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Twist In The Tale

How big box retail is reinventing itself

By

When Wal-Mart's chief executive Michael Duke had breakfast with the heads of consumer goods companies in India last week, he certainly had no inkling about how far this news would spread. Inside the rest rooms (we can vouch for the gents section) at the corporate headquarters of Aditya Birla Retail, neatly mounted notice boards share newspaper reports on the competition. Prominent among them is a report of Duke's India visit.

In a business that swears by the right location, this might not be the appropriate place to feed employees with information on rival retailers. But executives at the food and grocery retailer, led by its CEO Thomas Varghese, always keep competition on their radar. Varghese even admits to "losing sleep" over "3-4" of his rivals.

Still, the apparel-to-aluminium conglomerate Aditya Birla Group's retail chain, More, has come a long way (see box). Competition was the least of his worries when Varghese took charge in July 2008. A month after he assumed office, the financial meltdown sent shivers down the world economy. Retail, a business driven by market sentiments and consumer confidence, was among the worst hit. Soon, the flood of footfalls that most retailers were expecting was in danger of turning into a trickle. In the quarter ended December 2008, a KPMG report noted, sales had dropped by 11 per cent.

Just a few months before that, organised retail in India looked like a big-banner, star-studded movie. Some retailers were even paying salaries fit for movie stars, especially to their expatriate recruits. Take an average of Rs 2 crore as a salary to an expat and a scenario where a chain employs 200 expats (one chain had reportedly employed as many) — and it takes no genius to figure that the retail organisation is saddled with a huge pile of centralised costs. Ironically, it was happening in what consultant Ireena Vittal, a principal at consultancy McKinsey & Co., calls, "a middle class business". She adds: "Salaries were becoming astronomical. They are getting constrained again as they have to reflect a middle-class business."

To recover the big investments faster, retailers rolled out operations on a war-footing. Everyone was pursuing growth at what Shoppers Stop's Managing Director Govind Shrikhande terms as "pace without understanding the contours of the pace or the cost impact". Even the ones with less deeper pockets were scaling up as if there was no tomorrow. For example, value retailer Subhiksha scaled up from 1,000 outlets to 2,000 outlets before one could count the number of letters on its name. For another retailer, Vishal, it was more of the same thing.

Varghese says that everyone was rapidly rolling out stores and focusing on creating a large footprint rather than create stores that made money — “a valuation game, than hard-nosed business profitability”. In some ways, as an industry senior puts it, this was like a cricket match where the runs were flowing: “Spectators were egging batsmen on as they endangered their wickets trying to hit a sixer when only singles were required.” When the wickets fell, of the high scorers such as Vishal and Subhiksha, a chill of realism swept through the industry. “The unbridled and reckless acquisition of properties got retempered,” says Raghu Pillai, another industry veteran who is now the CEO at India’s largest retailer, Future Group.

Caught And Bowled

Everyone in the game had accumulated unwieldy cost structures. Rentals as a percentage of sales were at uncomfortable levels. Even veteran retailers such as Shoppers Stop, which had been in the business for nearly two decades, saw rentals go up to 10.85 per cent of sales. In better times, rentals used to be in the range of 8 per cent. Just this one component was now hurting bottomlines by as much as 285 basis points. In the food and grocery retail, where the recommended range for rentals is 4-5 per cent of sales, some retailers had picked up real estate tabs for as much as 10-12 per cent of sales.

SQUEEZING COSTS EVERYWHERE SHOPPERS STOP

Call it fortunate or unfortunate. “Just before the slowdown started, we had taken a strategic call to change our position to get into a new segment,” says B.S. Nagesh, vice-chairman of Shoppers Stop. With a loss of Rs 65 crore in 2008-09, the chain had to slash costs methodically and quickly. It first looked at, obviously, rentals. With new stores, rental deals were signed on a revenue-sharing basis. The chain expects to see an 80-100 basis points decline over the next three years. Rent, as a percentage of sales, has already dropped from 10.8 per cent to 10.5 per cent.

The second stop was power. “The power costs were going through the roof in many stores,” says Govind Shrikhande, managing director, Shoppers Stop. Apart from cutting consumption by 35 per cent, the firm also changed its supplier to lower rates, saving about 50 basis points. Overall, it managed to pull down operating costs by 380 basis points from 30 per cent of sales to 26.2 per cent of sales in the past fiscal.

The next challenge was manpower costs. “We took a tough call that we’ll not ask anybody to go,” says Shrikhande. So the top management took a 15-per cent pay cut. Then, while the repositioning towards bridge-to-luxury segment gave the firm a higher average ticket size, the gradual shift of its procurement model from ‘bought out’ to ‘concession and consignments’ also helped. In 2001, 98 per cent of stocks at Shoppers were bought out (where the company buys the merchandise), while only 2 per cent was concession and consignment (where the retailer does not invest in merchandise). The share of concession and consignments moved up to as much as 47 per cent by 2009-10 and the chain could cut its working capital needs. “Against Rs 400 per sq. ft, we now need only Rs 165,” says Shrikhande. The chain now saves Rs 2.5 crore on each new store. The break-even period has come down from 24-30 months in the past to 18-24 months. Margins on sales have improved by 20 basis points and Shoppers Stop swung back from a Rs 65-crore loss in 2008-09 to a profit of Rs 50 crore in 2009-10.

One retailer confides this was partly driven by consultant projections. “Their sales-per-square-feet assumptions were unrealistic,” he says. This firm, which had three ‘star’ advisors, was told it could get initial sales of Rs 1,200 per sq. ft per month that would increase to Rs 2,000 per sq. ft per month over a two-three year time frame. Now, three years past, this player has hit first year projections. Other consultants such as former retailer Ajay Kelkar, COO of consultants Hansa Cequity, say, “In this business, average ticket sizes have not moved up rapidly over the past 10 years.” The star consultants forecast margins of 24-28 per cent, while at best the food and grocery business (that form roughly two-thirds of the retail basket) in India gives retailer margins of about 18-20 per cent.

Still, retailers did not stop at the first two mistakes of paying high rentals and overestimating demand. “The entire industry chased too many models, too many formats, and too high a growth,” says Shrikhande. His firm’s case was no different. A conservative retailer, Shoppers had waited for about five years before it first expanded from its flagship departmental store in Mumbai’s suburb Andheri. It repeated the same with the hypermarket format, Hypercity, where the firm holds 51 per cent stake, when it ventured beyond its first outlet only after three years of existence.

But in other cases such as the catalogue format store Argos, food and beverage brands, Brio and Desi Café inside its stores, airport retail ventures, or its other brands Arcelia and Home Stop, the same levels of patience were missing. “In many of these formats, we had not done that homework and realised it was not getting anywhere. We decided to close Argos and the food and beverage retail formats. In other formats, we decided to relook at the cost structure,” says Shrikhande. Others were also in a hurry to cut losses. A study by research agency IMRB Retail shows India’s organised retail universe shrunk from 1,539 outlets in 2008 to 1,275 in 2009 (many more outlets were closed before that and several did after that too).

The Dressing Room
It was time for some serious reengineering. Most retailers started off looking at costs; it is easier to have a better handle on costs than on selling more to consumers. “Cost controls can also happen almost immediately. You must also target sales, but that might take time,” says Bijou Kurien, president and CEO-Lifestyle of Reliance Retail.

EMPLOYEES HOLD KEY TO PROFITABILITY ADITYA BIRLA RETAIL (MORE)

For the past year or so, back-end employees at Aditya Birla Retail have had to literally shoulder a lot more weight. For eight days in a year, employees who normally sit in the seemingly comfortable environs of the distribution centres and administrative office (CEO downwards) have had to work at the store — that too on weekends. Their task ranges from manning the cash tills to even lifting the stocks on their backs. "The pain points in the front end are not mitigated at the back end, when employees at the back end cannot empathise with real-time problems at the store level," says Thomas Varghese, CEO, Aditya Birla Retail. Weekends — that make up about 40 per cent of all retail sales — is when stores require extra support, and back-end employees can see for themselves the pressure and the need to respond fast. Consultants such as Susil Dungarwal of Beyond Square Feet agree. "Unfortunately, business development officers who are signing the store have never run a store and do not understand what store feasibility is."

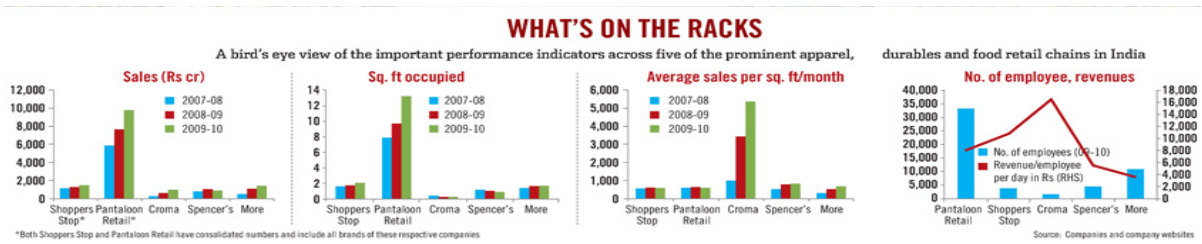
Under what was called Project 2000, More carried out an exercise where every 2,000 sq. ft outfit would carry 1.5 to 1.75 stock-keeping units per sq. ft. To simplify: if More displays five large bottles of Coca-Cola and Pepsi, it could potentially reduce that to four bottles each and use vacant space to fit in a third brand. This gives consumers a wider range to choose from. It has also sharpened focus on its private label strategy. For example, if private labels from More accounted for 3-4 per cent of sales in a category, say corn flakes, the eventual target was to take the share of More's private label sales to as much as 13-14 per cent.

More has also de-layered its organisation structure — like cutting down reporting layers between the store manager to COO from seven to five. In the case of the hypermarkets business, the regional heads were relocated to head office to save administration expenses. The collective result: at a store level, 85 per cent of More's 600-odd outlets are profitable now, from a negligible number earlier. As Varghese puts it, "There's a chalk and cheese difference."

The first cost every retailer caught by the scruff of the neck were rentals. Instead of paying a fixed rental to property owners, most retailers went in for a variable rent structure, where the property owner would get a percentage of store revenues — a bounty for the landlord in festive seasons like the current Diwali rush, or taking home a little less during the slack season. "Four out of five rentals are now as a percentage of sales. It's also a factor of the industry evolving and growing up," says McKinsey's Vittal. Kurien adds that this realisation has also dawned upon several real estate players and mall developers who have "got a lot more realistic in terms of what they think is affordable rent".

After hammering rentals down, the absolute size of stores came under scrutiny. From consumer durable retailer Croma to hypermarket brand Hypercity, everyone started questioning if their outlets were probably too big for a market like India. Ajit Joshi, CEO of the Tata Group-owned consumer durables retailer Croma, says, "As we do not have the same range as global markets, the store size could comfortably be at 8,000-12,000 sq. ft, against the average size of 14,000-15,000 sq. ft outlets that it used to focus on."

The chain also has small format Croma Zip outlets that are an average of 2,500-4,000 sq. ft. Joshi insists Croma was not hit by the slowdown, as it always practised a lean operation strategy (see box on page 42). Hypercity, which earlier scouted for properties in excess of 1,20,000 sq. ft, has now decided that the right size for its outlets will be in the range of 75,000-80,000 sq. ft. Not everyone is taking the ‘Honey, I Shrunk The Kids’ route, though. Vineet Kapila, president of the RPG Group’s Spencer’s Retail, says that in food and grocery retail, “a bias towards small sizes is not profitable in the longer term”. Till some years ago, Spencer’s had an average store size of 1,500 sq. ft, when most food and grocery retailers had outlets between 10,000-40,000 sq. ft. Now Spencer’s has an average of 4,000 sq. ft stores, and Kapila is looking at taking up to 14,000 sq. ft, if not more.



Another place to rationalise is back end. “Retailers took pride in saying they had put in place a farm-to-fork model, had collection centres and set up cold chains. Some retailers even said they will have air cargo to transport goods abroad,” says Ashutosh Chakradeo, head of buying, merchandising and supply chain for Hypercity.

In that initial euphoria, some companies ended up building as much as a 500,000 sq. ft of back-end facilities for a 1 million sq. ft front-end. Now the back-end has been rationalised to 10-20 per cent of the space occupied by the front end. “The slowdown reinforced its belief that you cannot have a back office built to cover the next 5-10 years. It should be enough for the next one-two years,” says B.S. Nagesh, vice-chairman of Shoppers Stop.

Other high-end retailers such as Godrej Nature’s Basket have given up their warehouses altogether and stopped importing stocks by themselves. Mohit Khattar, managing director, Godrej Nature’s Basket says the chain now involves third-party vendors from whom it picks up stock. “As a direct importer of food products, the risk of products not getting sold was on us and led to wastage. Now we pick what we want directly from the vendors, thereby lowering cost of storage,” he says.

A Fast Outfield

Earlier, stores were ordered to be customer focused. Now, they are rapped for not being profit-focused. “Four-wall profitability is becoming extremely important,” says Abheek Singhi, partner and director of The Boston Consulting Group. “Most retailers have refined processes in understanding catchments and are stocking relevant assortments in those markets,” says Puneet Avasthi, vice-president of IMRB Retail. But there is a lot more ground to be covered. Over 80 per cent of retail shelves carry branded merchandise with the balance being private labels. “For 80 per cent of sales, the brand owners and not the retailers are driving consumer understanding,” says Kelkar. Retailers focus on return on inventory, return on per sq. ft and return on labour. “I’m not sure if many retailers look at return on customer,” he says.

Hypercity claims to be the one chain doing that. “It is not just about how fast the stock moves, it is also about customer turns,” says Chakradeo. The chain identified a set of customers who joined the loyalty programme, but had not continued shopping at Hypercity. It mailed these consumers gift vouchers to be encashed on the next visit to Hypercity. Nearly 50 per cent of those customers responded and of that 15 per cent have continued shopping over the next 2-3 high months. Then, poring through buying patterns of its loyalty club, Hypercity noted that most of its women customers who bought personal care products also bought apparel from Hypercity outlets. So the chain has designed cross promotions between these two categories. In the non-food space, both Croma and Shoppers were in some ways lucky. Shoppers' repositioning exercise, as the chain progressed from targeting regular consumers to bridge-to-luxury customers, happened just before the slowdown. So did Croma’s introduction of private labels. Both these initiatives helped protect margins to some extent.

Future Group’s consumer durables retail venture, eZone, worked on the consumers’ willingness to spend. As nearly 75 per cent of consumers shop for durables either using credit cards or consumer finance, the chain is giving more value to credit-seeking consumers through group firm Future Money. Nitish Tipnis, president, eZone, points out that previously consumers who walked in to shop for a large ticket size had a pre-determined budget in mind.

For example, if they could afford to pay a monthly installment (EMI) of Rs 2,000, then they would decide what product to buy based on that price-band. The chain structured a finance scheme where consumers could buy whatever they want from eZone’s for an EMI of Rs 999. If they bought a high priced item, then the tenure of the loan would be higher. “This has significantly increased ticket sizes. Consumers can buy better aspirational products that they would have otherwise overlooked,” says Tipnis. As of now there is an upswing in overall sales and the July-September quarter saw an increase of 75 per cent in same store sales, compared to the same quarter last year, he claims.

BUILDING EMPIRE CLUSTER BY CLUSTER INFINITI RETAIL (CROMA)

You will never find a map of India in my office,” says Ajit Joshi, CEO, Infiniti Retail, which runs the Croma brand. He prefers a “clustering” strategy instead of having a national footprint at one shot. In Mumbai, Croma has 17 stores, and five in Pune — all catered by one distributor. Even if outlets are opened at Aurangabad or Nasik, the same distribution centre will manage the supplies there.

Croma plans to open outlets at Chandigarh, Amritsar and Jalandhar — all at one go. “We will open stores together, so that brings in efficiencies for the distribution centre.” These bursts of expansion have helped Croma grow from a sales turnover of Rs 283 crore two years ago to Rs 1,021 crore in the last fiscal. During 2008-09, Croma grew in double digits, say company executives.

Another initiative was to have private labels. “We did not know there was a downturn coming, when we launched private labels,” says Joshi. Croma’s strategy with private labels is to offer a price advan-tage as well as more features than branded products. So, a Croma-label vacuum cleaner comes with wet and dry options.

Then, while traditional wisdom says to go after home appliances because of the higher margins, Croma decided to focus on the digital space, offering a large mix of computers and mobile phones. The result, apart from the high volumes, is that the chain has better margins per square feet — as mobile phones or IT accessories take less display space than, say, a music system or a home appliance. Another benefit is that Croma has managed to develop better relations with OEMs such as Intel and Microsoft. Intel has even chosen Croma as a partner to launch a range of applications.

On the costs side, Joshi says the attempt is to “variabilise as many fixed costs as possible”. Along with rent, the chain is also looking at manpower. As most footfalls are during evenings, stores can have skeletal staff during the daytime on weekdays, or even hire on a part-time basis, while increasing the number of employees during the evening hours and weekends.

“You will soon have a situation where a retailer says he will take the everyday low price route and distinctly so,” says Kelkar. That is already happening. More’s hypermarkets and D’Mart are locked in battles over who delivers the best price. Others like Spencer’s are staying away from the sabse sasta route and are opting for “prices you can trust” approach by selling what Kapila calls “good taste at inexpensive rates”.

Godrej Nature’s Basket is aiming squarely at the top end. “We are very picky about product assortment. We do not juxtapose our brands with the regularly available Indian brands,” says Khattar. The chain has identified ‘gourmet’ as its niche. At present, both methods have their share of customers.

In the fortnight leading to Diwali, More’s hypermarkets offered a “lowest price guarantee” saying it will refund the price difference if consumers find a cheaper price tag anywhere else. In places such as Thane, consumers stood in kilometre-long queues to take advantage of these discounts. Wonder if this news reached Mike Duke.

With inputs from Suneera Tandon, Vishal Krishna and Meera Mohanty