matched and could transform the retail landscape as we know it today," says Arvind Singhal, Chairman of Delhi-based consultancy, Technopak.

A BATTLE OF EQUALS
Reliance and Bharti-Wal-Mart have more or less equal strengths.

AMBITION
Reliance: Mukesh Ambani doesn't believe in being #2 in any industry. He will want to build the biggest and most successful retail empire in India.
Bharti-Wal-Mart: Sunil Mittal is the #1 in telecom and has teamed up with the world's largest retailer, which will want leadership in India as well.

FINANCIAL MUSCLE
Reliance: The group, which has about Rs 1,01,563 crore in annual revenues and a market cap of Rs 1,76,669 crore (Dec. 8), has announced plans of investing Rs 25,000 crore in retail. No one doubts Reliance's ability to raise money.
Bharti-Wal-Mart: Its revenues are much smaller at Rs 11,760 crore but boasts a market cap of Rs 1,20,000 crore. With Wal-Mart backing it in retail, the combine could easily match, or exceed, Reliance's investment plans.

CAPABILITIES
Reliance: Has superlative project management skills, and has hired top-notch retail professionals to run its various retail verticals. With Wal-Mart in, will likely move with greater speed over the next one year.
Bharti-Wal-Mart: Bharti already caters to 30 million mobile phone customers, while Wal-Mart operates 6,400 stores worldwide, playing host to 176 million customers every week. Also runs the world's largest private IT network to connect its stores and suppliers.

'ENVIRONMENT' MANAGEMENT
Reliance: Has tremendous clout within the political system, and is well considered by almost all political parties.
Bharti-Wal-Mart: Sunil Mittal's father, Sat Paul Mittal, was a Congress MP, and the Mittal family continues to have the goodwill of the Congress party, although Mittal has friends in BJP as well.

A Clash of Titans

One big reason why Indian retailing will never be the same again is the money the two players will likely invest. As mentioned earlier, Reliance, which did not wish to comment for this story, plans to invest Rs 25,000 crore in everything from warehouses to reefer trucks to stand-alone hypermarkets to aircraft and airports (yes, you read that right; more about it in a bit). While the Bharti-Wal-Mart combine (call it

Bal-Mart) hasn't disclosed its investment plans, it's reasonable to assume that given its ambition, it will need to invest at least as much as Reliance. Agrees Ravi Deol, head of Bharti's retail operations: "The investment in back-end will be close to what Reliance is talking about."

RELIANCE FRESH

BIG BAZAAR

Competition's hotting up: Reliance Fresh represents the 'unbundled supermarket' concept

What sort of a retail model will the Bal-Mart build in India? The most obvious part is already known: The back-end, which means supply chain management, will be run by an equally-owned Bharti-Wal-Mart joint venture. The front-end will be fully owned by Bharti, thus, steering clear of foreign investment rules that bar foreign investors in retail, unless they are single-brand stores or wholesalers. "We will be pan-India and do all formats, ranging from hypermarkets to neighbourhood stores," says Rajan Mittal, brother of Sunil and the company's joint MD.

He won't offer further details, but if you want clues to Bal-Mart's India strategy, just look at Reliance Retail. Why? When you want to be the #1 or #2 retailer, there aren't too many routes you can take to the top. In India, that would mean 'every day low prices'-at least in categories where brand isn't a decisive factor. And the single-biggest category in the country is food and groceries, which accounts for three-fourths of the overall retail market (see Food & Groceries...). The only way to keep costs low is to have volumes and a supply chain that purrs like a Lexus.

According to people familiar with Reliance's retail strategy, the company will launch three broad formats: large supercentres or hypermarkets, mid-size hypermarkets, and neighbourhood stores, the idea being to capture both the daily spend and monthly spend of a typical consumer. The neighbourhood stores will be interesting to watch because they could be, what Technopak's Singhal calls, "unbundled supermarkets"-that is, stores focussed on specific categories such as vegetables and fruits (think Reliance Fresh), and dry grocery, with or without personal care.

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India's best-known hypermarket (Big Bazaar) will likely bear the brunt of Reliance and Bal-Mart's fury. For now, it plans to open more stores
Kishore Biyani
CEO/Future Group

Moving into neighbourhoods, of course, poses a problem. Zoning laws apart, good properties are hard to come by and there's always the neighbourhood store to compete with. But guess what? Reliance may not end up competing with the neighbourhood stores- at least, not those that are, say, 3,000 sq. ft big. Instead, such stores would want to become Reliance franchisees. Reason: better returns on investment. As the neighbourhood store stands today, it is severely disadvantaged: it doesn't have economies of scale, quality or great shopping environment, or a compelling product mix. Most of them don't handle fresh produce because the wastage is too high. Now, consider a scenario, where someone like Reliance comes in and says, "Mr Grocer, I'll double your return on investment, take the headache of supply chain and store management away from you, but let you sit at the till just like before because your social standing within your community is important to you." Which grocer, do you think, will say no to a proposition such as this one?

THE SINGLE-BRAND OPPORTUNITY
Starbucks and several other single-brand retailers will now enter India.

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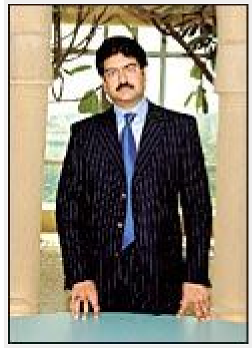
> **J**ust as surely as Tesco and Carrefour will follow Wal-Mart into India, the single-brand retailers will make a beeline too. Unlike the multi-brand retailer, where front-end foreign investment is barred, single-brand chains can own up to 51 per cent in their India ventures. Until now, brands such as Marks & Spencer, McDonald's, and TGIF have been operating in India through franchisees. The problem with such a model is obvious: how fast a chain is able to grow is dependent on the depth of the franchisee's pocket, and his ability to take losses for the first few years. Therefore, except for a few successful single-brand retailers such as McDonald's, most others have not been able to go beyond a handful of cities.
>
> But now, investors like Starbucks will have the confidence to come in with majority ownership. They will be able to partner with relatively large companies that are keen to get a piece of the retail market but don't have a strong brand of their own. While that will mean another retail segment, comprising the Baristas and Café Coffee Days, coming under foreign competition, it will also result in diversification of the organised retail market. Currently, clothing, textiles and fashion accessories account for 40 per cent of organised retail, while other categories such as jewellery and watches, and footwear account for 7 per cent and 9 per cent, respectively. Allowing single-brand chains majority ownership is a small concession the government has made, but it will have a profound impact on the supply chain.

Stretching this analogy a bit, it may even be possible for someone like Reliance to turn kirana stores (250-300 sq. ft in size) into, say, regional cooperatives, where Reliance becomes their faceless supply chain manager for a fee. Happy Commies, happy Reliance. Jokes apart, at least for the next several years, India will continue to have consumers-especially in smaller towns-who are more comfortable shopping at kiranas rather than supermarkets. No wonder, then, Reliance is being approached by at least a couple of microfinance institutions (MFIs) to sell to the poorest of poor. Under this arrangement, Reliance won't be paid by its poor customers but by the MFIs, which in turn will recover the money from their clients-in installments. At one stroke, Reliance's retail plans will move to an entirely different level. Bharti-Wal-Mart, then, may have no choice but to follow suit or, indeed, do better.

It's All About Scale

Some critics say that Reliance's investment plans are only market signalling, since retail isn't very capital intensive-stores are typically leased and the inventory has supplier credit, which means the retailer recovers the money even before he has paid his supplier. Well, the critics are wrong-not about the negative working capital bit, but about Reliance's intentions. The most important thing to understand about retail is that the back-end is often more critical than the front-end; there's no point in running stores that don't have what consumers want and when they want it. The name of the game is high throughput because margins are relatively thin. Ergo, "the company will have a pan-India footprint, covering 1,500 cities and towns and embracing all strata of society," Reliance's Chairman and Managing Director Mukesh Ambani told the company's shareholders not too long ago.



Has also announced plans of entering retail, but may choose to operate in select categories. Just the same, has big investment plans
Kumar Mangalam Birla
Chairman/ Aditya Birla Group

He's looking at

1,900 food stores (against the 110 today) and an investment of Rs 1,000 crore over the next three years
Sanjiv Goenka
Vice Chairman/ RPG Enterprises

Let's run some back-of-the-envelope calculations and see if Reliance will indeed need Rs 25,000 crore. Let's start with hypermarkets. As BT understands, Reliance Retail is targeting about 1,000 hypermarkets (besides 3,000 supermarkets and hundreds of specialty stores), which could be more than 100,000 sq. ft each in size. That works out to 100 million sq. ft. As a thumb rule, a no-frills hypermarket needs about Rs 400 per sq. ft to construct and another Rs 400 per sq. ft for interiors and fixtures. So, that alone works out to Rs 8,000 crore. Throw the land cost in, and the number could jump by 50 per cent.

Some of you may be wondering why Reliance would want to own the land its hypermarkets sit on. Good question. Once again, the answer is cost. No doubt, initial investments will be high, but it will freeze Reliance's 'rental' cost and even allow it to drive it down further by drawing tenants that fit in with the retail experience-say, banks (ATMs) or beauty salons. At the back-end, too, Reliance seems to want to own its warehouses, (reefer) trucks, and planes. Apparently, the company has either acquired certain defunct airports or got permission to land its cargo planes at several airports. Given the scale of its plans, two other things could happen: Reliance becomes the largest fleet operator in India and also the largest credit card issuer (that explains why it hired American Express' India boss, K. L. Muralidhara, in July this year).

"FEARS OF BACK-DOOR ENTRY ARE COMPLETELY UNFOUNDED"

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Checking in: Wal-Mart has met its match in global markets

S*peaking on behalf of the retail giant, Wal-Mart's Director of International Corporate Affairs,* **Beth Keck**, *defends the retailer's entry strategy. Excerpts from an e-mail interview:*

Wal-Mart had been talking to several companies in India for a possible tie-up. What were the reasons you settled for Bharti?

Bharti, with its deep knowledge of India's fast growing consumer market, and Wal-Mart, with its extensive global retail experience, share the same commitment to building relationships with producers in order to provide great quality at reasonable prices to consumers every day. We are pleased that our discussions with a well-respected company like Bharti have progressed to a stage where we have a Memorandum of Understanding to jointly explore opportunities in the retail sector, strictly within the law and fully compliant with existing guidelines.

The 'two-stage' deal is being described by some as a back-door entry into the Indian retail industry.

We would like to reassure our critics that Wal-Mart has every intention of not only doing things right, but also doing the right thing. The front-end will be fully owned and operated by Bharti. It is Bharti's intention to set up retail stores in different formats as per its own market research. Wal-Mart cannot and will not own these stores. Therefore, the fears of a back-door entry are completely unfounded and not based on the facts. In line with what is permitted under existing guidelines, Wal-Mart will focus on the back-end supply chain management, giving Bharti access to our proprietary knowhow in logistics and retail chain management, for which Wal-Mart is renowned worldwide.

What will be Wal-Mart's investment in the JV? Is there any clause in the deal that allows Wal-Mart to increase its stake once retail is opened up to foreign investors?

Our approach is that this is a partnership between equals. It is still early days as we have only just begun our discussions with Bharti. As you will appreciate, these discussions are bound by a confidentiality agreement. It would, therefore, be inappropriate to discuss any details of our discussions till a decision has been formalised. We remain committed to being

Coming to specifics, having launched Reliance Fresh in Hyderabad (the first store opened on November 2), the company has planned roll-outs in Delhi, Rajasthan, Gujarat and Chennai over the next six to eight months. The progress in Madhya Pradesh, West Bengal and Mumbai has been a little slow and the launch of Reliance Fresh in these places could be slightly delayed. The priority for the moment seems to be on getting the supply chain in place across all its verticals, including lifestyle, consumer durables/electronics and apparels. "The company is working towards the launch of its hypermarkets, which will initially come up in Ahmedabad and Jamnagar," says a person familiar with Reliance's plans. To be christened Reliance Mart, the first one may open in April 2007.

BT also learns that Reliance has finalised a name for its consumer electronics/durables chain, Reliance Digital. Apparently, these will be large stores covering 20,000-40,000 sq. ft and offer in-store brands (or private labels) in addition to popular brands. The first set of Reliance Digitals may open in Karnataka, Gujarat, and the national capital region (NCR). One thing seems evident: by the time the first Bal-Mart rolls out in another year or so, Reliance Retail will have opened several stores under different formats. And when the entire Rs 25,000 crore is invested in, say, five to 10 years, Reliance Retail could be a Rs 75,000-crore company. The calculation is based on Wal-Mart's asset-turnover ratio (total assets of $138 billion, or Rs 6,21,000 crore, and net sales of $312 billion, or Rs 14,04,000 crore), except that given India's higher population density, we have increased the multiple to 3, compared to Wal-Mart's 2.26.

What Happens to Competition?

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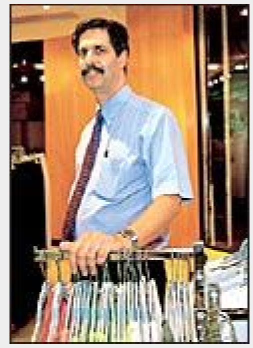
India's organised retail, although less than Rs 45,000 crore in size, already boasts of several players, and different formats and categories. The big players are Future Group (Big Bazaar and Pantaloon) of Kishore Biyani, the Tata Group (it runs departmental stores under Westside, a books and music chain called Landmark, hypermarket Star India Bazaar, and a consumer durables chain christened Croma, in a tie-up with UK's Woolworths), Sanjiv Goenka's RPG Group (FoodWorld and Spencer's), and Dubai-based Micky Jagtiani's Landmark Group (Lifestyle). That apart, there are several smaller players, including Subhiksha, Trinetra, and Nilgiri's. Most recently, the Kumar Mangalam Birla-led AV Birla Group has announced plans of entering retail.

This southern retailer is moving north. But it would have already sold out to Reliance Retail, but for a disagreement over valuation
R. Subramanian
MD/ Subhiksha Trading Services



The Tata Group-a big player with Westside and Landmark-has lined up investments in its existing formats. It might also bring in Tesco
Noel Tata
Managing Director/ Trent

The response from incumbents to impending competition has been feverish. "We are going about our expansion process and should have a total of 30 million sq. ft by 2010 from 4 million sq. ft now," says Future Group's Kishore Biyani. Big Bazaar, his flagship hypermarket brand, plans to up count from 40 stores to 100 by 2007. RPG Group's Goenka wants to have 1,900 food stores by 2010, compared to 110 today. RPG also has 200 music stores. "We are looking at an investment of Rs 1,000 crore over the next three years," says Goenka. The Tatas, too, have lined up investments in their existing formats, besides which they might still bring in Tesco on the rebound. (Bharti, it seems, wasn't happy with Tesco's scale of ambition for India). Tesco, however, told BT that "we remain excited by the opportunities in India and continue actively to review how best we might enter the market". Others like Carrefour may also follow.

So, who gets hurt and who survives? Actually, the market may be large enough for several large players; both Ambani and Mittal have put that figure at six to seven. Wal-Mart, despite its gigantic size, has only 8 per cent share of the American retail market (although, it has 20 and 22 per cent shares, respectively, in groceries and toys). "There's room for many, many players," says Technopak's Singhal. Yet, if you were a retailer like Big Bazaar, FoodWorld or even Subhiksha, you should be worrying. At the hypermarket end, a Big Bazaar or Spencer's would be hard-pressed to match the financial muscle or back-end skills of a Reliance or Bal-Mart. "Wal-Mart's biggest strength is in non-food categories, so they may not do food in the hypermarket format," thinks R. Subramanian of Subhiksha: Just the same, a Subhiksha must worry about losing its neighbourhood store franchisees to bigger players offering better returns.

SHOPPERS' STOP

Safe for now: Smart positioning could help Shoppers' Stop

As a result, some of them would want to sell out. Subhiksha, for instance, would have sold out already to Reliance Retail but for a disagreement over valuation. A Nilgiri's, where there are multiple promoter-owners and a private equity investor (Actis), will also want to cash in while the going is good. With the bigger players learning the ropes and opening stores every day, the window of opportunity for the smaller players to sell out will begin to close. That's something Gautam Adani must have realised when he decided to sell his Gujarat-based 50-store chain to Reliance for a reported Rs 100 crore. Reliance, on its part, must have considered the entry cost and time before agreeing to pay the price.

The chains that will have less to fear will be the Westsides and the Shoppers' Stops. Just like Macy's and Bloomingdale's, they will be less 'mass market' and, therefore, not in the crosshairs of a Bal-Mart or Reliance. That said, every retailer in the country will have to go back to the drawing board to find niches where they can survive. The really big fight may be between Reliance and Bal-Mart, but there will be plenty of sparring among the others as well. These are fights that will leave the industry looking very different from what it is today.