

## Truly Modern Challenges

These are challenging times for the retail industry. While India's consumption has remained intact or become stronger over the years, modern retail is facing many challenges. Some of these are a result of indiscriminate expansion, a lack of adequate investment in the supply chain, inventory planning and store operations, and, in some cases, are related to corporate governance.

Retail companies have recognised these issues and are trying to address them. Over the last couple of years, the focus has shifted from number of doors to the basic retailing tenets of unit-level economics and profitable growth. But we believe that the biggest and most acute challenge faced by the modern retail industry, namely finding the right real estate at the right price, does not have any easy solutions. Real estate forms the single largest operating expense for all brick-and-mortar formats, and, all things being equal, can make or break a business.

Unfortunately, there is little thought given to urban town planning, and so there are no areas reserved or earmarked for retail and entertainment. All new land blocks available within city limits — especially in the top eight to 10 cities — therefore compete with more lucrative residential or commercial real estate opportunities, increasing the acquisition cost for the developer, and thus the average rentals for retailers. This is a Catch-22 for both sides.

The second, and more important, issue is the serious dearth of real estate. Back-of-the-envelope calculations show that if our economy continues to grow at five to six per cent every year, by 2020 India would need an additional 2,000 million square feet of retail real estate across traditional and modern format to meet the additional demand. This is equivalent to 4,000 malls of half-a-million to a million square feet — against barely 60-70 good functional malls and a similar number of high streets in India today. In addition to retail real estate, there will be similar requirements for residential, commercial, industrial and other uses – which would add up to many billion more square feet. Where can India find this real estate?

Keeping these challenges in mind, it becomes imperative for the retail industry in its current form to find solutions which can enable it to survive by achieving scale and profitability.

The key enablers can be:

- **Free pricing, rather than MRP-led pricing:** Retailers the world over base the prices of their branded and private-label products on their locations, operating models, sourcing efficiencies and margins. Therefore, shopping in Fifth Avenue, New York, where real estate is very costly, would be more expensive than, let's say, shopping in Queens. In India, retailers' pricing is dictated by the Consumer Goods (Mandatory Printing of Cost of Production and Maximum Retail Price) Act, 2006, which in turn dictates their profits and profitability. Free pricing would enable retailers to calibrate product assortment, pricing and volumes for each of their locations, helping them to manage profitability in high-rental stores as well.
- **Increasing the Floor Space Index(FSI):** This would allow real estate development companies to make more efficient use of land parcels, in turn creating more retail space, which would ease some of the pressure on availability and premium on good locations.
- **Mixed-use developments:** The government should allow these, whereby retail, commercial and residential units can coexist on various levels of the same building. Currently, shopping centres are designed as standalone properties, which is the reason why the entire earnings for the real estate developer need to come from revenue share, minimum guarantees or rentals. Mixed-use developments would allow developers to demand the right price right for each type of use, spread their earnings and maximise the returns on their total investment. It would help retailers calibrate revenue share and minimum guarantees to suit the retail operating model for these locations.

At present however, there is a paralysis in policy making, at both Union and State government levels, which prevents the implementation of any or all of these possible solutions. Any serious attempt at countering this will require players industry-wide to come together and form a strong lobby. This is, however, a long-haul process and thus will need these players to demonstrate an enormous and continued patience with the decision-making bodies.

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