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SECTOR:
RETAIL, LIFESTYLE & LOGISTICS

SECTOR OVERVIEW: MARCH 2012

Valued at an impressive £345 billion and identified as being one of the top five retail markets in the world, the Indian retail industry has finally acquired its place in the global spotlight. What is striking is that the organised sector - estimated to be £17.5 billion, accounts for only 4% of its total volume but is expected to grow by approximately 9% to reach £163 billion over the next decade (report by Boston Consulting Group - BCG). One of the fastest growing elements of the organised retail segment is the luxury brands market in India which is currently worth £5.15 billion and is projected to expand by a staggering 20% year on year to reach £9.2 billion by 2015.

Luxury is defined as products and services that are not considered essential and are associated with affluence and indulgence. It is a higher priced offering that is perceived as being remarkably superior to its comparable substitutes and evokes a sense of belonging to a certain elite group. Luxury goods play the role of status symbols as they signify the greater purchasing power of those who can afford to acquire them.

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India's love affair with luxury dates back hundreds of years to the era of Indian royalty and princely kingdoms. The affinity for luxury goods is deeply ingrained in every Indian and is reflected in the age old popularity of expensive jewellery, elaborate weddings and the finest domestically manufactured fabrics which have become cultural icons symbolising a person's breeding and status in society.

Despite the country's historical connection with luxury, the modern day luxury market continued to remain at a relatively nascent stage in India for many years. Until now.

The recent turbo charged economic development over the last decade has fuelled the expansion of the luxury sector which is steadily gaining momentum and is on the cusp of a full blown explosion. Slow to take off at the outset, it disappointed the first wave of foreign retailers who rushed in hoping for it to be the next China.
However, change is now on the horizon and can be attributed to the emergence of a new generation of aspirational Indian consumers who are sophisticated, brand conscious and affluent.

According to Neelesh Hundekari, head of Indian luxury retail at consultancy AT Kearney and author of the recent "Indian

Luxury Review" report, these consumers comprising cash rich young entrepreneurs, wealthy businessmen, housewives and even university students are making up for lost time catching up with global trends, and are now buying everything from high-end handbags, jewellery, electronics and cars to expensive wines and spirits. Their primary motivation being to explicitly parade their wealth.

Frugality is a thing of the past – here come the big spenders!

Overview

This report attempts to paint a broad picture of the Indian luxury sector and its unique characteristics. It will start with a brief market analysis, cover the changing regulatory environment, and focus on new opportunities and challenges. It will highlight recent investments that have taken place as well as showcase one of India's most renowned luxury malls, High Street Phoenix.

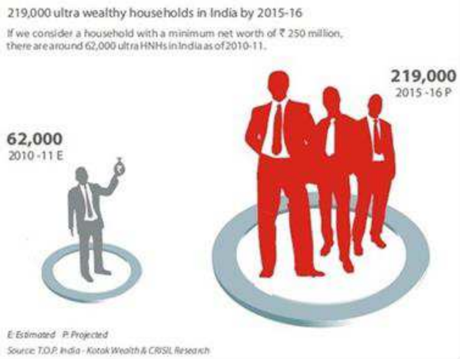
MARKET UPDATE

Driven by an increasing number of brand conscious wealth creators, the luxury market in India is expected to grow by a robust 20 % every year to touch £5.15 billion in 2012 and £9.2 billion by 2015 (CII –AT Kearney Report). Last year, sales of luxury goods grew by a similar pace to reach £3.6 billion despite high tariff barriers, a lack of retail infrastructure and costly rents.

Primary growth drivers propelling this surge in the luxury market are cars, electronics, the fine dining segment, clothing, accessories, jewellery and watches and personal care to name a few.

In 2010, luxury electronics and car segments registered a growth of over 35%, whereas fine dining grew by almost 40%. Clothing and accessories, jewellery, watches and personal care also witnessed a substantial growth rate, between 24-30%.

According to a 2011 Kotak Wealth Crisil report, India is currently estimated to have 62,000 households who have a net worth of over Rs. 250 million (£3.2million) and the number of these affluent individuals will triple by 2016 to rise to 219,000. Whereas the ultra wealthy ones (the Billionaire club) will grow even faster – their collective wealth will escalate from £500 billion currently to over £3 trillion, a big 5-fold jump!



This has attracted a host of international high-end labels to flood the market. Global big hitters such as Burberry, Hermes, Gucci, Chanel, Dior, and Paul Smith to name a few are spreading themselves from the lobbies of five-star hotels to branches in new shopping malls. Automobile giants such as Rolls Royce, Triumph, Aston Martin, Audi, Porsche and Ferrari have opened showrooms not just in the larger metros, but also in Tier 2 and Tier 3 cities which are witnessing a manifold increase in the demand for luxury cars. According to automotive expert Ronjoy Mukherjee, conspicuous spending on luxury cars has gone through the roof in these smaller towns with places like Kanpur and Aurangabad registering a massive growth of 120% !

Only the bigger luxury brands have come to India so far, but many more are expected to enter as the numbers of brand-smitten Indians continues to rise. "This is just a beginning where the big boom is waiting to happen," said Sanjay Kapoor, managing director at Genesis Luxury, which distributes brands like Bottega and Cavalli.

"India is one of the fastest growing markets for us," says Angela Ahrendts, CEO of Burberry which has seven stores in India. "The next couple of years are going to be the most fascinating times for the luxury industry here," says Ahrendts, who plans to scale up Burberry's presence through company-owned stores and retail sales at high end malls.

Burberry's store in Palladium Mall (High Street Phoenix) in Mumbai

It is worth pointing out that the immense scale of the Indian retail opportunity extends far beyond the pure luxury sector to cover general higher end retail (also termed as 'mass luxury') which appeals specifically to the new emerging middle class and to the young globally evolved consumers who prefer to buy at the high end of the non-luxury market. Stores like Superdry, Next, Hamleys, and Pavers England, fall into this bracket and have made major inroads into India to capture this particular market segment.

Luxury malls

Unlike the UK's Bond Street and the US's Fifth Avenue, India's luxury market has developed within malls rather than at high street locations. However, luxury malls are a relatively recent evolution; previously, exclusive hotels and major airports provided the only access to luxury brands.

DLF's Emporio located in New Delhi is heralded as India's first luxury mall and is positioned as 'India's finest luxury destination'. Opened in 2008, the mall is specifically designed to appeal to the city's nouveau-riche and offers four floors of premium international and domestic brands, restaurants, cafés and bars.

High Street Phoenix in Mumbai is another good example of a successful mixed use mall housing over 500 brands as well as a variety of food and drink, entertainment, commercial and residential complexes.

These luxury malls are set to be upgraded and transformed even further as fresh investment pours in, fuelled by major improvements in the regulatory environment.

Regulatory Environment

Earlier this year, the Union Cabinet removed the 51% cap on FDI in retail to permit single brand foreign retailers to enter the nation's £345 billion retail market without the need for a local partner.

This decision was welcomed by the retail community both in India and overseas as it is hoped that it will significantly increase investment flows into this sector which have been relatively poor till date. Under the previous regime of 51% FDI in single brand retail, FDI totalled only £28.48 million (Rs 231 crore), constituting barely 0.03% of total FDI inflows into India. (Ernst and Young 2012) The new regulation will encourage international players selling just one brand under their roof such as iconic furniture brand IKEA (Sweden) and apparel retailer Arcadia Group (the UK) to enter the market on a full ownership basis and will also enable those single-brand global companies that are already in India through local partnerships to have complete control of their operations in India. These include Marks and Spencer and Jimmy Choo (the UK), Zara (Spain) and Christian Dior and Louis Vuitton (France).

It has also raised expectations that the government might loosen restrictions on foreign multi-brand retailers like Wal-Mart Stores Inc., which are still excluded from India's retail market.

51% FDI in multi-brand retail was previously announced in November 2011 but was shelved soon after due to political differences with some allies and the Opposition. Since its suspension, the government has been building consensus on the matter with other parties and stakeholder groups with a view to re-introducing this reform. Our sources have indicated that the Indian Budget on 16th March will bring a welcome announcement.

Impact of FDI in single brand retail on the sector

In addition to boosting the overall growth of the retail sector in India, this proposal is also expected to benefit the sector in numerous other ways:

Skills development: FDI in retail will make way for inflow of knowledge from international experts resulting in capacity building which in addition to financial investments is extremely important for the industry.

Infrastructure Improvement: FDI in retail will enhance investment in infrastructure from retail players, third party supply chain companies as well as the Government on the back of a sophisticated front end that international players are likely to bring. This will improve the efficiencies along the supply chain, which in turn will reduce wastage, and bring down costs to the consumer.

Wider consumer choice and a more competitive marketplace: According to Rajan Bharti Mittal, Vice Chairman and MD, Bharti Enterprise, the increased investments by foreign single-brand retailers will not only help improve consumer choice but also enhance competitiveness of Indian enterprises through access to global designs, technologies and management practices.

Domestic brands benefit: One of the immediate consequences of the removal of the FDI limit was a huge jump in the shares of major Indian vendors like Pantaloon Retail, India's largest retailer, apparel retailer Provogue India and Shoppers Stop to name a few. Pantaloon gained 4.4% to reach 153.30 rupees (approx £2), in Mumbai while Provogue India Ltd., rose by 8.4% and Shopper's Stop Ltd. gained 5.1% respectively.

Improvement of the employment situation: The requirement by foreign retailers to source at least 30% of the value of products from the small and cottage industry sector will revitalise these SMEs and have a positive impact on the overall employment situation in the country.

The industry wide view is that given its myriad benefits, 100% FDI in retail should be extended to the multi brand segment as well in order to truly make a difference to this sector. "We hope the initiative is a precursor to further liberalization in the sector in the days to come," Rajan Bharti Mittal, Wal-Mart's India partner for wholesale stores, said in an e-mailed statement.

New opportunities

E-retailing

With 121 million claimed internet users and Indian e-retailing sales about to tip past the $1 billion mark (£627 million), India's fledgling online retail segment is set to take the country by storm.

According to Google, at present only about 10% of India's population is online, although that number is set to triple by 2014.

This exponential growth is driven by factors such as increasing internet and smartphone penetration, telecoms players investing in high-speed wireless infrastructure, escalating demand for new technologies by India's burgeoning young population and an influx of innovative promotions to lure customers by new online retailers. In addition, soaring real estate costs in India and the need to save time have inspired many an online venture. Another key advantage of e-commerce is that it also opens up another route to the customer for accessing consumer goods which as yet do not have a physical presence in India. For many international brands who lack a showroom, franchise or a distribution house in India, online shopping portals are a particularly useful entry strategy.

E-commerce or E-retailing offers retailers huge benefits over the brick and mortar stores. Not only does it allow them to cater to consumers across geographies, but it also makes it possible to run a 24-7 operation which has access to unlimited shelf space – and all this with less expensive infrastructure. For a country like India, that lacks space in cities, this business model is a good way of growing the consumption-driven economy.

To date, the growth of online retail industry in India has been restricted by obstacles such as the low base of internet users, slow speed connections, unfamiliarity with the medium, fear of scams/ frauds, personal security issues as well as fragmented logistics and unreliable delivery channels.

However, this scenario is changing significantly and rapidly, fuelled by heightened domestic competition from a large number of homegrown companies who are exploding across the country such as Flipkart, Exclusively.in, Myntra.com, 99labels, Bigshoebazaar.com, Snapdeal, Naaptol.com, Taggle.com, and Timtara.com. Flipkart's recent acquisition (in Feb 2012) of its main competitor LetsBuy.com is a case in point and indicative of the huge growth of the Indian ecommerce sector.

The immense potential presented by India's online segment has attracted major international players such as online retail giant Amazon, which recently announced its plans to enter the Indian market in the first quarter of 2012 and set up its own operations in Hyderabad, Bangalore and Chennai as well as a warehouse in Mumbai.

it is clear that India's online retail revolution has finally arrived and is here to stay.

Tier 2 and Tier 3 Cities

Until 5 years ago, it was primarily big cities like Delhi and Mumbai that saw brands targeting select clientele. The new patrons of the high life in small town India are a recent phenomenon but one that is quickly becoming a force to reckon with. This change has not gone unnoticed by many brands who, in addition to expanding in the metros, are rapidly making inroads into tier 2 and tier 3 cities such as Hyderabad, Pune, and Surat as well.

According to experts, the nouveau riche in smaller towns constitute over 50% of luxury buyers in India. Hermes set up a store at the Ista Hotel in Pune last year, while brands like Canali, Jimmy Choo, Bottega Veneta and Ermenegildo Zegna claim 15% of their sales come from small city buyers. To cash in on clients in Lucknow, Jalandhar, Ludhiana, Jaipur and Panipat, DLF Emporio has been innovating with weekend shopping festivals and tie-ups with hotel chains.

The Internet and social media have also been instrumental in connecting luxury firms with once hard-to-reach consumers in smaller cities and rural areas.

Challenges that have hampered the growth of luxury retail

It is evident that the Indian luxury sector displays long term potential but challenges such as FDI restrictions, import duties, poor infrastructure, and costly real estate pose hurdles in its development.

Import duties:

Retail analysts say steep import tariffs of up to 35-40% impede the growth of the India’s luxury sector by making branded goods more expensive than in some outside countries. "World-over, customs duty varies from 15-20%, but in India, it's much higher, making brands very expensive," said Pradeep Hirani, chairman of designer retailer Kimaya Fashions.

There is a real need for import duties to be reduced so that the Indian consumer is not compelled to travel to buy a product cheaper elsewhere. Besides being beneficial to the customer, lower import duties will result in an increase in revenues for the Indian government as higher investments will pump much more foreign currency and interest into the country.

Neelesh Hundekari, head of Indian luxury retail at consultancy A.T. Kearney, says Indians may buy a Porsche car in India because it is difficult to import, but may prefer to pick up a Louis Vuitton handbag in Dubai. "They would like to find a good bargain even if the absolute price of the product is pretty high. They would worry about the last $100, even if they are buying something which is worth several thousand dollars. If they can actually get it from overseas without paying the extra price, then they won’t get it from here. An interesting contradiction to that is cars, for which they will pay any price to get what they want." Hunderkari explained.

Infrastructure:

India also lacks suitable infrastructure to sell luxury goods. Its crowded cities have few upscale shopping areas outside of five-star hotels. Only two shopping malls - one in Delhi and the other in Bangalore - exclusively sell luxury brands. As a result, most luxury brands have a presence only in the larger cities such as Delhi, Mumbai and Bangalore, despite the large consumer base in smaller towns.

Despite having only 3 stores in India compared to 16 in China, the country head of Louis Vuitton in India, Tikka Shatrujit Singh remains optimistic about the market and its untapped potential. "Cities need to develop. Malls need to come up. That is one constraint for growth. We need to see a 100 more luxury malls opening up in India, or at least 20 more or 30 more," Singh stated.

FDI restrictions:

Globally single brand retail follows a business model of 100% ownership and given the previous restrictive policy environment (permitting only 51% FDI in single brand retail), most international brands have so far been reluctant to establish their presence in India as they're typically not interested in joint ventures. However, all this looks set to change with relaxation in FDI regulations.

INVESTMENT UPDATE

Recent FDI decisions have stimulated several investment announcements:

- Following close on the heels of the Indian Government's decision to allow 100% foreign direct investment (FDI) in single-brand retail, luxury brand retailers have announced their expansion plans in Indian markets. Brands like Vertu, Christian Loubotin, Armani Junior, among others, will open their exclusive stores at DLF Emporio in 2012, while brands like Van Laack and Diesel Black Gold commenced their Indian operations in January 2012.
- Real estate major DLF's subsidiary DLF Brands has struck a deal with Chicago-based Claire's Stores Inc to bring the latter to India and open its 75 stores over 2011-16. Claire's is a specialty retailer which targets young girls through over 3,000 stores globally.
- Scandinavian home products giant, Ikea, the largest furniture retailer in the world, has been in dialogue with the Indian government for the last three years to ease policy restrictions as it was keen to enter the Indian market on its own. In November 2011, soon after the government announced the opening of the retail market, it decided to enter but expressed reservations over the 30% sourcing clause from Indian SMEs. Ikea CEO Mikael Ohlsson met Commerce and Industry Minister Anand Sharma in Europe in early February and informed him that India is an important market for them and that although the sourcing clause is tough to cater to, the company is willing to be involved in strengthening SMEs in India. Ikea is also considering making structural changes in its Indian operations team to cater to the specific and circumstantial requirements of India.
- US-based coffee giant Starbucks have signed a memorandum of understanding (MoU) with Tata Coffee to source coffee beans and open its coffee shops in India.
- In February this year, Flipkart, India's biggest online retailer of books and electronics gadgets, acquired smaller rival Letsbuy as part of a strategic move to consolidate its position ahead of Amazon.com Inc's planned entry into the Indian market. The acquisition, valued at approximately £15.6 million involves a combination of cash and equity and will allow Letsbuy, and its 350 employees, to continue to operate independently under the existing management structure.

CASE STUDY - HIGH STREET PHOENIX

High Street Phoenix, (HSP) is Mumbai's largest shopping and entertainment destination, located at Lower Parel. Designed by Benoy, the internationally renowned British architecture firm, it covers 3.3 million square feet of space and houses over 500 brands (including 300 internationally renowned ones), as well as a variety of food and drink, entertainment, commercial and residential complexes.

The mall is made up of five separate areas: Phoenix Mills, Skyzone Mall, the Galleria, PVR Cinemas, and, the most recently established, Palladium Mall. The Palladium bears the closest resemblance to traditional mall in the West and is the location of choice for luxury international brands such as Burberry, Diesel, Estee Lauder, Paul Smith, and Bo Concept, in addition to upmarket Indian designers such as AND (Anita Dongre's casual line), Shantanu and Nikhil and Satya Paul. It also boasts India's first Manchester United Store and café.

The rest of Phoenix Mills is an indoor-outdoor complex with a more Indian feel featuring everything from Big Bazaar (India's CostCo equivalent), to Hamley's and McDonald's. Around the corner, enter the Skyzone Mall and Galleria where you will find renowned UK retailers like Marks and Spencer, and The Comedy Store as well as Pavers England and Clarks.

According to Centre Manager, Rajendra Kalkar, High Street Phoenix has been ranked the best performing mall in India in terms of business. Consumption in this mall is 40% higher than at other Indian malls. Brands entering India have been known to enjoy a 90% success rate if they establish their stores at High Street Phoenix.

This is because footfalls at this location can be as high as 80,000 people per day on a weekend (Friday, Saturday and Sunday) and approximately 50,000 on weekdays with an average conversion rate of 50%. It is clear that Indian consumers have evolved considerably over the last decade and are looking to spend their newly acquired wealth on quality goods. There is no dearth of profits to be made.

As part of their ambitious plans for India, Pavers England, the premium British footwear brand, which operate a nationwide network of 15 stores and 70 concessions, opened a store in the Galleria section of Phoenix Mills in early October 2011 and have reported a healthy 30% growth in sales every month since then.

Conclusion

In order to ensure its sustainable development over the long term, the luxury retail sector in India needs to offer something uniquely Indian and specifically attuned to the Indian consumers and their cultural environment. From product range and styling, through to branding and the retail environment, the sector needs to create a bespoke and personalised experience and display global luxury credentials with an Indian accent. This customised approach will appeal to the sophisticated and price sensitive Indian consumers and discourage them from travelling abroad to shop at more established luxury capitals like London, New York, Paris or Milan. UK luxury brands and retailers are advised to incorporate this dimension into their India market entry and expansion strategy.

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