August 2014

Sector Report
Retail, Lifestyle & Logistics

Report highlights:

- *In focus: Fashion and Beauty sector in India and route-to-market strategies*
- *New government's stance on FDI in retail*
- *Market and Investment updates*

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SECTOR:
RETAIL, LIFESTYLE & LOGISTICS

SECTOR OVERVIEW: August 2014

Welcome to this quarter's edition of UKIBC's sector report on Retail, Lifestyle & Logistics. In this report, we cover India's growing Fashion and Beauty retail sector, including key highlights, market statistics, and current trends in the Industry, with an emphasis on route-to-market strategies.

India's Fashion and Beauty sector has great growth potential and is attracting a large number of foreign retailers and brands. India's new government poses an interesting opportunity to improve the business environment, requiring an understanding of the new leadership's stance on FDI in retail. In this report we explore this, alongside some of the initial announcements in the latest Union Budget.

We hope you will find this report useful, and we look forward to your comments and suggestions.

Economic Indicators

Indicator	Q3	Q4
Real GDP Growth (%)	4.6	4.6
FDI (GBP bn, Monthly Average)	1.0	1.6
FII (GBP bn, Monthly Average)	0.5	1.9
NCAER Business Confidence Index	122.3	127
FDI in Hotel & Tourism (GBP mn)	68	124
FDI in Food Processing (GBP mn)	894	311
FDI in Air & Sea Transport (GBP mn)	14	8
FDI in Retail Trading - Single Brand (GBP mn)	0.2	5.4

Relevant Indices	3 Months	6 Months
S&P BSE FMCG Index: Returns (%)	3.4	6.5

References: Reserve Bank of India, RBI Bulletin CSO MOSPI Department of Industrial Policy and Promotion, Bombay Stock Exchange

Note: Data retrieved on June 4th 2014

In Focus: Fashion and Beauty (Route-to-Market)

The Indian retail market, currently valued at GBP 293 billion (2013) is expected to grow at a CAGR of 6% till 2023 to reach GBP 516 billion. The fashion and beauty sector (including apparel, accessories, jewellery) is the second largest segment within retail spending in India, after food and beverages.

Apparel retail in India is currently worth GBP 24 billion, accounting for 8% of the overall (organised + unorganised) retail market and 33% of the organised retail market. The beauty and personal care segment in India is currently valued at GBP 700 million, and is expected to reach GBP 2.9 billion by 2023, growing at a CAGR of 15%. Within beauty, cosmetics are growing at 15-20% annually and have great potential. The apparel sector, which is the mainstay of organised retail, is a lucrative opportunity for foreign players, given that organised retail penetration is expected to increase from 8% currently to 24% by 2023.

Socio-economic factors have contributed to growth in the retail industry, namely the expanding working population, emerging middle class, growth in working women population, and a young and aspiring population, alongside high GDP growth and rising income levels. Macroeconomic performance has been stagnant over the past few years with the economy growing at less than 5% in the last two years, inflation remaining persistently high in the double digits and currency depreciation, in which has indeed resulted in a decline in consumer spending. However, this is likely to change In view of the election of a new government whose mandate is strongly on economic performance.

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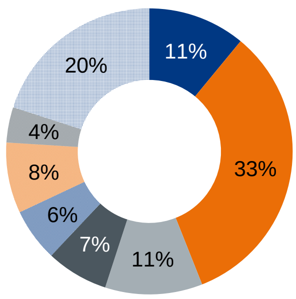
Overview and Key Trends

The fashion and beauty industry has witnessed significant changes over the years and has also registered sustained growth owing to the expanding Indian economy, favourable demographics and rising private consumption.

Figure 1: Indian Organised Retail – Sector Contribution



- Food and Grocery
- Apparel
- Mobile & Telecom
- Food Service
- Jewellery
- Consumer Electronics
- Footwear
- Others

References: Technopak, Ibef

Key trends in the Indian apparel sector include:

- **Growing Value Consciousness:** Given the current economic slowdown, consumers have started displaying caution and are trading down purchases
- **Rise in e-tailing:** In June 2013, India's internet user base stood at 190 million and expected to grow by 28 per cent to reach 243 million by June 2014. Increased internet penetration is driving the growth of online retailing in India
- **Global branding with local merchandising:** To cater to varied needs of the Indian consumers, many international brands have shifted parts of designing as well as manufacturing to local partners in India
- **Emerging Partnership model:** As a result of relaxed FDI norms and the level of control provided to the foreign player, the joint-venture route is catching up
- **Shifting Sourcing strategies:** Owing to high import duties, many players are moving to India based sourcing models and reducing their imports. Leading brands such as M&S, Arrow, Lacoste have started sourcing a considerable portion of their merchandise (sold in India) locally.

Key Trends in the Beauty Sector:

- **Innovation:** 'Indianisation' of products is the key to high product acceptance in the Indian market and players are focusing on this
- **Rising advertising and marketing spend:** Companies are moving to digital advertising and investing more in advertising and marketing to maximise growth
- **Partnerships:** Companies are exploring newer channels of growth apart from traditional B2C channels, including direct to customer and B2B partnerships, to maximise reach

Route-to-market: Evolution and Opportunities

The Indian fashion and beauty sector offers a number of opportunities for international brands and retailers, primarily due to the high growth potential of the market. Prevailing penetration rates of organised retail remain low, and coupled with an aspiring consumer class with a preference for foreign brands, present a compelling investment case for foreign apparel and beauty brands.

Foreign brands have been operating in India for more than two decades now, but the scale of operations and the growth trajectory changed dramatically in the past decade, as India's economic growth gained momentum. A large number of foreign fashion brands have entered the market through the following routes:

Licensing	Owing to low investments, lower risks and a closed economy, licensing was the preferred entry mode for most retailers in 1980s
Franchising	As import duties dropped and realty witnessed a boom, franchising picked up as an entry mode from mid 1990s – 2005
Wholly Owned Subsidiaries (WOS)	Enabling greater control over products and direct reach, many companies established WOSs in early 1990s, and later post liberalisation of FDI norms, 2006 onwards
Joint Ventures	As a result of FDI policy revisions and relaxation in 2006, JVs (majority and minority shareholding) gained impetus, allowing for greater control over operations and supply chain.

An interesting trend in the market is the consolidation in the e-tailing space and increased focus on fashion and beauty e-tailing by leading players such as Flipkart, Snapdeal and Fashionandyou.

Flipkart recently acquired Myntra.com, an online fashion retailer and has plans to invest GBP 60 million in the fashion segment alone. Online fashion retailer Fashionandyou acquired online fashion and beauty retailer Urbantouch for GBP 30 million in 2012. Snapdeal acquired Doozton.com, an online product discovery platform, in April 2014.

Although the current FDI norms do not allow FDI in B2C e-commerce in India, brands can tie up with third party online retailers to sell their products in the market. This channel is gaining popularity and has already witnessed British brands such as Dorothy Perkins and Miss Selfridges. These players have announced plans to enter India by tying up with fashion e-tailer Jabong.com. While Dorothy Perkins is already avaialble via Jabong.com, Miss Selfridges is expected to be launched later during this year.

India is a challenging market to enter into and to sustain business operations owing to the wide variation in consumer preferences across regions, a complex regulatory environment, and lengthy decision-making. Key challenges any foreign investor may face while entering India include:

- **Regulations - Complex FDI policy:** Currently 100% FDI is allowed in single brand retail and up to 51% in multi-brand retail, with conditions (sourcing, brand ownership). Although the BJP-led central government has been openly critical about the UPA government's decision to allow 51% FDI in multi-brand retail, it has not made any efforts to roll back the legislation
- **Import regulations, supply chain and infrastructure:**Import duties and the current tax structure leads to higher costs for retailers. These include regulatory restrictions on debt funding into India, taxes charged on repatriation of profits from India, indirect taxes on in-country transactions and movement of goods within and between states and withholding tax on royalty payments out of India. Also, logistics costs are considerably high in the country - around 13-14% of the GDP compared to 7-8% for developed nations
- **Limited prime retail space, mall management services and high rentals:** According to CBRE research, currently 60% of global retailers have an India presence but lack of prime space and legislative issues deter growth

Looking Ahead

While India offers its share of challenges for a potential entrant, the opportunities and long term potential clearly offset the challenges that may be faced initially.

Although the new government is currently not supportive of FDI in MBRT (multi brand retail trading), it has avoided taking any steps to reverse the UPA government's decision on the policy change in 2012. Commerce and Industry Minister Nirmala Sitharaman clarified in Parliament last week that there is status quo on this matter and the government will take a call once it receives an application.

The government is soon expected to introduce GST (Goods and Services Tax) and DTC (Direct Taxes Code). The GST alone is likely to lead to a considerable decline in logistics and distribution costs that are currently incurred due to multiple taxes at central and state levels. If GST is introduced, Central sales tax (CST) is expected to come down from 2% to 1%.

There are currently a significant number of foreign players who have either announced plans or are already in the process of entering the Indian market. These include Swedish apparel brand Hennes & Mauritz (H&M), Japan's Uniqlo and British beauty brand Lush. British retailer Arcadia is also looking at launching 'Miss Selfridges' and 'Topshop' brands in India.

Dynamic strategies is the key

A common element among successful foreign companies in India is their ability to customise their products and services as per local tastes and preferences and calibrate their strategy in response to evolving economic and industry dynamics.

- S. Oliver which had tied up with apparel exporter Orient Craft, ended the alliance and tied up with a new partner, Design Pod through a majority owned joint venture. The restructuring was done to gain a larger share in the Indian market. The company has repositioned the brand, changed its sourcing strategy, reduced the entry-level prices by 40% while reducing the store size (from 5,000 sq. ft. to 1,200-2,400 sq. ft.). It has also devised an aggressive expansion strategy for Tier II cities

- Benetton, the Italian apparel retailer is a good example of adapting to create a niche for itself. It entered India through a licensee (Dalmia). Benetton then transitioned into a 50:50 joint venture in 1991, and finally in 2004 took over the Indian business completely. However, in 2006 it took the franchising route for its premium fashion brand Sisley, appointing Trent (a Tata Group company) as the national retail franchisee

There is an expectation that in the short term, a new leadership will indeed improve India's macroeconomic performance, which will offer a more stable operating environment for businesses.

We have already started seeing early signs of this positivity with Amazon commencing operations and rapidly scaling up. Amazon, which entered India in June, 2013 already had 4,000 sellers on its marketplace. It is offering multiple services to lure sellers, such as allowing sellers to start selling goods the day they register and 'easy ship' which allows sellers to ask Amazon to pick up and ship the product, with 'cash-on-delivery' for the sellers orders.

References: India Brand Equity Foundation (IBEF), Thirdeyesight, Technopak, Ernst & Young, The Times of India, The Economic Times, NDTV Profit

Market Update

Key Highlights of Union Budget 2014-15

The new Union Government's inaugural Budget for FY 2014-15 was presented on July 10, 2014 by Finance Minister Arun Jaitley. The key proposals regarding the retail, lifestyle and logistics sectors are as follows:

- Increase in the personal income tax exemption limit is likely to spur increased spending on FMCG products, benefitting retail companies
- Allocated GBP 500 million to increase warehousing capacity. This would help in strengthening infrastructure for storage of not only food grains but perishables goods as well and will also create ample employment opportunities at the doorstep of farmers
- Announced plans to set up 16 new ports, improving infrastructure and providing opportunities for port operators.
- Permission to companies manufacturing in India to sell their products through e-commerce channels without any additional approval. This includes foreign investors and those having 100% FDI in single brand retail

New Commerce and Industry Minister Nirmala Sitharaman says no to FDI in multi-brand retail

Nirmala Sitharaman, India's newly appointed Commerce and Industry Minister has reaffirmed BJP's stance on FDI in multi-brand retail trade (MBRT) in a statement in Parliament this month.

The minister stressed that the government has not taken any decision on the matter yet and will take a call when it receives an application in this regard. However, she did not specify if the previous government's decision of allowing 51% FDI in MBRT will be reversed.

Economic Times, 14th August

First FDI transaction in multi-brand retail gets CCI nod: Tesco gets approval for 50% stake in Trent Hypermarket

A day after the new central government rejected FDI in MBRT in India, the fair trade regulator CCI (Competition Commission of India) approved Tesco's purchase of a 50% stake in Tata's Trent Hypermarket Ltd. (THL).

CCI said since Tesco was not earlier engaged in retail business in India, the transaction "is not likely to have appreciable adverse effect on competition in India".

Indian Express, 28th May

American lingerie brand Miraclesuit enters India through etailer Zivame.com

Miraclesuit, an American shapewear brand has entered the Indian market through Zivame.com which carries the brand's collection of body shaping and smoothening undergarments, starting from GBP 21.

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Carrefour looking to exit wholesale operation in India

French retailer Carrefour, which runs five wholesale stores in India in Delhi, Jaipur, Bangalore, Meerut and Agra, is said to be planning to exit the market soon.

According to reports, the move comes after the retailer was unable to partner or sell its operations to Bharti Enterprises.

Times of India, 3rd May

Wal-Mart Announces plan to open 50 independent stores

While Carrefour is exiting India, retailers like Wal-Mart are planning expansion. Wal-Mart, which parted ways with its Indian partner Bharti in October 2013 recently announced plans to add 50 independent stores over the next four to five years.

India Today, 29th April

Foreign Players plan to step up expansion in India

German Retailer Metro to have 50 wholesale stores in India by 2020

As a part of its overall strategy of growth in emerging markets, German retailer Metro AG has announced plans to expand its portfolio to 50 wholesale stores in the country by 2020, from 16 currently.

The retailer which has recently witnessed sustained like-for-like sales growth in India wants to make India one of its "focus expansion countries", alongside Russia, China and Turkey.

NDTV Profit, 5th May

Marks & Spencer Plans to Open 100 Stores in India By 2016

Britain's largest clothing retailer Marks & Spencer has announced plans of opening up 100 stores in India by 2016 as against 86 planned last year.

The clothing retailer, which operates a joint venture with Reliance retail, currently runs 40 stores in the country. It said its Indian same-store-sales grew 13 per cent in the fiscal year ended March 2014.

Reuters, 20th May

Investment Update

Flipkart buys Myntra in biggest e-commerce deal

Flipkart, India's largest online retailer acquired a majority stake in Myntra, the fashion retailer. The move comes as a part of Flipkart's plans to strengthen its market position in the fashion segment. In line with the plans, Flipkart will invest GBP 60 million in the fashion category.

"It is a 100% acquisition and going forward, we have big plans in this segment. Flipkart and Myntra are getting together to create one of the largest e-commerce stories and together we will dominate the market," said Flipkart co-founder and CEO Sachin Bansal.

Since Amazon entered India last year, the competition in the e-tailing segment has heated up and Flipkart's acquisition of Myntra is seen as a move to strengthen their position and to build up scale to compete with Amazon.

Times of India, 22nd May

UK beauty brand 'Lush' to enter India

British beauty brand Lush, which is known for fresh handmade cosmetics and currently operates 900 stores globally has applied to the Department of Industrial Policy and Promotion (DIPP) under the single brand retail category.

The retailer which already sources goods including henna, indigo, saffron and jasmine. from India plans to tap the Indian market as a part of its current global expansion plans. It will invest in Delhi in its first phase of investment.

Business Standard, 28th March

Sanpdeal acquires product discovery platform Doozton.com

Indicating speeding consolidation in the Indian online fashion retail space, Snapdeal has acquired Doozton.com, an online discovery platform for an undisclosed amount.

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According to Snapdeal.com co-founder and COO Rohit Bansal "The technology built by Doozton will enable an artful and personalised way of listing and suggesting fashion merchandise on Snapdeal, making the acquisition fruitful for buyers and sellers on the platform."

Times of India, 16th Apr

Events Update

India Retail Forum 2014

DATE: 17th and 18th September 2014

VENUE: Renaissance Hotel, Mumbai

DESCRIPTION:

Since its inception in 2005, IRF has been at the forefront of strategic issues related to modern retail in India. Positioned as the knowledge platform for the retail industry, it is regularly graced by industry leaders, policy-makers, infrastructure developers, business facilitators and academia, making it the flagship industry event in India.

Inidaretailforum

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Please note:

- Conversion rate used across the report is for June 4th, 2014. 1 GBP =99.05 INR and 1 GBP = 1.67 USD
- Numbers rounded across the report

Information provided in this report is for reference only. When negotiating supply contracts and before beginning actual export, companies are advised to consult closely with their importer or distributor.