

SECTOR:
RETAIL, LIFESTYLE & LOGISTICS

SECTOR OVERVIEW:
June 2013

India is expected to become the world's fifth largest economy in terms of consumption by 2025. The country, with an outstandingly young population and growing incomes, is a highly attractive retail destination. In this quarter I focus on India's beauty and wellness sector, the third largest spending category in retail after food and apparel, and one with great potential for British brands as is shown by our case study on The Body Shop India.

Challenges in the retail sector remain, with continued uncertainty on the government's rules applicable to the 51% FDI cap on multi-brand retail. Meanwhile, anticipation is building up on the much-awaited passage of the GST bill.

Also here you will find some key points from our insightful event featuring Rakesh Biyani, joint MD of India's Future Group, which touched on some interesting retail themes such as taxes and consumer behaviours. I hope that you will find this report useful, and as always, we welcome your comments. For more information on India's retail sector and business to business dialogue, please get in touch.

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In Focus: India's beauty and wellness sector

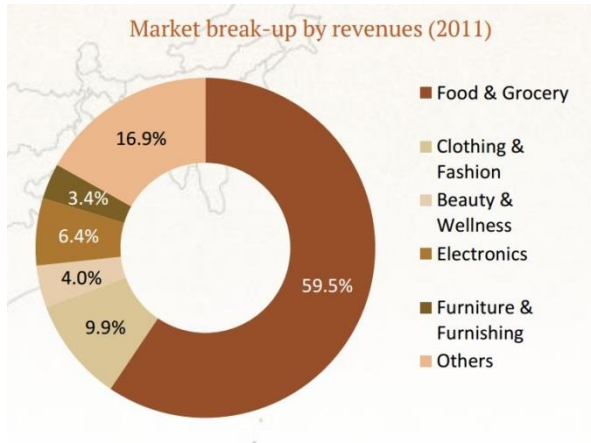
India's fast-emerging consumer market has rightfully captured the attention of many international brands. [A T Kearney's Global Retail Development Index](#) in 2012 ranked India fifth most favourable destination for international retailers, ahead of the UAE, Russia, Indonesia and Saudi Arabia. Indian retail is expected to grow at a CAGR of 15-20% over the next five years, with forecasts of it reaching a [market size of US\\$ 574 billion by 2015](#).

As we discussed in a [recent report produced jointly with Ernst & Young](#), India is expected to become the world's fifth largest economy in terms of consumption by 2025. And this economic growth is powered majorly by India's favourable demographics and rising incomes. By 2025, roughly 63% of Indians will be in the working age group of 15-60 years, an emerging consumer group with strong aspirations and greater disposable incomes.

The greatest share of consumer spending in India remains strongly in food: in 2011, 48% of [total household income was spent on food and groceries](#). However, patterns are expected to change as incomes rise, with a greater share being allocated to discretionary categories such as apparel and lifestyle products, including beauty and wellness.



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Source: IBEF Retail presentation, March 2013. With data from Deloitte's Indian Retail Market

Reaching out to emerging consumers

Beauty and wellness is the third largest contributing category to retail revenues in India, after food and groceries, and apparel. In a report by [Euromonitor International](#), beauty and personal care are reported to have increased strongly in both volume and value, in large part driven by new consumers in tier 2 and tier 3 Indian cities. This has been the experience of British brand The Body Shop, which entered the market in 2006. The brand operates more than 80 stores in India, and has ambitious plans for expansion. According to R S Roy, Editorial Director at the Images Group, The Body Shop India is achieving same-store growth of about 17%, with most of it (10-11%) coming from an increase in average bill value, which is reportedly higher in small towns than in larger cities.

Local beauty brand [Nyassa](#) for example runs six standalone stores, but rentals are one of its biggest costs. The company is therefore actively looking for strategic tie-ups and VC funding to increase its retail presence. This 6-year old Indian maker of aromatherapy products has already improved its distribution and is [reported to be looking to invest in a distribution company](#) to enable them to reach out to India's mom-and-pop stores across the country.

As is also highlighted in Euromonitor International's report, direct sales of beauty products have a very strong presence in India. Perhaps due to the challenging distribution infrastructure in India as well as insufficient retail space, direct sellers such as Avon, Oriflame and Modicare have established a better connect with consumers.

Indian beauty and luxury firms are indeed also making an impact. In 2008, [Estee Lauder acquired a minority stake in Forest Essentials](#), an Indian brand of ayurvedic skin, body and hair care products. The move made Forest Essentials [the only ayurvedic brand in the New York-based group](#), next to popular international brands like Clinique, Origins, MAC, Tommy Hilfiger, Donna Karan and, of course, Estee Lauder.

A fast-moving environment

But, as can be expected, challenges do exist. Insufficient and inadequate retail space, import duties, and a deficient supply chain infrastructure should all be taken into account.

Technopak Advisors estimates an additional mall space requirement of 45 million sq ft in the top Tier 1 Indian cities New Delhi, Mumbai, Kolkata and Chennai; and 21 million sq ft needed in the next four cities of Bangalore, Pune, Hyderabad and Ahmedabad.

But as we learned last November in an [exclusive retail roundtable featuring Ms Pritti Ravindra](#), General Manager of Retail at Bombay Realty, there is a good outlook for more suitable retail space in India for luxury and premium brands. Economic growth and more favourable FDI policies in the country are generating greater confidence among investors to build more and better commercial spaces.

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[Mall space formats in India](#) are at the moment dominated by: hypermarkets 21%; apparel stores 19%; multiplexes, gaming and food courts 14%; and department stores 10%; with the remaining share including footwear, restaurants and fast food, supermarkets, mobile stores, jewellery, and pharmacy outlets. The latter category occupies only a tiny 1% of mall space. The expectation is for this trend to continue with hypermarkets attracting the greatest share of development investment.

Taking the above into account, India's new generation of consumers continues to experience rising disposable incomes, and they are showing a keener interest in buying wellness and beauty products. Trending products in the market include hair care products, skin care, bath and shower, and natural or ayurvedic products.

In an article on [The Hindu Businessline](#), Ishween Anand, founder of Indian beauty firm Nyassa, says that "The consuming class of premium bath brands may be just 5 per cent of the market, but they are the ones looking for discretionary products... we believe there are consumers who are willing to pay Rs 200 (£2.50) for a bar of soap."

Market Update

UKIBC Retail Sector View: GST reform in India

In case you missed it, in our [latest retail sector view column](#) we discussed the impact of India's Goods and Services Tax reform:

India's indirect tax system has for long been identified as an important area for reform. It is considered to be highly inefficient, with multiple levies which generate problems of double taxation and barriers to the movement of goods across Indian states. For a few years there has been discussion of reform in the shape of the pan-India Goods and Services Tax (GST), one which is widely regarded as potentially the most significant in India since the reforms of the 1990s. It would mean lower tax rates across the retail chain, a simplified tax regime, and a real economic unification of the country. Its impact on the retail market would be ground-breaking.

To better understand its implications, we asked UKIBC's strategic partner PwC to share their thoughts on this tax reform and their vision on when to expect its implementation. To read their contribution, [click here](#).

GST Roadmap and the Indian retail sector

The Goods and Services Tax (GST) is one of the most important tax reforms in India, awaited and anticipated by industry at large. The date of introduction of GST is not certain, yet pursuant to the assurances given by the Honorable Union Finance Minister in his Budget Speech 2013, GST is expected to be introduced in the not too distant future.

The question whether GST will remove the complexities of the present tax structure and its inherent difficulties is yet to be answered.

Indirect Tax system in India – As it stands today and its inefficiencies

In India, both the Federal and State Governments levy different indirect taxes on each taxable event in the supply chain (such as Excise duty on 'manufacture', Value Added Tax (VAT) on 'sale', service tax on 'services' etc) often resulting in a multiplicity of taxes.

Under the current indirect tax system goods and services are treated differently. While goods are chargeable to excise duty and VAT/Central Sales Tax (CST), services are chargeable to service tax. There are nevertheless instances of double taxation e.g. tax on intangibles, turnkey contracts etc wherein either the full value or part value of the transaction are being taxed both as goods or services.

The existing tax regime also has a cascading effect of taxes due to inadequacies in the set off mechanism e.g. set off of CST, VAT paid by service providers and service tax paid by traders is not available.

It is hoped that under the GST regime some of the inefficiencies of the current tax system will be addressed.

GST – The next big step in India's tax regime

India is most likely to implement a 'dual GST'. In a 'dual GST' regime, all transactions of goods and services made for consideration would attract two levies i.e. Central GST (CGST) and State GST (SGST). GST would be implemented with single CGST statute (administered by the federal government) which would be applicable across India. However, for SGST, each state will have its own statute. GST will subsume almost all of the indirect taxes. A summary of taxes proposed to be subsumed are set out below:

Federal taxes	State taxes
<ul style="list-style-type: none"> Central Excise Duty Service Tax Additional Duty of Customs Special Additional Duty of Customs Surcharges and cesses 	<ul style="list-style-type: none"> VAT/Sales tax Entertainment tax Luxury Tax Taxes on lottery, betting and gambling Entry tax not in lieu of Octroi Surcharges and cesses

*CGST will be phased out after introduction of GST



A fresh view on the Indian consumer

In April, we welcomed Mr Rakesh Biyani, joint MD of India's Future Group, to speak at an event on [opportunities in Indian retail](#). At the event, Rakesh gave attendees an insightful view of the realities on the ground, discussing how Indian consumers have evolved and what this means for retailers.

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His recommendations for British businesses in India were:

- The real India is in the inner cities and small towns. British brands should go beyond the metros and reach out to the real Indian consumer in these areas.
- Even a world class brand needs to rebuild itself in India and educate consumers about its unique value proposition. Indian customers are highly discerning, sensitive to value and generally more willing to save than to spend.
- Businesses have gone to India attempting similar strategies to those used in other foreign markets but faced disappointment. India is different and strategies should reflect this.
- Generate new ideas to grow consumption and change the mind-set of Indian customers. Innovate by offering new formats and concepts.
- Choose the right partner and make sure you look for strategic alignment.
- The 3 P's to enter India: Planning, Patience and Pricing



Rakesh Biyani, joint MD of India's Future Group

Infrastructure, import duties and other challenges

The event generated an insightful discussion on some of the challenges frequently experienced by British brands in India. Mr Biyani skillfully answered questions from the audience, which dealt with a variety of topics, from demand for British brands to taxes:

India's consuming class is 200 million-strong and has the money but not enough products to spend it on. British brands should make the most of the fact that Indian consumers have an inherent affinity for British products and associate them with high quality.

One of the concerns commonly expressed by retailers is India's fragmented supply chain and lacking infrastructure. However, logistics are improving rapidly, with a major influx of international logistics companies significantly speeding up the movement of goods across the country. Similarly, infrastructure is fast improving.

Import duties have also been identified as a challenge to foreign brands as the added duty often puts them at a price disadvantage. However, the 10% import duty is not so high as to be restrictive, and examples were mentioned of retailers who have opted to manufacture more locally to reduce costs and import duties, while others have absorbed the cost of duties to secure customer loyalty early through competitive prices.

Also in terms of taxes, Rakesh mentioned the GST bill, which is expected to be passed in the near future. The reform will likely transform India into a seamless marketplace.

If you wish to learn more about B2B dialogue in the retail sector, please get in touch at: Tara.Panjwani@ukibc.com.

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Case Study: The Body Shop

<http://www.thebodyshop.in/>

The Body Shop is a global manufacturer and retailer of naturally inspired, ethically produced beauty and cosmetics products, present in over 65 countries around the world. The UK-based beauty brand entered India in 2006, having tied up with Quest Retail under a franchise agreement.

Quest Retail is part of Indian group Planet Retail. It is one of the leading specialty retailers in India working at the forefront of International brands for the last 10 years. The Body Shop currently operates more than 80 stores across India, with estimated sales of US\$ 20 million.

1. When did you first enter the Indian market? Describe your market entry strategy

The Body Shop entered the Indian Market in June 2006. Even prior to its launch, The Body Shop was extremely well known and popular with the segment of Indian consumers travelling overseas for business or holiday. The Body Shop has always had a strong base of loyal Indian consumers because of its natural ingredients and the ethical values espoused by the brand.

2. What motivated your business to foray into India?

India is an emerging market in respect of the growing middle and higher middle class customer base. Its GDP growth has ranged between 6-8% for the last decade. Considering The Body Shop's already strong base of loyal Indian consumers, it was a logical move for the brand to go to there.

3. Tell us about your business in India: In which Indian cities are you currently active?

The Body Shop is currently present in 30 Indian cities including metropolitan centres and Tier 1/2/3/4 cities. India has a huge geographical expanse across 3.2 million sq km and 35 states and union territories. The cultural diversity is that of Europe with over 20 official languages and 2000 dialects.

There are regional variances in consumer preferences and varying purchasing habits and criteria across socio-economic segments even within metropolitan Tier 1 cities. In smaller towns and cities, the exposure level of consumers, their purchasing behaviour and criteria are different from the metros, so retailers have to customize their offering and promotions accordingly.

4. What are the key factors that have contributed to your success?

- Retail expertise and extensive experience of retail in India
- Strong The Body Shop brand positioning and customer recall
- Natural, 100% vegetarian products, which suit local tastes
- Ethical brand and values leadership
- Aggressive expansion providing visibility and reach to Indian consumers.

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5. What have been your biggest challenges of entering and operating in India?

- Deficient supply chain infrastructure
- Lack of quality and quantity of real estate developments
- Shortage of trained and skilled staff for retail stores
- Burdensome import duty structure
- Multiple and complex regulatory and compliance requirements
- Multiple taxation structures