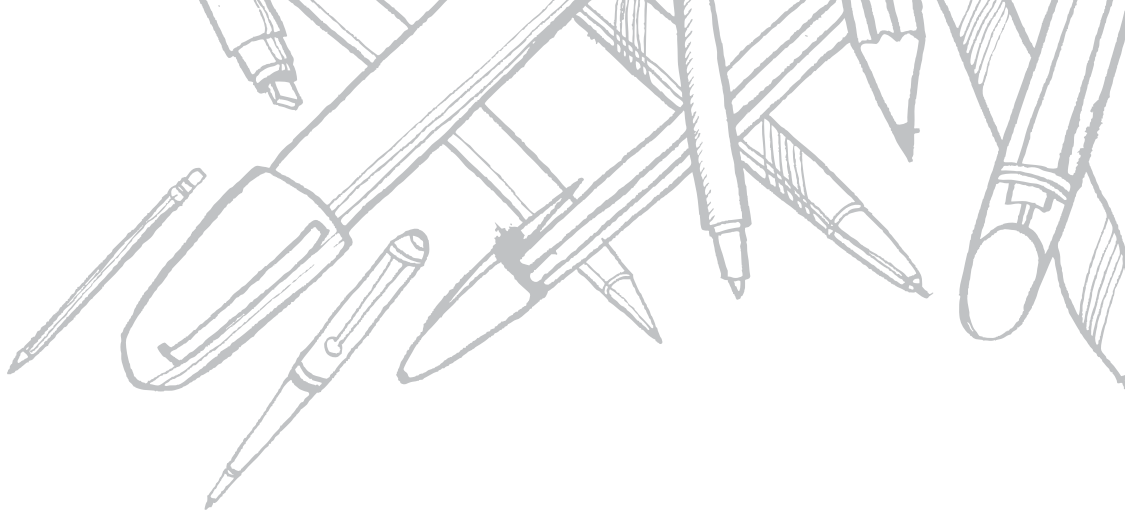


A person wearing a dark jacket is carrying a large blue bag over their shoulder and holding a shopping bag with a pink logo. The background is a blurred, colorful scene, possibly a market or a street. A yellow diagonal line runs across the image from the bottom left to the top right. The text is overlaid on the right side of the image.

# Road to India's consumer market

March 2013

# Foreword



**Pinakiranjan Mishra**

Partner and National Leader  
Retail & Consumer Products  
Ernst & Young India

Dear reader,

We are delighted to present our report, "Road to India's consumer market," in association with the UK India Business Council (UKIBC).

The recent global economic slowdown has limited the avenues of growth for retail and consumer product companies in developed markets of the US and Europe. On the other hand, India's retail and consumer products sector is under penetrated, large and growing. With the recent regulatory changes, changing consumption pattern and growth in supply, India's retail and consumer products sector is expected to register robust growth.

While the opportunities offered by the Indian retail sector are immense, international players must be aware that the consumer and market dynamics in India differ from their home markets, often leading to challenges for the unprepared.

The report provides an overview of some of the key trends, challenges and the overall outlook for the Indian consumer market, such as: Consumer behavior and the changing face of Indian consumerism, new retail and wholesale channels, issues such as supply chain and people and key success factors for entering and setting up a business in India's consumer sector.

We hope that international retailers find this report useful in contextualizing the modus operandi and construction of the consumer market as they evaluate opportunities available in India.



# Forerunner



**Richard Heald**  
Chief Executive Officer  
UKIBC

Dear reader,

The UKIBC is delighted to produce this important report in association with Ernst and Young, one of its valuable members.

The UK has considerable expertise in the retail sector. For example, food and drink processing and packaging is the country's single-largest manufacturing sector, and it is growing at a faster rate than most other sectors, spreading to international markets. UK fashion brands, such as Burberry and retailers, such as Hamleys which embody the British spirit enjoy a great demand in India. Britain's supply-chain logistics and transportation expertise are among the most sophisticated in the world.

The Indian consumer has evolved significantly and is fast emerging as a real force to reckon with. The consumer from India has gone from being deprived to being flooded with offers, from being price-conscious to being value-conscious, and from buying need-based goods to now spending on lifestyle and discretionary items.

India's young generation, in particular, has entered the global spotlight. This generation has increasingly become well-educated, media savvy and ambitious. They are likely to continue to be the focus of international marketers around the world.

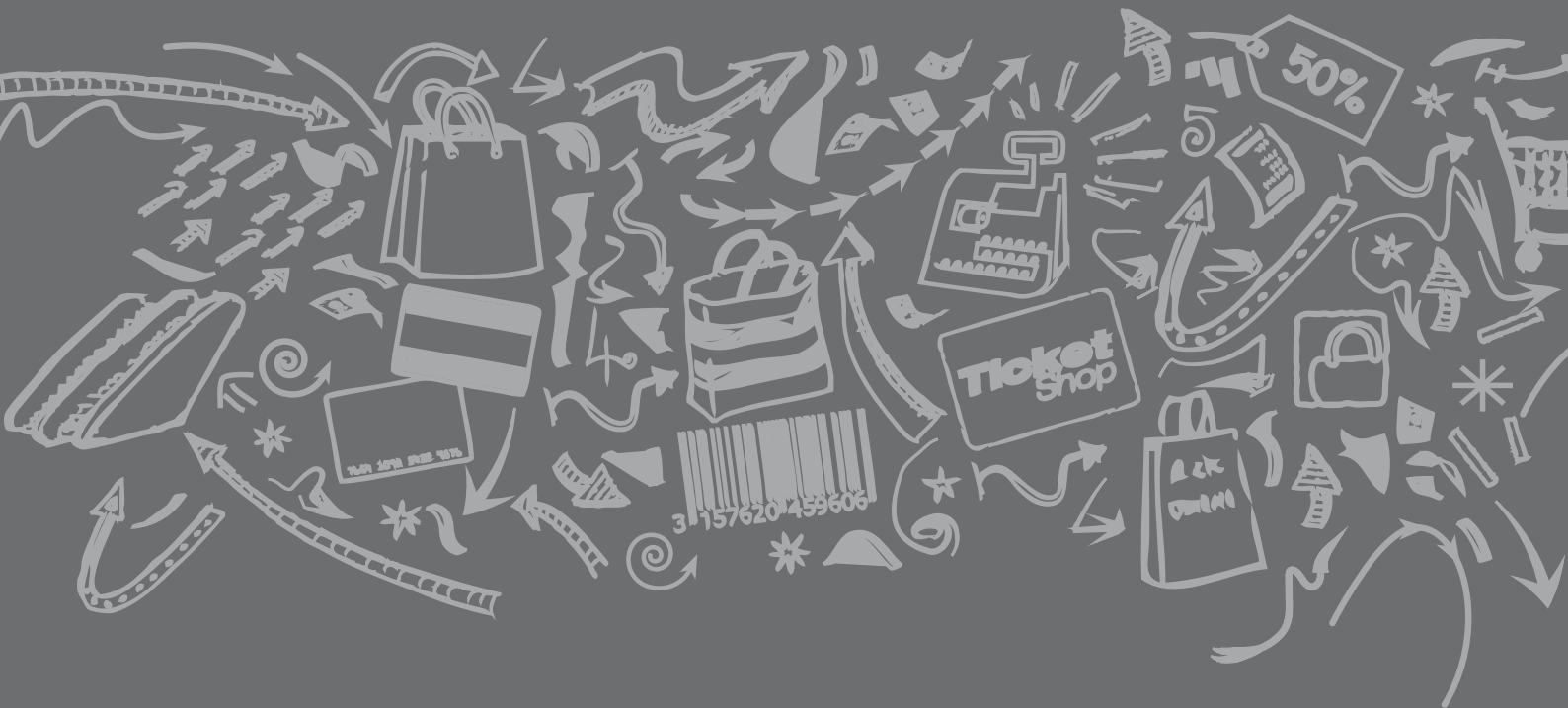
Initially allowing 100% FDI in single-brand retail, and following it up with permitting up to 51% FDI in multi-brand retail was a game-changer in 2012. These reforms are expected to usher in significant improvements to India's fragmented agri-food supply chain. They are also likely to help farmers get better deals for their products and offer a wider choice of goods to consumers at reduced prices. With the implementation of FDI, India is finally expected to be able to achieve its retail potential. India's retail sector has been developing at a fast pace and becoming increasingly competitive. More and more retailers are now understanding the importance of meeting consumer demands and are tailoring their products and services to capture and retain customers in order to outdo their rivals. In this report we focus on:

- ▶ The Indian consumer landscape and regulatory environment
- ▶ Various points of sale in India, such as traditional trade, modern trade, online retail, direct selling, and cash and carry wholesale
- ▶ Sub-sectors, where British companies may meet rising or unmet demand

This report reiterates the UKIBC's commitment to connecting UK businesses to the emerging opportunities in India. We hope it will inspire existing and future British business ventures in India.

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# Executive summary

India is a country with a population of more than 1.2 billion. The activities in the Indian consumer sector have gained higher prominence than most other sectors in the country because of this large population. Furthermore, India is at the cusp of consumerism and the demand for discretionary spending categories has been increasing faster than the overall consumption market. This has presented a healthy opportunity for companies who are evaluating an entry in the Indian market.

The Indian consumer market was valued at about US\$1.1 trillion in 2012 and is expected to grow at a healthy CAGR of 13% till 2020 to reach a size of US\$3 trillion. Traditionally, the Indian consumer wallet has been dominated by necessary products, such as food and home products. However, with changing socio-economic and demographic profile, consumption pattern has also been undergoing a change.

Although discretionary spending has been increasing, food is expected to remain the biggest part of the Indian consumption pie. The pattern of food consumption is likely to shift toward the category of value added, processed and packaged food. This changed pattern is expected to drive the growth of this particular category. Apart from this, discretionary spending categories, such as lifestyle, home products, and transport and communication are expected to grow at CAGR of 15-20%, giving rise to the next wave of consumerism.

Driven by this growth, the US\$500-billion Indian retail market is expected to increase at a rate of 12% per annum to reach US\$ 800 billion by 2016. The relevant organized market, which is currently valued at US\$ 35 billion, is expected to grow at 21% per annum to reach a size of US\$ 76 billion by 2016.

This growth in organized retail market is likely to be driven by demand side factors, such as an increase in consumption of value added and imported products, and supply side factors, such as penetration into the Tier II and Tier III cities and introduction of new (specialty) formats.

The recent liberalization of the Foreign Direct Investment (FDI) policy for retailing in India, has allowed foreign retailers to set up operations (100% ownership in single-brand retailing and up to 51% ownership in multi-brand retailing) in the country with certain conditions around sourcing and ownership.

Furthermore, given the time taken to set up retail operations in India, the organized segment is expected to gain further momentum from the policy change. However, that is only likely to happen toward the second half of this decade.

Due to the high operating cost of retail, low penetration of consumer products and consumer price sensitivity, several companies have ventured into online retailing and direct selling as an alternate channel. Although currently these channels are small, they are expected to register a healthy double-digit growth in the future.

Rising income levels, growing number of youths and people from the middle class, methods like uptrading are expected to drive India's consumption story and offer scalable business opportunities to retail and consumer products companies. However, India offers its unique challenges, such as diversity of demand, a lack of technology and process orientation, developing infrastructure, an unstable political environment and evolving regulatory environment. Therefore, any successful company would require a well-planned strategy to enter India.

In a nutshell, the Indian market offers significant potential for new entrants and existing players in the consumer products and retailing sectors. However, a new entrant needs to take these challenges into account and spend time to learn the Indian way of business.

# 01

## Overview of the Indian economy

### 1.1 India is one of the largest economies in the world and is expected to grow faster than its peers in the coming decades

India has a population of more than 1.2 billion, and is one of the world's largest consumer markets. India's GDP (US\$ 1.9 trillion) is currently the 10th largest in the world, and the country is likely to become the third largest economy in the world by 2030.

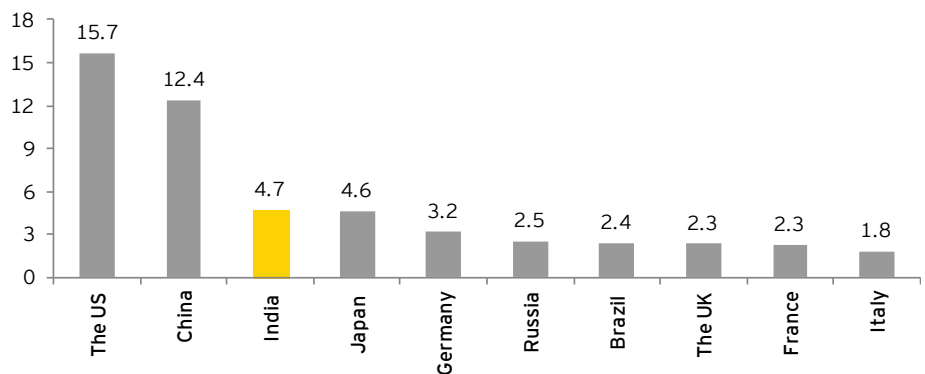
Rank	GDP 2012	GDP 2020	GDP 2030
1	The US	The US	China
2	China	China	The US
3	Japan	Japan	India
4	Germany	Germany	Japan
5	France	The UK	Russia
6	The UK	India	Germany
7	Brazil	France	Brazil
8	Italy	Russia	The UK
9	Russia	Italy	France
10	India	Brazil	Italy

Source: IMF World Economic Outlook, April 2012

In terms of purchasing power parity (PPP), India is currently the third largest economy in the world after the US and China, with a GDP (in PPP terms) of US\$ 4.7 trillion in 2012.

India's GDP has grown at an average rate of 8% over the past five years. It is among the few economies that have grown at a healthy rate since the onset of global recession in 2008.

Top 10 countries by GDP (PPP terms) (in USD trillion; 2012)



Source: Global IHS Insight





India's GDP growth slowed down to 5% in 2012 due to external factors, such as the continuing global economic slowdown (specifically the crisis in the Eurozone) and internal factors, such as high inflation, increasing trade deficits and weakening of the rupee. Other major economies of the world have also witnessed a slowdown in growth after the recovery in 2011 and India continues to be one of the fastest growing economies.

## 1.2 India is expected to maintain its growth trajectory in the future

Real GDP growth (% change)

	2011	2012	2013	2014	2015	2016	2017
China	9.3	7.8	8.2	8.4	8.5	8.2	7.7
India	6.3	5.1	6.0	7.0	7.7	7.9	8.4
Russia	4.3	5.8	3.2	4.1	3.8	3.9	3.6
Brazil	2.7	1.0	3.0	4.6	4.3	4.7	4.5
The US	1.8	2.2	1.9	2.8	3.3	2.9	2.8
The UK	0.9	0.0	0.8	1.4	2.0	2.5	2.4

India's GDP growth is poised to overtake that of China in 2017

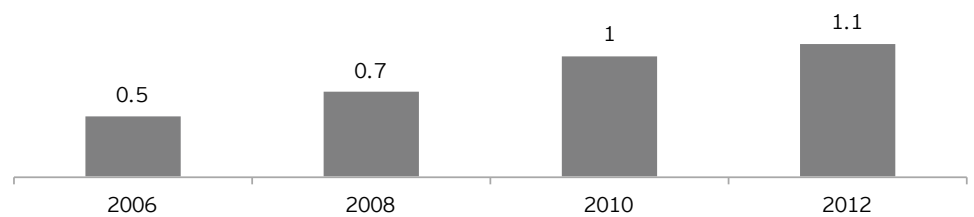
Despite the current slowdown, India remains one of the fastest growing economies in the world

### 1.3 Private consumption expenditure forms a major share of the GDP

By 2025, India is expected to become the world's fifth largest economy in terms of consumption, an improvement from its twelfth position in 2010.

Increasing consumption expenditure in the country has supported economic growth over the last few years and has also helped India to be relatively resilient to the global economic downturn.

#### Private consumption in US\$Tn



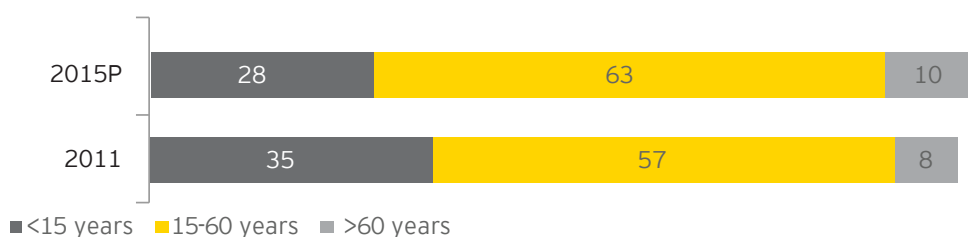
Source: Global IHS Insights, EY research

### 1.4 India has a large working/consuming population with a relatively low median age

Favorable demographics and rising income levels are critical factors in ensuring sustainable economic growth for a country.

In 2011, 57% of India's population (~700 million) was in the working age group of 15-60 years. This is expected to increase to 63% by 2015 (~820 million). This large working population is expected to emerge as the key consumer group and drive the growth of consumption expenditure.

#### Age distribution of India's population (%)

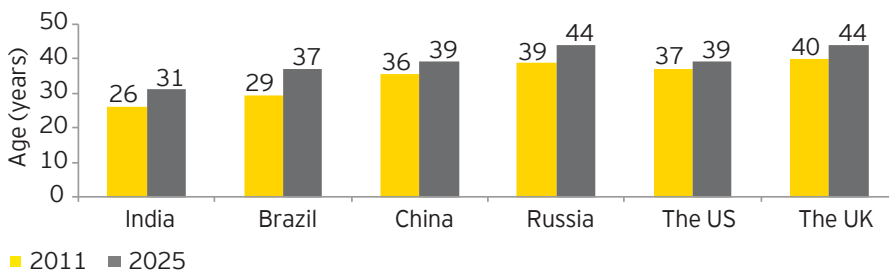


Source: Census of India 2011 and Crisil Retail report, 2011



## India's economic fundamentals are strong making it one of the attractive destinations for investments

### Median age of some major economies



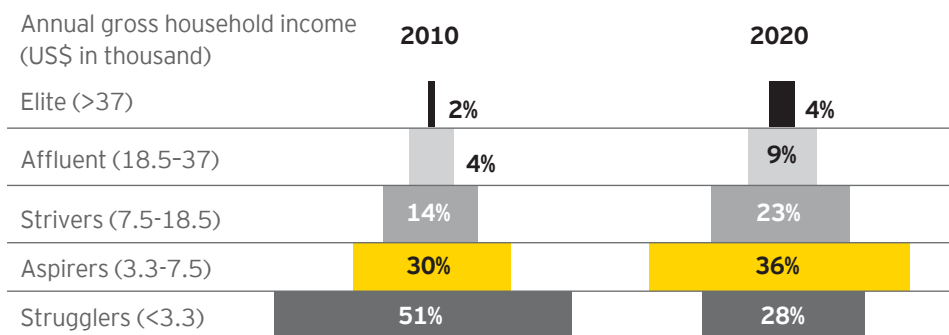
Source: CIA, UN, EY research

The median age of the population in India (26 years in 2011) is the lowest among the major economies. With the median age being expected to be 31 years in 2025, the Indian population is likely to continue to be among the youngest in the world.

## 1.5 The number of households in the middle income group is expected to expand, resulting in a threefold increase in the average household income between 2010 and 2020

India's income pyramid currently has a wide base of "struggler" and "aspirer" households. However, with rising income, this pyramid has been rapidly changing. Around 59% of the population is likely to reach the "aspirer" and "striver" class (constituting the middle income group) by 2020, as compared to 44% in 2010. The share of the "affluent" and "elite" sections is also expected to increase to 13% by 2020, a rise from its share of 6% in 2010.

### Distribution of households by income

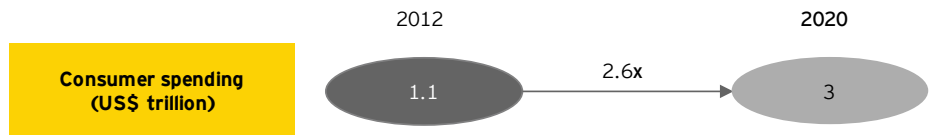


Source: BCG - CII report - "The Tiger Soars"

# 02 The Indian consumption landscape

## 2.1 Buoyed by a strong economy, increasing middle income group and rising household income, consumer spending is likely to expand significantly

Consumer spending expected to more than double by 2020

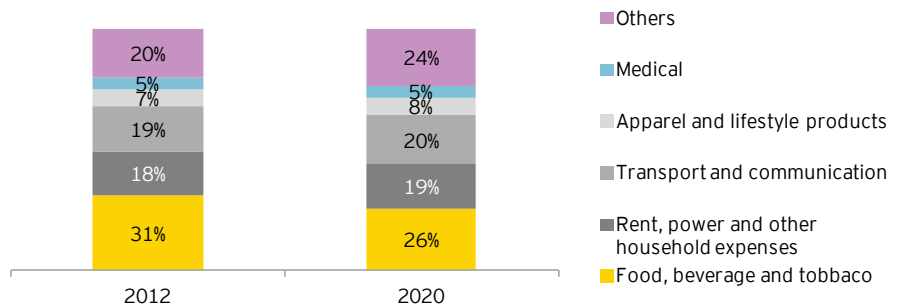


Source: Global IHS Insight, EY research

Overall consumer spending is likely to grow at an annual rate of 13% – from US\$1.1 trillion in 2012 to US\$3 trillion by 2020.

## 2.2 A change is expected in pattern of goods consumed and its share in wallet - the composition of the spend across discretionary categories is expected to increase and the consumer will also move up the quality ladder within categories

Share of consumption spending in 2012 and 2020



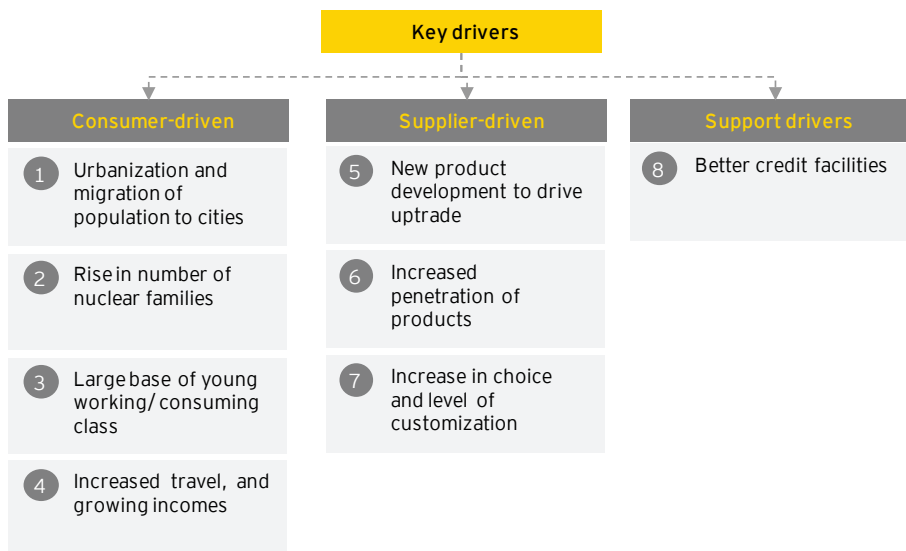
Source: Economic Survey 2012, EY research

With changing socio-economic and demographic profiles, consumption patterns are undergoing a distinct change.

Although the increase in spending in the food category may be lower than other categories, a shift in consumption pattern towards value added and processed food is likely to drive the value growth of the sector.

Spending on rent, utilities, transportation and communication are expected to increase further. The share of lifestyle category is expected to increase marginally. This is forecasted to be largely caused by rising income, affluence and consumerism.

## 2.3 This shift in consumer demand pattern is likely to be inclusive and is expected to be largely driven by:



**1. Increasing urbanization and migration to towns and cities is likely to lead to an increase in consumption in India and drive further uptrade**

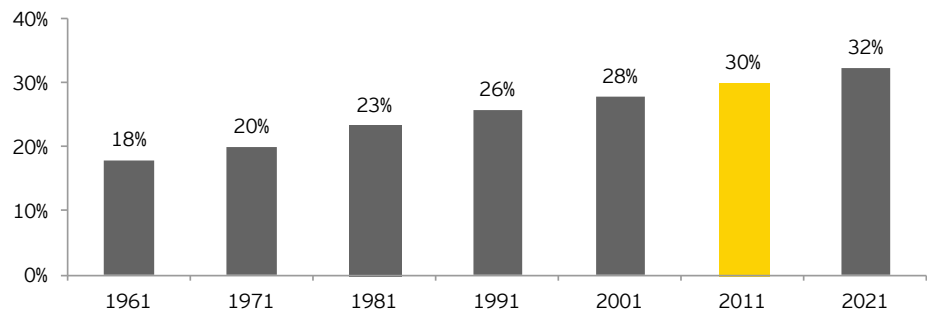
Expansion of urban areas and migration of the population has propelled consumption growth.

This migrating population has been increasingly introducing new products to their families residing in semi-urban and rural regions.

Currently ~30% of India (~0.36 billion – approximately the population of the US) resides in cities and towns.

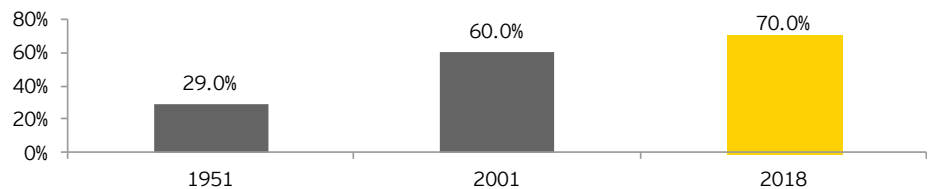
With the development of smaller towns, the contribution of urban areas to India's GDP has increased from 29% in 1951 to ~60% in 2001. It is likely to increase further and reach 70% by 2018.

**Urban population in India (%)**



Source: Census of India, 2011

**Contribution of urban India to GDP (%)**



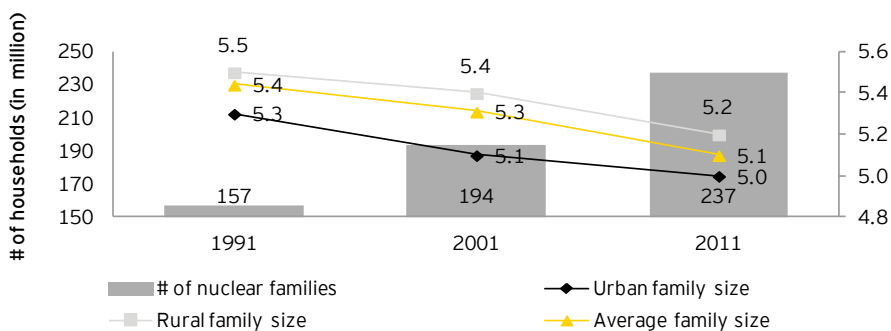
Source: Crisil, 2011

## 2. Growth in the number of nuclear families is driving consumerism in discretionary categories

Growth of urbanization is increasingly leading to smaller families, which have a greater freedom for purchase decisions

Nuclear families spend ~30% more for convenience, service and availability per capita than joint families. The former spend especially on clothing, housing, education and leisure.

### Number and size of households



Source: Census of India, EY research

## 3. India has a large working/consuming population with a relatively low median age

The median age of the population in India (26 years in 2011) is the lowest among the major economies. This young population has a tendency to spend more on discretionary categories than an average Indian.

## 4. Increasing awareness, travel and income levels are resulting in changing tastes and preferences

Growth of foreign travel and exposure to the western lifestyle has resulted in a shift in consumption habits, leading to uptrade.

Increased reach of media and technology has improved awareness among consumers. This has increased the need for better quality products across the consumer wallet.

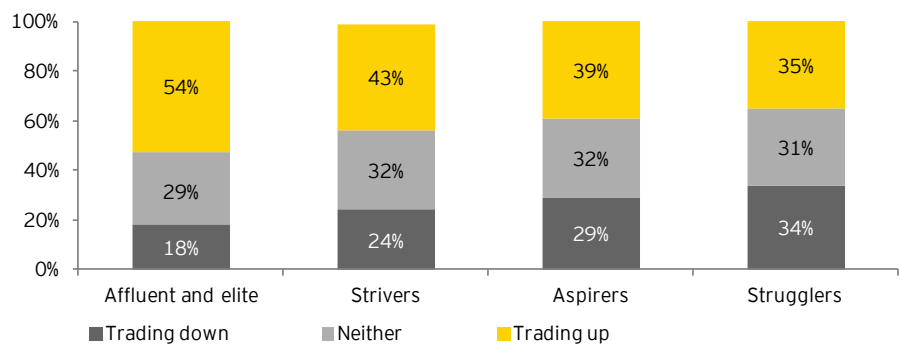


**5. Indian consumers are trading up with new product introductions**

Indian consumers have been increasingly emphasizing on nutrition and convenience. Product categories, such as packaged juices, ready-to-eat food and value-added dairy products are primed to take off, especially among the middle class and above.

The penetration of value-added food products is still very low, which has provided a huge opportunity for new and existing players.

**Tendency to up-trade in food and groceries**



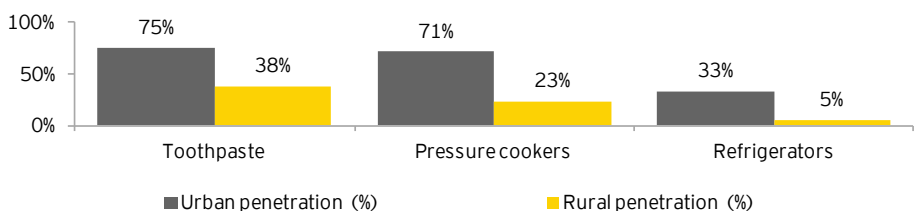
Source: BCG - CII report - "The Tiger Soars"

**6. Players are increasingly penetrating untapped but challenging rural markets**

Consumer goods companies have been increasingly expanding their product portfolios and changing distribution models to target micro-markets in urban and rural areas.

Increased affordability and the narrowing price gap have aided this penetration.

**Under-penetrated Indian markets**



Source: Marketing Whitebook, 2010-2011

Rural consumers "affordability and availability"	Urban consumers "convenience and nutrition"
<ul style="list-style-type: none"> <li>▶ Rural consumers are increasingly purchasing consumer goods. However, being affordable to a large section of this society has posed to be a challenge for the consumer goods companies.</li> <li>▶ A food products company has rolled out a potato chips brand, which will be sold at 40% lower than its flagship brand.</li> <li>▶ The rural opportunity is untapped and can drive the next wave of volume growth for retail and consumer companies. However, these companies may need to re-align their strategy.</li> </ul>	<ul style="list-style-type: none"> <li>▶ Urban consumers are increasingly trading up to better FMCG, food and other consumer goods. Indian consumer companies are introducing products to drive this upward movement.</li> <li>▶ A leading food products company has introduced a premium stirred yogurt, targeting "health conscious" consumers.</li> <li>▶ Value-added products are gaining popularity.</li> <li>▶ The urban consumers are making the shift towards lifestyle categories which may drive the growth of niche consumer products.</li> </ul>

### 7. The Indian consumer is getting spoilt for choice and this trend is expected to continue

The consumer market has developed over the last decade. Leading players have introduced a range of products to target opportunities across price points and geographies.

This trend is expected to continue with increasing penetration.

Increase in consumer choices	2000	2005	2010
TV channels	161	251	395
Refrigerator	48	96	160

Source: Avendus Capital, EY research

### 8. Growth in consumer credit has resulted in the increased availability of goods

Consumer financing has been a major driver in the consumer market. Retailers have been marketing expensive goods more aggressively by providing financing options. While this has been aimed at the lower and middle income groups, higher income groups are also getting attracted by these facilities and trading up further.

**The Indian consumer market opportunity has been backed by robust domestic trends, which is expected to drive a healthy growth of 13% per annum till 2020**

# 03

## The Indian regulatory environment

**3.1 The regulatory environment around the Indian retail sector has evolved over a period of time. The Government of India made a momentous announcement regarding foreign investments in the Indian retail sector in 2012. This development is likely to provide momentum to the growth plans of several global retailers with plans to set up shop in India.**

- ▶ Historically, retail in India has always been classified as Single-Brand Retail (SBR) and Multi-Brand Retail (MBR) from a regulatory standpoint. Until recently, FDI with prior Government approval was permitted only in case of SBR, subject to fulfilment of prescribed conditions. FDI in MBR was prohibited.
- ▶ Permitting FDI in MBR in a calibrated manner had been on the cards for a while. Considering the sensitive nature of this reform, certain guidelines have been prescribed to permit FDI infusion in Indian retail ventures. Furthermore, conditions related to SBR have also been relaxed, considering the practical difficulties faced by retailers in complying with them.



Conditions – MBR	Conditions – SBR
<p>Up to 51% FDI in MBR has been permitted, with prior Government approval, in the ten states and union territories favoring FDI</p> <p>FDI has been permitted, subject to the fulfillment of the following specified conditions:</p> <ul style="list-style-type: none"> <li>▶ Minimum US\$100 million to be brought in as FDI</li> <li>▶ 50% of the FDI to be invested in backend infrastructure within three years of the first tranche of FDI</li> <li>▶ At least 30% of the value of the procurement of manufactured/ processed products need to be sourced from Indian small industries</li> <li>▶ Retail sales outlets to be set up only in cities with a population of more than 1 million as per the 2011 census, and 10 kms around the municipal limits of such cities. In case, the approving state/ union territory does not have a city with a population of more than 1 million, retail sales outlets may be set up in cities of their choice and would also cover an area of 10 kms around its municipal limits.</li> <li>▶ E-commerce not permitted for MBR</li> </ul>	<p>Up to 100% FDI in SBR has been permitted, with prior Government approval, subject to the fulfillment of prescribed conditions. Sourcing conditions are applicable for FDI beyond 51%.</p> <p>The following conditions have also been amended:</p> <ul style="list-style-type: none"> <li>▶ Brand ownership requirement - A non-resident entity, whether owner of the brand or otherwise, would now be permitted to undertake single brand product retail trading in the country. Where the entity is not the brand owner, it should have a legally tenable agreement with the brand owner for which approval is being sought.</li> <li>▶ Mandatory sourcing condition – For FDI beyond 51%, domestic sourcing of goods (up to 30% of goods purchased) is to be preferably undertaken from medium and small enterprises (MSMEs), village and cottage industries, and artisans and craftsmen in all sectors. The calculation of 30% sourcing for the initial five years is to be on the basis of the average of five years of total value of goods purchased. Thereafter it is to be on an annual basis.</li> <li>▶ E-commerce not permitted for SBR</li> <li>▶ Other existing conditions for SBR to continue</li> </ul>

- ▶ With the above changes, there is a possibility of a lot of action around new foreign investments, several joint venture arrangements and the entry of global retailers in India.
- ▶ Presently, several foreign players have set up cash and carry operations in India and now there is a likelihood of a spur in the exercise to “migrate to a retail company” model.
- ▶ FDI reforms may provide further impetus to the Indian retailers to access foreign funds for long-term capital expansion and boost their Indian retail operations. It is also likely to open up doors for strategic partnerships with global players, whereby Indian retailers can gain access to several niche retail segments.

### 3.2 The importance of structuring the operating model. The model needs to be designed in light of the conditions prescribed for FDI.

- ▶ The operational model is a starting point for set-up in India. There are several operational aspects that need consideration, which inter alia include the following:

Local partnership/ alliance structuring	Product portfolio	Sourcing of products	Marketing strategy/ target customers
Store location and size	IT systems and ERP	Asset and employee base	Local expertise

- ▶ In addition to the operating structures, an essential exercise for retailers and investors with Indian plans is to be to consider the following tax and regulatory parameters so that they tie in with the ultimate business objective.





<b>Indian legal presence</b>	From a legal presence perspective, the typical choice could be between setting up of any one of the following entities in India (i)Liaison office; (ii)Branch office; (iii)Subsidiary company or a (iv)Limited Liability Partnership.
<b>Tax structure</b>	Tax structuring involves identifying appropriate holding company structure, funding model, inter-company transfer pricing policies which help to achieve tax efficiencies on profit repatriation, divestment, exit, etc.
<b>Regulatory approvals</b>	Drafting the application to the government/ Foreign Investment Promotion Board (FIPB) would be a key aspect that the retailer needs to consider and the contents of the application need to be strategically determined.
<b>Agreements and documentation</b>	Various inter-company agreements such as distribution, franchise, shareholders, option, product supply, support services, etc should be appropriately documented from an Indian tax and regulatory standpoint.
<b>Financial analysis business plan</b>	Business plans and financial models need to be looked into from various perspectives such as the pricing of goods, royalty, service charges, credit terms, etc.
<b>Deputation structuring</b>	While planning the deputation structure for overseas employees into India, the retailer will have to consider permanent establishment risks, exchange control implications on salary remittances and other income-tax implications.
<b>Indirect taxes</b>	A tax effective supply chain system in India is a factor of various indirect taxes such as customs, excise duty, service taxes, etc and it will help in achieving long-term tax efficiencies at various levels of operations.

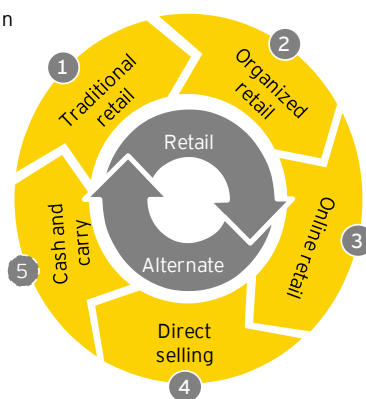
- ▶ Appropriate and thorough planning can make a foreign retailer's entry to the Indian market smooth and systematic. It can also increase its chance of being successful in the growing and lucrative Indian retail market.

# 04 Retail and wholesale channels in India

## Common retail and wholesale channels in the Indian consumer market

- ▶ Indian retail is dominated by traditional retail.
- ▶ There are about 12 million outlets operating across India.

- ▶ Cash and carry is an emerging channel
- ▶ A cash and carry store typically services trade (B2B) customers
- ▶ It currently serves as a route to venture into the Indian market through wholesaling



- ▶ Organized retail is an emerging channel and offers huge growth potential due to low penetration
- ▶ Leading domestic and international players are foraying to tap this potential

- ▶ Online retail is an emerging channel and offers good business potential
- ▶ It is emerging segment and requires capital and time investment in market development

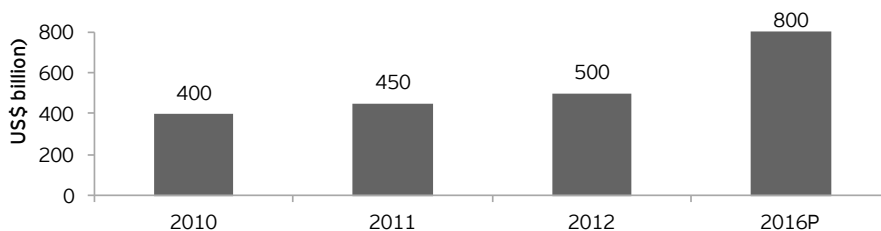
- ▶ Direct is considered to be an alternate channel in India.
- ▶ Several consumer products companies have adopted direct selling route and achieved sizeable scale

Point of Sale	Category	Reach
Traditional Retail	<ul style="list-style-type: none"> <li>▶ Mass merchandize, mainly food, FMCG and consumer durables</li> </ul>	<ul style="list-style-type: none"> <li>▶ Vast reach across the country</li> <li>▶ 12 million estimated outlets</li> </ul>
Organized Retail	<ul style="list-style-type: none"> <li>▶ Both mass merchandize and luxury products, such as food, apparel and consumer durables</li> </ul>	<ul style="list-style-type: none"> <li>▶ Concentrated in Tier I and Tier II cities</li> <li>▶ Top 10 cities contribute 75% of the organized market in this sector</li> </ul>
Online trade	<ul style="list-style-type: none"> <li>▶ Primarily books, electronics and other lifestyle products and accessories</li> </ul>	<ul style="list-style-type: none"> <li>▶ Typically in 50 major cities, though demand from smaller cities is increasing due to higher internet penetration</li> </ul>
Direct Selling	<ul style="list-style-type: none"> <li>▶ Health and wellness categories</li> <li>▶ Personal care products, such as shampoo, soap and hair oil</li> </ul>	<ul style="list-style-type: none"> <li>▶ Total distributor base of around 4 million people in 2011</li> </ul>
Cash and Carry	<ul style="list-style-type: none"> <li>▶ Largely mass merchandize, such as food, apparel and consumer durables</li> </ul>	<ul style="list-style-type: none"> <li>▶ Concentrated in metros and select cities, typically with a population of about 0.5 million and above</li> </ul>

## 4.1 Indian retail sector (traditional and organized retail) is thriving on the burgeoning consumer market

- ▶ In 2012, this sector was valued at an estimated US\$ 500 billion and was among the largest employers in the country.
- ▶ The retail sector in India is set to grow at a rapid pace with a gradual shift toward organized retailing formats.
- ▶ By 2016, Indian retail sector is likely to grow to US\$800 billion, at a CAGR of over 12%.

Retail industry size in India (US\$ billion)



Source: EY research

**Food and grocery form the largest share of the Indian retail market.** This includes retailing of fresh fruits and vegetables, dairy products, staples, cereals, processed foods, ready-to-eat meals, spices and other edible products. Despite its large size, this sector has remained highly unorganized and fragmented. It is dominated by the traditional channel – mom and pop stores/ kiranas. With the penetration of supermarkets, hypermarkets and convenience stores, the share of traditional trade is expected to come down marginally.

Packaged and processed foods form only 15% of India's food consumption and have been witnessing significant growth of 18% p.a. between 2006 and 2011. The fastest growing sub-categories include dairy, confectionery, pasta & noodles, snacks and ice-cream.

Several Indian and foreign players have set up specialty retail formats focusing on selling food products, such as yoghurt, ice-cream, imported processed foods and confectioneries and have gained traction in the Indian consumer market,

**Apparel and accessories is the second largest category in the retail sector.** Like food, the apparel category was historically dominated by unbranded players selling through small garment and textile shops. However, with the entry of foreign brands and the liberalization of FDI regulations in single brand, this scenario has changed. Today, apparel is considered as one of the most organized segments. The market share of branded apparel has increased from less than 5% to 10% in the last decade.

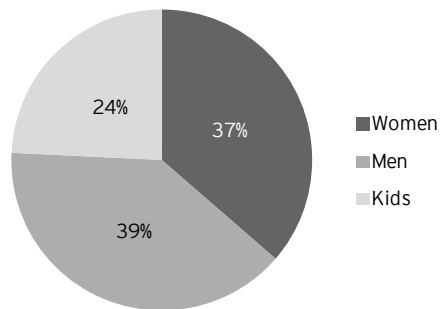
In 2012, the apparel and accessories market was valued at US\$51 billion, constituting about 10% of the Indian retail market (US\$ 500 billion). It is growing at a healthy rate of 15% per annum.

Unlike global markets, where womenswear is the larger segment, the menswear segment is currently larger in India. However, the womenswear segment has been growing at a faster rate and is expected to surpass the menswear segment in the next 3-5 years.

Going forward, food, apparel and consumer durables are expected to drive the sizeable value growth of the sector.

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**Split of the apparel retail market in 2012**



Source: EY research

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## 4.2 Traditional retail to retain its popularity and viability despite the entry of large organized players in the market

India's traditional retail accounted for about 93% share of the country's US\$500-billion retailing market in 2012. Although its share has dropped from 99% in 1999 to 93% in 2012, it remains the preferred point of sale, largely due to its deep penetration.

Mom and Pop/ Kirana stores are expected to retain their presence in India even as organized retail evolves. Shoppers' attitude, existing regulations and a cost advantage over organized retail is likely to help retain the popularity and viability of unorganized retail.

### 4.2.1 Key characteristics of the traditional retail outlets

Convenience	<ul style="list-style-type: none"> <li>▶ Easy accessibility with late operational hours</li> <li>▶ Offers convenient credit period</li> <li>▶ Provides free home delivery</li> </ul>
Cost	<ul style="list-style-type: none"> <li>▶ Lower operating costs due to unorganized nature</li> <li>▶ Provides competitive prices</li> </ul>
Choice	<ul style="list-style-type: none"> <li>▶ Maintains assortments of commonly bought products, including local brands</li> <li>▶ Enjoys customer's trust and recommends products</li> </ul>
Collaboration	<ul style="list-style-type: none"> <li>▶ Collaborating with consumer product companies to improve in-store experience and service</li> <li>▶ Setting up kiosks and other concessionaires in the store</li> </ul>
Customer service	<ul style="list-style-type: none"> <li>▶ Established personal relations with most of the consumers, resulting in trust</li> <li>▶ Provides insight about demand-supply situation and therefore, advice on appropriate stocking</li> <li>▶ Constantly takes feedback to improve the range and quality of products</li> </ul>

### 4.2.2 Traditional retail stores are opting for a modern makeover to woo customers

Traditional retail stores are attempting to directly compete with the organized retail players. A few unorganized players have replicated the look and practices of modern stores.

An increasing number of players are upgrading their services, their merchandise assortment (stocking imported products), experience, layout and lighting to attract customers while simultaneously driving margins.

Traditional retailers have a large and loyal customer base. These retailers are evolving and adapting with the changing consumer landscape to retain and upgrade these consumer groups.



### 4.2.3 Challenges faced by traditional retail stores

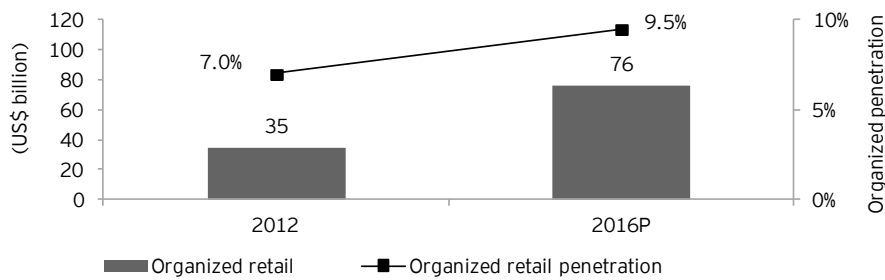
<p><b>Adverse impact of liberalization in FDI regulations</b></p>	<p>Ease of FDI regulations in retail is expected to have an adverse impact on traditional outlets in select markets. The organized retailers would focus on improving the supply chain (reducing the wastage) and drive additional margin from their vendors. This would provide an advantage for organized retailers.</p>
<p><b>Adapting assortment strategy to meet changing consumer demand</b></p>	<p>Traditional retailers find it difficult to change their mindset of shifting their focus to meet the changing consumer requirements. To be competitive the traditional retailer may have to revisit its merchandising and customer service strategy and build required capabilities to sustain the business.</p>
<p><b>Shrinking profit margins</b></p>	<p>Leading consumer goods company have reduced gross margins offered to the trade across several categories. At the same time, the retail operating costs have increased resulting in increased pressure on the profit margins. Traditional retailers are increasing revisiting their product strategy to balance value and volume off-take.</p>
<p><b>Poor customer shopping experience</b></p>	<p>Smaller store size limits the ability of a traditional retail store to display products. This impacts the customers' overall shopping experience since he is not able to "touch and feel" the product. Further, the store's ability to up-sell new products is curtailed since the products may not "meet the eye" of the customer</p>
<p><b>Losing "convenience and personal" edge</b></p>	<p>Traditionally, mom-and-pop stores focused on providing credit and customized service to retain consumers. However, supermarkets have now started using these incentives to attract the consumers. Further, to make the deal more attractive, they throw in freebies or discount coupons, which the small grocery stores cannot afford.</p>
<p><b>Lack of technological and systems orientation</b></p>	<p>Several traditional stores have refrained from adopting POS and inventory management technologies. With the growing complexity of the retail business, large traditional stores may have to incur investments in technology and systems</p>

## 4.3 India has a low penetration of organized retail; however, it is growing at a rapid pace

The Indian modern retail industry is expected to grow at a rapid pace to US\$76 billion by 2016 from an estimated size of US\$35 billion in 2012, with a CAGR of 21%.

Organized retail penetration is expected to increase from 7% in 2012 to 9.5% in 2016 in India.

**Share of modern trade in India**



Source: EY research

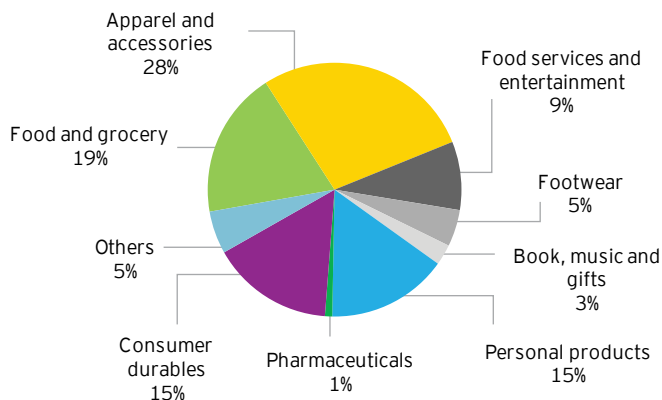
The recent liberalization of FDI policy for multi-brand retail may provide the required thrust for the growth of supermarket, hypermarket and department stores.

With the recent development in FDI policy for single-brand retailing, leading global retailers are evaluating a potential foray and this may further drive the penetration of modern trade formats in the country.

Apparel retail has a strong organized presence among the major segments. Post first round of changes in the FDI policy for single brand retail in 2006, several players have ventured into the market with specialty formats, such as personal products, footwear, food services and entertainment. Furthermore, the markets in these segments are restricted to urban and semiurban regions.

Post FDI liberalization for multi-brand retail, the food and grocery segment is expected to thrive further and drive the next wave of growth in the organized sector.

**Penetration of organized retail in major categories (2011-12)**

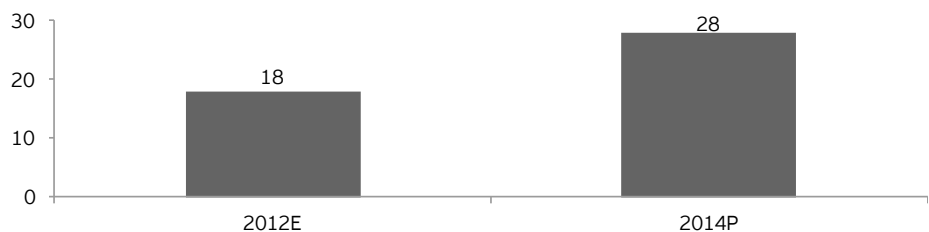


Source: EY research

### 4.3.1 Key drivers for modern retail trade

- ▶ **Changing consumer behavior:** Evolving demographics and consumer behavior in India strongly support the concept of modern retailing. Exposure to developed economies and an increase in brand consciousness, supported by higher income levels, are shifting consumers from a low-price to a convenient, high-value and a superior shopping experience.
- ▶ **Growing retail space:** Increasing retail space and strong growth in the number of shopping malls have been stimulating the development of the modern retail trade
- ▶ **Investments in infrastructure creation:** Investments in real estate, supply chain cold storage and warehousing are being encouraged to further drive growth in the retail sector
- ▶ **Increasing availability of plastic money:** Easy availability of credit and debit cards has made it convenient for Indian consumers to shop without carrying "too much cash" in their pockets.

Number of credit cards (mn)



Source: Netscribes retail report 2012, RBI

- ▶ **Retailers are now focusing on private label products collaborative ventures:** Retailers are increasing their focus on private labels and are looking to double their sales share over the next four years. While the share of private labels in the apparel and accessories sector is high, the focus is now shifting to FMCG, grocery and electronics.
- ▶ **Buoyed by strong growth drivers, new avenues of consumption are emerging in Tier II and Tier III cities with a large consumer base:** The penetration of organized retail in India is expected to create new "hot spots" of consumption, mostly in Tier II and Tier III cities which have a large consumption base. Cities, such as Ahmedabad, Jaipur, Nagpur, Ludhiana, Surat, Vadodara, Aurangabad and Kochi are expected to witness investments in mega retail projects and emerge as new avenues of consumption.
- ▶ **Introduction of innovative formats by retailers**
  - a. **Specialty formats:** Innovative specialty formats, such as "Wedding Malls" have started attracting attention. These stores stock a complete range of wedding needs – ranging from apparel to jewelry – and are fast making their presence felt in the Indian market.

- b. Luxury formats:** Traditionally, these stores were located in 5 star hotel properties. However, with the introduction of high-end malls, there are more avenues for retailing luxury goods.
  - c. Transit formats:** New airports and metro rail stations are being seen as newer avenues of retail.
- **Differentiation** - Leading Indian modern trade stores stock products/brands procured by local importers. Some modern trade retailers directly partner with leading foreign consumer product companies to exclusively retail & distribute their products in the Indian market

#### 4.3.2 Common challenges faced by organized retailers in India

##### **Lack of adequate infrastructure, real estate availability and high costs hamper the development**

Poor roads and a lack of cold chain infrastructure require existing players to invest time and capital in building the facilities, thus reducing the speed to market

High rentals and time-consuming processes to setup stores result in further delays and an increased cost of retail operations

##### **Government conditions for FDI in retail have made it difficult for some foreign retailers to enter the Indian market**

The conditions laid out for multi-brand retailing around investment, sourcing and markets open for foreign retailers may be difficult for some of them to comply with.

##### **The modern retail sector has been facing an acute shortage of trained personnel with the required skill-set**

Although there is an abundant supply of manpower in India, there is a lack of trained manpower, forcing Indian companies to invest in training operations for their employees. Furthermore, the attrition in the sector is high, thus increasing the overall recruitment and retaining cost.

Given these issues, typically a retailer in India has been hiring more manpower per store, as compared to stores in developed countries.

##### **The indirect tax regime increases the complexity in the supply chain**

India's indirect tax regime, with varying tax rates, is complex. This has adversely impacted the supply-chain model and operating costs of consumer goods companies. Furthermore, retailers have been facing challenges in efficiently implementing the supply chain software across stores and integrating it with the central warehouse.

##### **Diversity of the Indian market**

India is a market of markets. Socio-cultural and disparity in income levels result in diversity in demand across catchments within the same city. Therefore, retailers are required to strategize according to each store/unit level.

As real estate price are sky rocketing, retail rentals are eating into the profit margin of retailers

Poor supply chain and its complexities are among the weakest links in India's retail sector

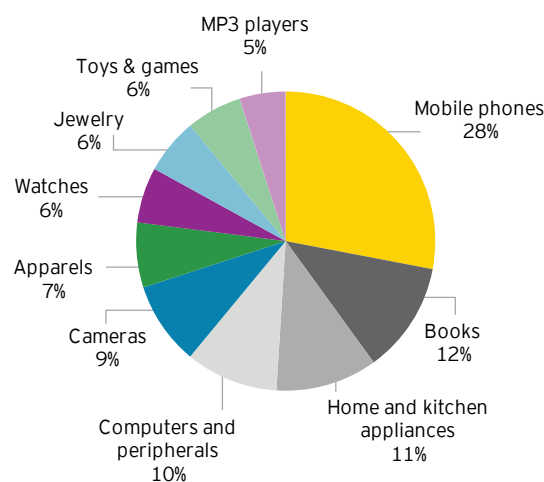
## 4.4 Online retail is an emerging retail channel and it has seen strong growth in recent years

- ▶ In 2012, market size of the Indian online retail (e-tail) was US\$1.6 billion. This market segment has seen one of the fastest growths (CAGR: ~50% in FY09-FY11) among the major retail channels in the country.
- ▶ With the growing acceptability of online retail, the arrival of several entrants with innovative market strategies and the increase in internet penetration, the online retail market is expected to sustain its growth till 2014. Online retail has served as a complementing channel for leading organized retailers. Low real estate costs, increasing accessibility of products and favorable pricing are driving the growth of the channel.
- ▶ In the last decade, the online retail sector has experienced the entry of several B2B and B2C websites, largely focusing on offerings related to convenience and availability.

### Indian online retail is following the global trend

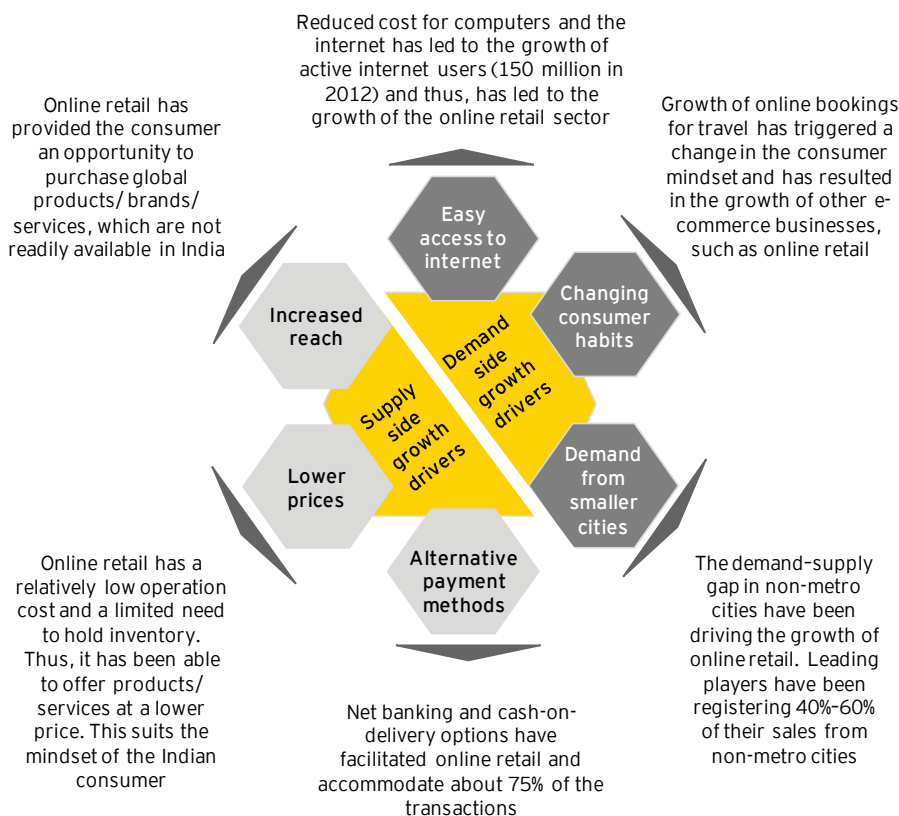
The current growth of online retail in India has been driven by a few product categories, which is in-line with the early phase of the global online industry. Currently, selective product categories, such as books, electronics and other lifestyle products account for the majority of online retail sales. However, with the growing popularity and familiarity of online retail, the category spread is also being extended to apparels and grocery products.

Indian e-tailing market split by category (2012)



Source: EY research

#### 4.4.1 Drivers for growth in online retail channel



Source: EY research

#### 4.4.2 Challenges faced by online retail

- ▶ **Profitability:** In spite of the rapid growth of online retail, most players have not achieved profitability and break-even, primarily due to high initial investments on setting up supply and delivery operations and spending on actions for customer acquisition, such as brand building, awareness creation and advertising.
- ▶ **Cash on Delivery (CoD):** CoD has been driving volume growth for the online retail sector. However, it seems unsustainable due to high instances of returns due to rejection (especially for low-ticket items), reverse logistics and transaction costs. The other problems associated with CoD are long lead times before the revenue can be booked, fraud risks and higher working capital requirements.
- ▶ **Infrastructure:** Reach and reliability of third-party logistics service providers are limited, especially outside the major cities in India. On the other hand, the cost of building one's own supply chain and logistics remain high for online retailers. This makes the business model capital-intensive. As a result of this, managing supply chain and logistics infrastructure has remained a major challenge for all online retail players.



## 4.5 Direct selling channel in India has seen a strong growth in recent times

In 2010-2011, direct selling recorded a growth of 27% to reach around US\$1 billion. The market is expected to grow at a CAGR 20% to reach around US\$2 billion by 2014-2015\*.

### 4.5.1 Emerging trends in the direct selling channel in India

The direct selling segment is dominated by the health and wellness category, which has registered a market share of 40%. This is followed by the 32% market share of cosmetics and personal care products.

Direct selling has also gained importance among various other categories, such as nutritional supplements and consumer durables (e.g., water purifiers and vacuum cleaners). This is particularly true in markets where these products are not available through other channels and where customers require product demonstrations.

Leading companies adopting direct selling channels have been able to sell to the Indian consumer largely due to their high standards and the convenience of direct home delivery.

- ▶ Leading players continue to penetrate smaller cities to expand their distribution network and gain market share, in the process building a robust base for the growth of the channel.
- ▶ The model encourages the participation of women (typically the non-working population in India) by providing them a business opportunity, which, in turn, drives the channel's uptake in the country. The number of independent women sales-consultants increased from 1.2 million to 2.1 million during 2010-11. This number is expected to rise further.
- ▶ Consumers are increasingly being educated on various direct selling schemes, and this has increased the acceptance of the model.

The southern part of India has remained the hub for direct selling, followed by west India. This is primarily due to the presence of a large base of independent sales consultants, coupled with high levels of awareness among the consumers.

Leading players have also been revising their strategy to focus on Tier I and Tier II cities. Companies have been modifying product portfolios to introduce smaller stock keeping units (SKUs) in order to increase their appeal to the masses. For instance, players have used sachets as a marketing method to gain the trust of consumers in these areas.

Similarly, players have also been introducing luxury products in their core markets, with a view to upgrade the existing customer. Furthermore, the Government of India is in the process of framing a law which can protect the Indian consumers from fraudulent (fly-by-night) direct selling and multi-level marketing companies. However, the policies may impose certain restrictions on genuine direct-selling companies.

\* [http://articles.economictimes.indiatimes.com/2012-05-03/news/31559063\\_1\\_idsa-growth-distributor](http://articles.economictimes.indiatimes.com/2012-05-03/news/31559063_1_idsa-growth-distributor)

## 4.6 Cash and carry wholesale has emerged as a mode of entry in the Indian market through wholesale operations for leading global players

The FDI regime in India till 2012 restricted investment in retail trade except single brand retailing with prior government approval, subject to the fulfillment of prescribed conditions.

However, 100% FDI was allowed in wholesale cash and carry operations wherein players are allowed to sell goods to retailers, industrial, commercial, institutional or other professional business users. Professional business users include as retailers, hoteliers, restaurants, caterers, corporate entities. Players are also allowed to sell to other wholesalers and related subordinated service providers.

Foreign players have leveraged this opportunity to study and learn India's diversity in consumption pattern and build a sustainable supply-chain network to support their operations.

Some players have leveraged this opportunity to set up a cash and carry business to manage the back-end operations for leading Indian retailers, thus providing access to global best practices for retailing operations.

### 4.6.1 Emerging Trends in the Indian C&C Market

► **Market is currently dominated by foreign players**

Cash & carry is new business concept for India, and currently foreign players from Europe and The US command majority share of this emerging market segment.

► **Players have focused on locating the stores in major cities with access to highways**

Leading players have established presence in major cities with a population of 0.5million and above. The stores are typically between 50,000 to 100,000 sq feet, at locations which are easily accessible (preferably highways) from their catchments.

► **The gestation period seems to be long**

Most cash and carry store operators in India are currently struggling to achieve robust profitability. This is largely due to the high operating costs at store level and the added burden of corporate overheads. The segment is nascent and is expected to turn profitable as it matures.

► **Cash and carry players have been increasingly altering their supply-chain strategy to reduce procurement costs and drive profitability**

Leading players are increasingly procuring staples and fresh products from mandis. Furthermore, players have been developing private label portfolio more and more to drive profitable revenue growth.

► **Cash and carry is emerging as a key channel for consumer products companies**

The growth of the cash and carry segment is driving penetration for most consumer product companies. These companies are increasingly assisting the cash and carry players in the form of trade schemes and distribution support to drive further penetration.

# 05

## Key steps to success for a new entrant

The Indian consumers' requirements are rapidly evolving, with an emphasis on value-added products. Introduction of quality (Indian and imported) products through modern retail is a common way to address this demand.

Opportunities to penetrate new regions and categories are also present. However, these markets may require investments in market development programs, such as educating the consumers and channel partners.

The Indian consumer also remains cost-conscious. It is, therefore, imperative for companies to offer price advantage. Consumer companies may cater to this consumer group via sourcing and operational efficiency, while a retailer may evaluate a private-label program.

### Implications for a new entrant

	Retail Companies	Consumer Product Companies
Tapping the demand	<ul style="list-style-type: none"> <li>▶ Create specific formats, which cater to different tiered cities</li> <li>▶ Secure the right real estate</li> <li>▶ Optimize the product portfolio with a mix of private labels and discount brands</li> <li>▶ Collaborate with manufacturers to offer local products</li> <li>▶ Develop a store layout and service delivery system suitable to Indian consumer</li> </ul>	<ul style="list-style-type: none"> <li>▶ Adapt products to cater to regional habits/needs</li> <li>▶ Tailor products as per price tiers and channels</li> <li>▶ Serve niche segments through customized products</li> <li>▶ Drive penetration and develop new channels (cash and carry, vending, on-trade etc)</li> </ul>
Supply chain strategy	<ul style="list-style-type: none"> <li>▶ Collaborate with vendors and service providers</li> <li>▶ Invest in manpower and technologies and develop processes for efficient supply-chain operations.</li> </ul>	<ul style="list-style-type: none"> <li>▶ Consider local manufacturing</li> <li>▶ Secure supplies at consistent quality and price</li> <li>▶ Invest in supply-chain infrastructure</li> <li>▶ Efficient supply chain from tax perspective</li> </ul>
Marketing	<ul style="list-style-type: none"> <li>▶ Invest in marketing programs to drive required footfalls</li> <li>▶ Offer consistent customer experience</li> <li>▶ Run instore promotions to drive trails</li> </ul>	<ul style="list-style-type: none"> <li>▶ Build brands in Indian market</li> <li>▶ Leverage brand strengths</li> <li>▶ Invest in innovation and marketing (brand and utility of the product)</li> </ul>
Organization strategy	<ul style="list-style-type: none"> <li>▶ Involve local teams for strategy and decision making</li> <li>▶ Invest in training and manpower development</li> </ul>	<ul style="list-style-type: none"> <li>▶ Involve local teams for strategy and decision making</li> <li>▶ Invest in training and manpower development</li> </ul>

Source: EY research

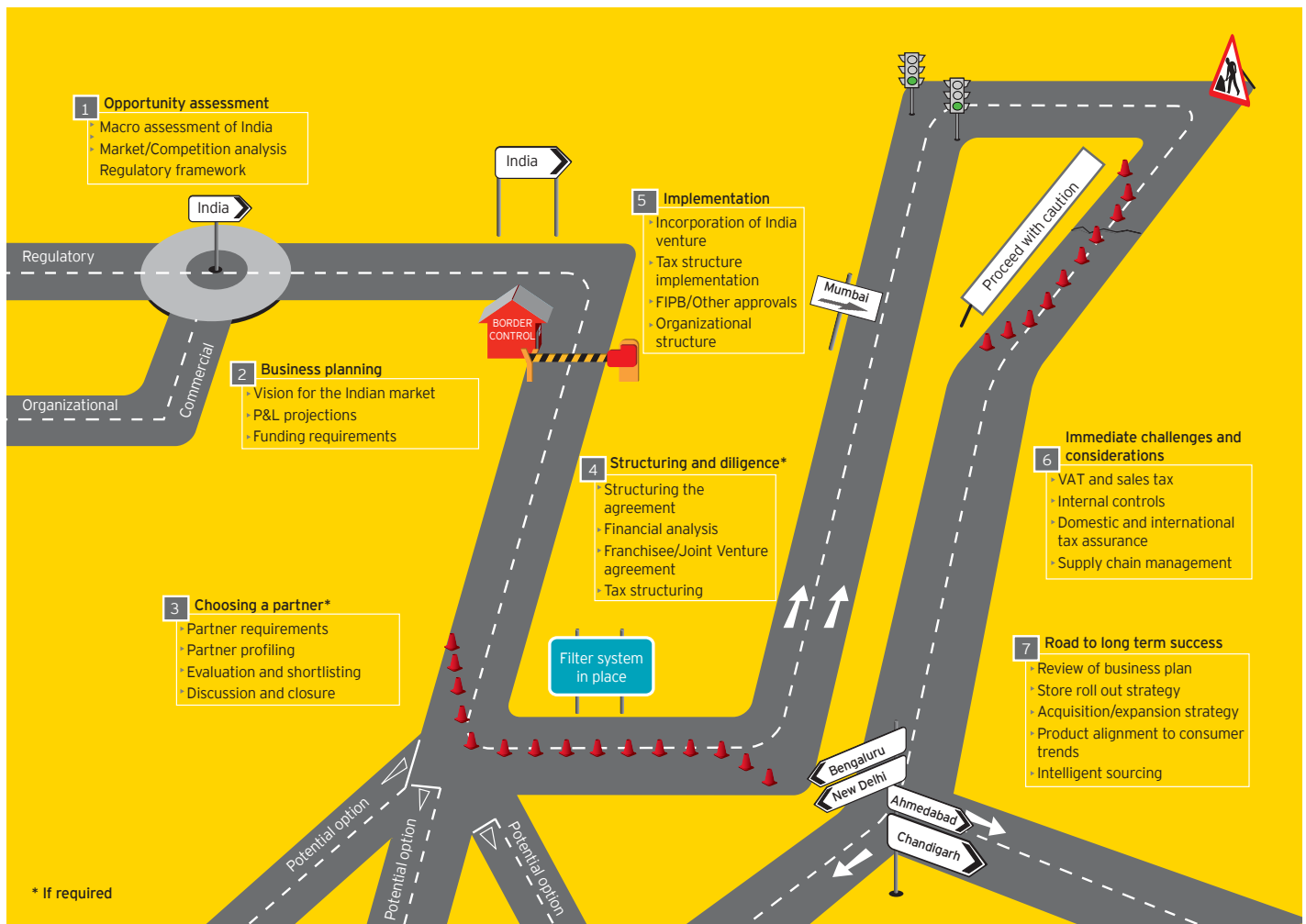
# Conclusion and the way forward

# 06

The Indian consumer market has experienced unprecedented growth in the last decade. This trend is expected to continue and the economy is likely to emerge as one of the fastest growing economies in the world. This growth is expected to create opportunities across the spectrum, i.e., across categories and channels. The food and grocery sector is expected to remain as the mainstay of the economy. Increase in penetration of processed and packaged food is likely to be a key driver for this category. Furthermore, consumer products, such as apparels, personal products durables are likely to present a sizeable opportunity to foreign and domestic players. From a channel perspective, the organized retail market is at an inflexion point of growth. Currently, the retail channel is largely unorganized, and traditional retailers contribute toward more than 93% of the market. The organized market is expected to gain share and grow at 21% per annum, as compared to the 12% per annum growth of the overall retail market. This is likely to create opportunities for Indian and foreign retailers. Furthermore, liberalization in a regulatory environment may encourage entry of foreign players in the market. This is expected to provide an increased thrust to the growth of the organized market, which has not yet been penetrated much in India

Despite this liberalization, it is critical for a foreign player to conduct a detailed opportunity assessment and tailor its business model and strategy for the Indian environment.

A typical decision road map for entry of retail business to India has been presented in the diagram below.



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### About UK India Business Council (UKIBC)

The UK India Business Council is the premier business-led organisation promoting bilateral trade and investment between the two countries. Our mission is to facilitate an increase in trade between the UK and India through business to business dialogue.

UKIBC plays an influential role in creating and sustaining an environment in which free-trade and investment flourishes. Through the facilitation of partnerships, and with an extensive network of influential corporate and individual members, UKIBC provides the resource, knowledge and infrastructure support vital for UK companies to make the most of emerging opportunities in India. Find out more at [www.UKIBC.com](http://www.UKIBC.com)