Case Study Series

University of St.Gallen

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CROSSROADS Inc. (Part A): Entering the Indian Retail Market

Teaching Note

Reference no …

This case was written by Saransh Tyagi and Sandeep Singh (PGP at the Indian Institute of Management Bangalore) and Gopalakrishnan Narayanamurthy (Fellow Program in Management at Indian Institute of Management Kozhikode) with the support of Assistant Professor Dr. Roger Moser (University of St. Gallen). The authors are grateful to the numerous experts that have provided input to this case. It is exclusively intended as the basis for class discussion rather than to illustrate either the effective or ineffective handling of a management situation. The case was compiled from interviews with retail experts in India and publicly available sources. The case was developed without external funding.

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Case Synopsis

For the last few years, India had been the most attractive retail destination due to its enormous untapped potential and huge manpower supply. Organized retail was projected to grow by over 40% in the next few years and still reach just 7% market share of the entire retail industry depicting the enormous business potential for local and foreign retailers. CROSSROADS Inc. had decided to enter the Indian retail space and Jeff Mitchell, CEO, had to develop the company's market entry strategy for India. The entry of foreign players in the front end was still not allowed and hence CROSSROADS Inc. had to partner with an Indian player or follow the wholesale (Cash & Carry) model of Metro.

Target Audience

The target audiences for the case are BSc and MSc students and management trainees who are interested in learning how a Foreign Direct Investment (FDI) strategy implementation in the Indian retail sector looks like. Students need to have some basic understanding of the different international entry modes of firms, country specific FDI regulations with special reference to India, supply chain concepts and the challenges of doing business in emerging markets (e.g. diversity of business infrastructure, cultural differences, educational voids, workforce skills etc.).

Case Objectives

To make students understand:

- The Indian retail industry: current landscape, regulations and future opportunities
- The Indian retail consumer: their evolution over the years, their preferences and expectations
- Possible strategies for a foreign retailer trying to enter the Indian retail market

Teaching Plan

The faculty might first introduce/repeat the key concepts including different market entry modes of firms and country specific FDI regulations with special reference to India as well as the challenges of doing business in emerging markets. This can happen prior to the case study session.

In a second step, the faculty might discuss the actual case with the class depending on the way the class is used to prepare/discuss a case study. The faculty might highlight the following characteristics:

- Evolution of Indian retail industry
- Retail formats in India
- Importance of Indian market for international companies in organized retail

- Influence of Indian government regulations on business operations
- Challenges in Indian retail industry

The six assignment questions listed below can help in having a defined flow of presentations by different groups of students or discussions in the plenum. Each question can be presented (approx. 10 min) and discussed (approx. 10 min) thereby allowing the class to complete the case analysis and discussion in approximately 90-120 min.

Question/Assignment 1: What is the current landscape of the Indian Retail Industry?

Question/Assignment 2: How should CROSSROADS Inc. enter the Indian Retail industry?

Question/Assignment 3: Should they aim at becoming a pan-India player or a zonal player only?

Question/Assignment 4: Which places should they first open their stores in?

Question/Assignment 5: What should be the product range offering in India?

Question/Assignment 6: What are the FDI regulations in the case for the retail industry in India and how do they look today?

Case Analysis Notes

Question/Assignment 1: What is the current landscape of the Indian Retail Industry?

Retailing as an industry depends up on customer’s tastes, preferences and of course the buying pattern of the people. Retailers have to deal with concerned state governments and unclear legislation in order to establish and run their operations in India. There has been a significant growth in the number of people using supermarkets and hypermarkets for their daily requirements. With the advent of time the store formats have been changing -some of the old formats are being scrapped and new formats are being tested and implemented by retailers in India. The increased use of the Internet in India has led to one more interesting format, i.e. E-tailing. Store formats in India can be divided broadly in two categories, i.e. store based formats and non-store based formats.

Store-based Formats

Exclusive Brand Outlets (EBOs):

EBOs are exclusive outlets that sell merchandises exclusively of one brand. In such type of EBOs what is unique is that they keep the store name as their brand name itself. In India the concept is still mushrooming. Presently we can name few of them like Bata, Montecarlo, Sony, Peter England, Reebok, Nike, Adidas, Levi's etc.

Hypermarkets:

Hypermarkets are large retail stores, basically offering a range of products at lower prices. Typical hypermarkets can be up to 3, 00,000 to 5, 00,000 sq. ft. They usually store larger quantities of food and non-food items such as fresh produces, groceries, apparels, electronic goods, consumer durables and non-durables, etc. In India, the major players in this format are Big Bazaar of Pantaloon Retails, Star Bazaar of Trent India, HyperCity of Rahejas, Reliance Mart of Reliance Retail, Spencer's Hyper of RPG Group, and More Hyper of ABG Retail.

Supermarkets:

A typical supermarket is a self-service store of size up to 5,000-15,000 sq. ft. This kind of stores mainly offers food items like vegetables, fruits, groceries, fresh and frozen produces, and non-food items like toiletries, household articles, stationary, and gift items. Location for such stores is usually an important aspect, generally places near to residential locations or places where people can easily walk down or drive over for a quick purchase.

Department Stores:

Department Stores are stores usually having floor area varying between 15, 000 to 1, 50,000 sq. ft. based up on the assortment. Usually the merchandise includes large variety of apparels, cosmetics, toys to footwear, jewelry, furniture and household goods. The increased purchasing power of the working people, changed lifestyles have given enough boosts to this format. Stores like Shoppers Stop, Pantaloons, Globus, Wills-Lifestyle, Westside, etc. are some of the prominent players in this format.

Discounters/Factory Outlets:

Walmart can be considered the founder of such format. Here in this format goods are sold with a wide variety and limited services. Concentration is majorly on prices. Prices are kept as low as possible to gain the advantage against the competitor. Presently very few players are operating in this format. Players like The Loot, My Dollar Store, Max Retail, etc. are some of them.

Convenience and Forecourt:

These are the stores selling items like groceries, personal care products, OTC drugs, milk and other dairy products. The floor area stays between 500 to 3,000 sq. ft. As a convenience store they remain open seven days of week and for extended periods also. Café Coffee Day, KB's Fair Price shop, Easy Day (Bharti Retail) Spencer's Daily, Big Apple, Spinach local, etc. are some of the famous in these formats.

Kiosks, Food Courts & Express Formats:

These kinds of formats are basically the outcome of the increasing number of malls and multiplexes. These formats are usually not operated on standalone basis, rather in to the malls and multiplexes where footfalls are more in number. These stores actually make the shopping an experience for the people as they satisfy their smaller needs.

Express Stores are basically an extension to the main retail chain or brand, located in the malls or hypermarkets. Brands like Pizza Hut, Café Coffee Day, Nirula's, etc. have their Express stores in major malls and multiplexes.

Specialty Stores/Category Killers:

This is the format which offers the wide range in single product categories like books, music, apparels, shoes, auto parts and fruits, vegetables as well. Category Killers are the also a type of specialty store but with a difference. They offer goods with larger assortment and at discounted prices. In Indian markets still very few stores are there in this format like Staple and that too in very limited categories of products.

Cash-and-Carry:

Cash and carry is a form of trade in which goods are sold from a wholesale warehouse operated either on a self-service basis, or on the basis of samples (with the customer selecting from specimen articles using a manual or computerized ordering system but not serving himself) or a combination of the two.

The format is yet to develop in Indian retail sector. At present only German retailer Metro AG is there in this format with two outlets in Bangalore, one each in Hyderabad and Kolkata.

Non-Store Based Formats:

With the advent of time, the number of people using Internet in India has crossed a land mark. Today more than 40 million (Source: IAMA[1]) people use Internet and the number is increasing day and night. Same is the case for mobile users with more than 250 mn. users.

E-Tailing:

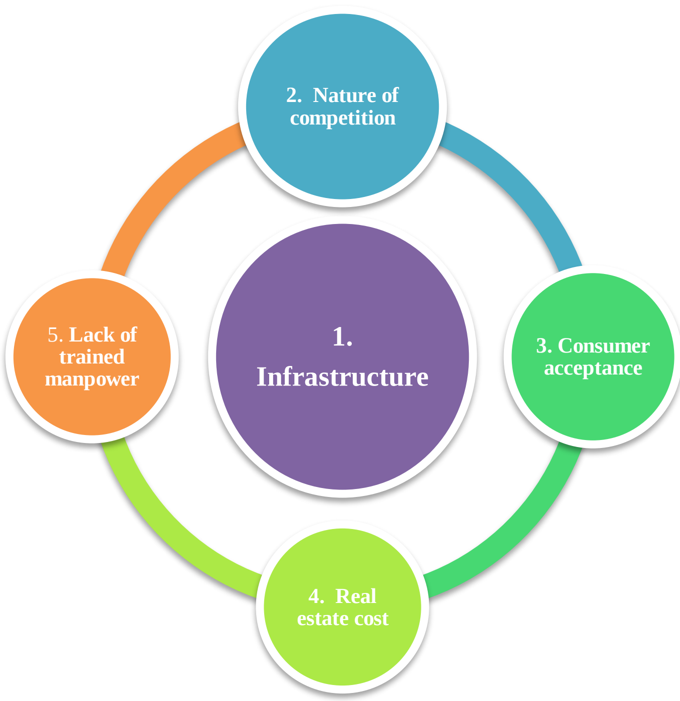
In E-tailing the shopping is done through browsing products on Internet and making online payment subsequently. In India the trend is not as popular as it is in western countries reason being lack of security of the online payment transactions, mind-set of the consumers, etc. But the picture is changing now as more and more people have started using internet for various purposes like ticket booking, hotel reservation, etc. so this paves the way for this format in

[1] IAMA stands for Internet and Mobile Association.

retailing. At present foreign operators like eBay, PayPal, Amazon.com, etc. are there with Future Bazaar, Naukri.com, ezeego, Indiatimes.com as few Indian operators.

Question/Assignment 2: How should CROSSROADS Inc. enter the Indian Retail industry?

CROSSROADS Inc. has a number of options available within itself to enter the Indian market. Metro's Cash & Carry format is the only segment in which it can enter on its own as wholly owned subsidiary without any joint venture. However, this is a risky proposition as the company has no previous experience in the Indian market. The dynamics of the Indian market are very different from the dynamics of the European retail industry.



- **Infrastructure** is the major cause of concern of retailers in India. While the back end is highly streamlined and much easier to establish in Europe, it is a serious impediment in India. A foreign player entering single handedly in the Indian market would not only need to invest in the front end but would in fact require a much higher investment in establishing the back end operations.
- One of the major differences is the **nature of competition**. While the street hawkers and Mom & Pop stores are the major competitors in India (holding the majority of market share), other organized retailers are the major competitors in Europe.
- Another major difference lies in the **consumer characteristics and acceptance**. The Indian consumer preferences have been rapidly changing over the past few years.

Traditionally, the Indian consumer has been very price sensitive but this has changed now and more and more people look for convenience and health.

- The **real estate cost** in the major Indian cities is on a rise and it would require a huge investment from any new entrant to establish its retail outlets in a major city.
- **Lack of trained manpower** is an impediment in leveraging the usage of the available resources. Business cannot optimally grow when the manpower, both front end as well as back end, is not sufficiently trained.

Considering these factors, it is quite evident that entering single-handedly in a new territory such as India might not be a decision that is easy to implement. Thus, the Cash & Carry segment might not be a market which CROSSROADS Inc. should target.

Opening stores through franchisee is also not a viable option. CROSSROADS Inc., though being a big brand in Europe, is not a well-known brand in India. Going through this route would also mean that the company would have little control over its market as it would not be directly attached to the consumers in India. It would also have to share its profits with the franchisee owners.

Therefore, a better strategy might be to enter the Indian market in partnership with an Indian player. There are two options available for CROSSROADS Inc. in such a scenario:

1. **A strategic license agreement with an Indian player**: SPAR, the Dutch retailer has entered India through this route. CROSSROADS Inc. would enter into a licensing agreement with a domestic retailer or partner with an Indian promoter owned company. This would also allow the company to use its brand name and would help in marketing its retail chain. In such an agreement the investment will be done by the Indian player which will invest in the CROSSROADS Inc. branded retail outlets. The terms of the licensing agreement would include the profit sharing model.

   Although, this model would help CROSSROADS Inc. gain an entry into the Indian retail industry, the operations would still be controlled by the Indian company both at the front and back end. CROSSROADS Inc. would just be positioning/developing its brand name in the Indian retail industry.

2. **A joint venture**: Walmart, the world's biggest retailer, has entered India through this route by partnering with India's leading telecom provider *Bharti*. CROSSROADS Inc. would enter into an agreement with an Indian player to setup the retail network. FDI of 100% is allowed in the back end with the total investment restricted to 49% of the total in the joint venture.

   This might be a better route for CROSSROADS Inc. to enter India as such a joint venture would help the company to get a better understanding of the Indian market and its consumers. CROSSROADS Inc. can use its vast experience in the industry to establish the back end supply chain network for the retail outlets. There are large business houses in India who might be interested in joining hands with one of the most successful retailers in Europe, enter the lucrative Indian retail market and take care of the front end leaving the back end issues for the more experienced player to handle.

Once the FDI regulations are more relaxed then this model would be an ideal spring board to launch its full fledged entry into the Indian market.

Question/Assignment 3: Should they aim at becoming a pan-India player or a zonal player only?

In order to become a pan-India player, CROSSROADS Inc. would require a huge investment upfront. As already discussed, India is a new market for the company and it should follow a very cautious expansion strategy. Reliance Retail entered the Indian market in a big way with stores in almost all major cities in India. However, they had to face huge losses and are now in the process of restructuring their strategy.

Therefore, it might be advisable to first enter a few cities only instead of establishing an all India presence. CROSSWORD Inc. should first go through the learning curve where it can use its past knowledge combined with its experience in India to develop a better growth strategy. It does not want to land up in a situation where it finds the investment made getting stuck up in an unprofitable business.

Question/Assignment 4: Which places should they first open their stores in?

As already stated, CROSSROADS Inc. should first target a few cities in the country. Metros like Mumbai, Delhi, Chennai or Bangalore which have a high ratio of working population would be an ideal place to start its operation. Walmart has started its operations in few Tier 2 cities in the state of Punjab primarily to take advantage of the low real estate costs while they move up the learning curve. However, they are away from the major target markets which reside in the Metros and Tier 1 cities.

Question/Assignment 5: What should be the product range offering in India?

CROSSROADS Inc. should definitely enter the fresh food and the processed food segments. These are the segments which are currently highly fragmented and offer the highest potential for growth in India. The company has a vast experience in this sector and can use it to establish a low cost and agile supply chain catering to the Indian requirements. The marketing would be the prerogative of the Indian partner and CROSSROADS Inc. can focus all it resources and expertise in establishing the back end operations including sourcing, warehousing, distribution etc.

Question/Assignment 6: What are the FDI regulations in the case for the retail industry in India and how do they look today?

In 2009, the Indian Government allowed 51% foreign direct investment (FDI) in single brand retail while for multiple brands no FDI is allowed. Thus, a foreign retailer cannot simply setup a front end on its own. It has to partner with a local player who will own the front end shops. For setting up the back end *(e.g. cold storages)* or wholesaling (*Cash & Carry*), 100% FDI is allowed.

While companies like Metro AG (Germany) and Shoprite (South Africa) have already taken advantage of 100% FDI in 'cash and carry' businesses and Carrefour (France) and Tesco (UK) have announced their intention to do so, single brand retailers like Marks & Spencer (UK) and Vision Express (Netherlands) have been forced to accept partnerships with local business houses for entry into single brand retail. Given the availability of local partners, many of them would have liked to go on their own.

Multi brand retail giants like Walmart, Carrefour, and Tesco have been compelled to either take the franchise route and/or provide technical (back end) services. Some large players have even chosen to wait until the policy has completely changed to meet their requirements. Although, no major policy change decision is expected in the near future, the government is believed to be considering relaxation in FDI norms for both single and multi-brand retail. The earliest reforms are likely to come in single branded luxury retail. The official line so far has been to consider allowing 100% FDI in single brand retail in the segments that do not adversely affect local employment. It is also believed that, despite pronouncements to the contrary, the commerce ministry has mooted a proposal that seeks to allow up to 49% (*as against 0% at present*) FDI in multi-brand retail.

However, the regulations today might have changed from 2009 and provide new opportunities for foreign retailers to enter the Indian retail market.

In sum, CROSSROADS Inc. would have to incorporate the key growth strategies adopted by retailers in India:

- ***Revamping the existing business structure***. Future Retails, the strategy has been to serve customers with the cheapest merchandise available along with a good quality; moreover, recently it has been announced by them that the entire operations of the company is being revamped and operations would be split in to two heads i.e. front end and back end. Front end would be handled by Future group whereas for the back end strategic partnership would be done with experienced players. Aditya Birla Retail Ltd. is also planning something similar to its competitor; the group has decided to re-launch all the outlets under a different name.
- ***Forming the strategic alliance between the domestic and international players.*** The domestic large corporate houses who were not experienced in to the retailing business did require a partner and for the international retail giants this is an opportunity to form an

alliance and enter in to the most attractive retail market as direct entry is restricted by FDI regulations. As a result of which we see alliances like Bharti-Wal-Mart, TESCO-Trent (Retail arm of Tata), and Future Group-Carrefour (Unconfirmed).

The business model that these alliances are adapting is obviously cash-and-carry and franchisee model. E.g. Bharti-Wal-Mart is about to open their first cash-and-carry store in Amritsar by May end, they plan to expand initially in north India and then Plan to grow arms in other regions. Wal-Mart is also going to help Bharti Retail in to handling the logistics and Supply-chain of 'Easy Day' outlets (wholly owned by Bharti Retail). They have already established one distribution center (DC) in Punjab for the same. (NA 2009)

Trent India Ltd. the retail arm of the Tata group of companies has also formed an alliance with British retail giant TESCO for a franchisee deal. And it is also heard that the Future Group is in talk with the French retail giant Carrefour for the strategic alliance to handle the back end operations of the domestic retail giant.

- ***Innovative business models and new formats for outlets.*** Be it small or a large organization, the innovation level in forming a business model along with a fully-fledged plan with respect to all minute details from stores operations to HR related issues is a must requirement.

  All major players in retailing have been trying varied formats from hypermarkets to Kiosks and Cash-and-carry to Specialty Stores like Reliance Fresh, Reliance Wellness, The Loot (Discounter), Mom & Me (Mahindra Retail) etc.

  In an Interview conducted by SMI India, with Mr. Amit Mukherjee, CIO, RPG Retails Ltd, he gave his opinions with respect to future growth strategies and according to him the scenario is changing with recession setting in. He sees that specialty and niche retail formats are a talk of the day now. Moreover, he also sees domestic players foraying in to multi-formats so that they can capture maximum out of the pocket of the customers. E.g. Future Group with presence in formats like Hypermarkets with Big Bazaar, Departmental stores with 'Central' etc. Reliance Retail also is present in multiple formats like Hypermarkets, Supermarkets and Specialty Stores etc.

- ***Rationalization and Rightsizing***. With the recession setting in sales for all companies in retailing in India has got affected. And unfortunately companies which forayed in the retail market with lots of expectations have to either entirely or partially close the operations. The rat race among the domestic corporate houses, improper and insufficient planning with respect to the retail operations, especially supply chain and training of personnel for front end and back end, mad expansion plans, etc also seem to be some of the reasons for the same.