

Case Study

IMPACT OF GLOBAL MELTDOWN ON RETAIL SECTOR IN INDIA

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RETAILING is the interface between the producer and the individual consumer buying for personal consumption. This excludes direct interface between the manufacturer and institutional buyers such as the government and other bulk customers. A retailer is one who stocks the producer's goods and is involved in the act of selling it to the individual consumer, at a margin of profit. As such, retailing is the last link that connects the individual consumer with the manufacturing and distribution chain.

The retail industry is divided into organised and unorganised sectors. Organised retailing refers to trading activities undertaken by licensed retailers, that is, those who are registered for sales tax, income tax, etc. These include the corporate-backed hypermarkets and retail chains, and also the privately owned large retail businesses. Unorganised retailing, on the other hand, refers to the traditional formats of low-cost retailing, for example, the local *kirana* shops, owner manned general stores, *paan / beedi* shops, convenience stores, hand cart and pavement vendors, etc.

Unorganised retailing is by far the prevalent form of trade in India – constituting 98% of total trade, while organised trade accounts only for the remaining 2%. Estimates vary widely about the true size of the retail business in India. Food retail trade is a very large segment of the total economic activity of our country and due to its vast employment potential, it deserves very special focused attention. Efficiency enhancements and increase in the food retail sales activity would have a cascading effect on employment and economic activity in the rural areas for the marginalized workers.

While, momentum of retail business in some areas may continue, the sector cannot escape from heat of the global financial meltdown, say experts.

“Because of the global crisis, there would be decline in disposable income, and sales of upper end goods as well as lifestyle items would get hampered somewhat. The ultimate cause of all the problems we're facing is government, with its taxes, regulations, inflation – and wars, pogroms, confiscations, persecutions and myriad other stupidities (www.financialsense.com). But the proximate cause of the recent unpleasantness is Subprime mortgages.

The Proximate Cause

The genesis of the current crisis is US Subprime mortgages. For well over a decade, lenders have been making mortgage loans available to literally anybody with a pulse who wanted to own a house. Several times in the mid-'90s lenders were loaning more than 100% of the appraised value of a house. Even back then, it seemed that was the top of the housing bubble.

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This leads to one of the more interesting distortions arising from a really big credit-driven boom. You know the old saying: *If you owe a banker a little money and can't pay, you're in trouble. But if you owe a lot of money, he's in trouble.* That's exactly what's happened there. All those new homeowners are already having trouble paying their mortgages. As rates go up, their ranks will swell since they're almost all on floating-rate mortgages. Higher rates and more distress sales will take housing prices lower, which, in turn, will encourage more people to leave their keys in the mailbox and walk away.

Now the question arises that why did a country like India, with a billion population, 10000 miles away from US suffering for a mistake committed by some one whom we don't even know...

Are these the adverse effects of Globalisation???

There are mainly 5 areas that could really feel the heat because of the American economic slowdown.....

1. Information Technology
2. Real Estate
3. Banking
4. Insurance and
5. B Schools.

Why is IT important in the first place? - Any slowdown in this sector will straight away hit the new generation working class of India who are the biggest spenders in the current day. So obviously this will in turn effect all the other dependent sectors like Real Estate, **Retail**, Consulting and the list never ends.. So the equation works like this...

Large US corporations => Indian IT Companies => Indian Real Estate, **Retail**, Telecom etc...

Business - Slowdown in Retail

As Wall Street unravels and the economy confronts its crucial holiday spending season, consumers cannot be expected to prop up retailers as they did in past downturns. Even luxury stores, whose customers have been immune in recent years to retail price sticker shock, are expected to take a hit this time, most consumers were already struggling with high food and energy prices, shrinking home equity and concerns about their jobs even before the financial crisis hit with a vengeance in September. Wharton Marketing Professor Stephen Hoch says – “It's been a rotten year for the consumer already, and this latest round of ugly developments has probably not fundamentally changed the situation. The people affected now are the upper end who have – or had – accumulated wealth and have lost a third of it. This is the nail in the coffin of the luxury sector.”

Deloitte Research forecasts a 2.5% increase in spending for the period between October and January, but – after accounting for inflation of more than 4.5% – that's actually a decline, and puts this holiday season on par with downturns in 2002, 1991 and 1981.

Chief economist at Deloitte Research, says that in recent years, luxury retailers had been able to sustain strong growth by developing new entry-level brands and products to draw in ‘aspirational’ shoppers with lower incomes than traditional customers. Now those aspirational spenders who helped support high-end retailers in recent years are more susceptible to the economic downdraft than long-time clientele. *Luxury retailers are no longer “bulletproof”*

The most vulnerable retailers are department and specialty stores in the middle market. These retailers offer a product mix that is highly discretionary and affected sharply by the loss of income or layoffs.

Small, independent retailers will also struggle. Locally owned shops usually can't offer the lowest price because they are too small to buy directly from manufacturers and must cover the costs of their wholesale supply network. "They are going to get hit like everybody else,"

Global meltdown has adversely affected growth of retail industry in India "Everyone in retail industry are postponing their expansion plans and are adopting a wait and watch strategy,"

India's retail industry is changing or putting on hold expansion plans largely due to the economic slowdown. The latest victims are Subhiksha and Spinach retail.

R Subramanian, Founder and Managing Director of Subhiksha Retail, India's largest retailer in terms of number of stores, feels that while global economic meltdown would cause some pain, it will in the long run help the industry lead a healthy life.

"Fruits and vegetables have been de-emphasised in some stores. A few months back, Subhiksha had outlined a Rs 1,000-crore expansion plan. The number of Subhiksha outlets was to touch 2,200 by March 2009 up from 1,320 last fiscal. But now the company is more cautious. Subhiksha now hopes to roll out consumer-durable stores only post June-July next year by which time it expects rentals to fall further by about 40%.

It has even asked some 700-odd employees from its 97 stores in Chennai, to pick up groceries in lieu of their outstanding dues against non-payment of salaries. Most of the employees, including two of its Vice Presidents, according to the Buzz, have not been paid their salaries for the past two months.

Even this offer has created a piquant situation for the employees as they find store shelves almost empty as there are hardly any goods left to pick. The reason for disappearance of goods from the shelves is said to be the stoppage of supplies by many vendors, including the country's largest FMCG player Unilever. These vendors, according to reports, have not been paid dues against earlier supplies.

It has also shut down 90-odd convenience stores across the country in the last one month.

The discount chain has withdrawn from fresh foods (fruits & vegetables) segment and also cut down on supplies of pharmaceutical products

Meanwhile, Wadhawan food retail had opened more than 200 convenience stores under its Spinach, Sabka Bazaar and Smart brands. But its hypermarket plans seems to have been put on the backburner. The company says it will focus on neighborhood stores in the near future and is expecting a further correction in property prices.

Inventory-to-sales ratios are at historic lows and retailers have been extremely cautious month-to-month about hiring.

Therefore in this distress situation the Retailers' top strategy should be to survive. **While lower gasoline prices are a relief to consumers, the price decline will not be enough** to override all the other challenges retailers face this holiday season noting that Wal-Mart has already taken a strong stand on toy pricing in an attempt to maintain its position. Retailers should take a hard look at every aspect of their operations.

If a concept or location is not working, the current climate does not offer enough of a cushion to keep addressing the problem until it can be turned around for a payoff. "You have to cut your losses and focus on the core business and make sure that is performing well."

While, one cannot predict the extent of adverse impact that global financial meltdown will have on

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retail sector, there is one retail category in India, which irrespective of the difficult economic environment, is growing at a much faster rate than expected, which is 'luxury' and 'super luxury' cars. Luxury car brand Mercedes Benz, achieved the record sales of over 3,000 cars in first nine months of the year, thereby, registering a growth of 56 per cent over the same period last year. Another super luxury car brand Bentley of the UK, has registered a growth of 20 per cent last year.

Scott Hoyt, senior director of consumer economics at Moody's Economy.com, says consumer spending this holiday season will be shaped by two forces. Faced with declining home prices, job worries and credit card debt, consumers simply are in no position to raise spending levels. In addition, they have lost confidence in the economic future, making them especially wary of spending. "Confidence is down in the doldrums," states Hoyt. **"While consumer spending and debt levels had reached unsustainable levels and were bound to come down, Hoyt says, the abrupt and painful collapse in housing prices and dramatic stock market losses have brutalised consumer psyches. As a result, the slowdown may be harsher than it would have been had the bubble deflated more gradually."**

Economists expect consumers to face several years of retrenchment, but other elements of the economy, including business investment, trade, and energy productivity and investment will step forward to replace consumers in driving future growth. "We will have a recovery next year, probably late next year, but we're going to have a very different economy," they say. "We have had a consumer driven economy for 25 years. Now we will have an export and business-led economy."

Questions

1. In what ways the global meltdown will effect the retail sector in India? In case it is going to impact the growth of the retail sector negatively, how long will it take to come out of the negative impact?
2. What trend would you be predicting by way of the structural changes in the retail sector, i.e hyper markets, multibrands mall, mid size malls or small size malls etc?
3. The much affected sector namely the reality sector followed by IT and ITES, how long in your opinion this negative impact will effect these sectors? What measures in your opinion need to be initiated both at the level of government as well as the industry?

Reference

<http://www.financialsense.com/editorials/casey/2007/0828.html>

<http://www.knowledge.wharton.upenn.edu/article.cfm?articleid=2081>