Retail economics and four essential for retail success

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Abstract

This article is focusing on economics of organized retail sector in India and the authors suggest four essentials things for the success of retail business in India. India’s central government announced retail reforms for both multi-brand stores and single-brand stores. Total retail employment in India, both organized and unorganized, account for about 6% of Indian labor work force currently - most of which is unorganized. Accepting this basic view of retail economics, the primary task for a successful retailer is to get the “economics of the box” (store) working. The four basic essentials for retail success suggested by authors are Insight-Driven Enterprise, Agile Supply Chain, A Superior Customer Experience, and Global Information Integrity. The balance of this article delves into each of these four imperatives and outlines how, working in concert, they form the foundation of a transformed economic landscape for forward-thinking retailers.

Keywords: Retail economics, retail success
1. Introduction

Retailing in India is one of the pillars of its economy and accounts for 14 to 15 percent of its GDP. The Indian retail market is estimated to be US$ 450 billion and one of the top five retail markets in the world by economic value. India is one of the fastest growing retail markets in the world, with 1.2 billion people. As of 2013, India's retailing industry was essentially owner manned small shops. In 2010, larger format convenience stores and supermarkets accounted for about 4 percent of the industry, and these were present only in large urban centers. India's retail and logistics industry employs about 40 million Indians (3.3% of Indian population). Until 2011, Indian central government denied foreign direct investment (FDI) in multi-brand retail, forbidding foreign groups from any ownership in supermarkets, convenience stores or any retail outlets. Even single-brand retail was limited to 51% ownership and a bureaucratic process. In November 2011, India's central government announced retail reforms for both multi-brand stores and single-brand stores. These market reforms paved the way for retail innovation and competition with multi-brand retailers such as Wal-Mart, Carrefour and Tesco, as well single brand majors such as IKEA, Nike, and Apple. The announcement sparked intense activism, both in opposition and in support of the reforms. In December 2011, under pressure from the opposition, Indian government placed the retail reforms on hold till it reaches a consensus. In January 2012, India approved reforms for single-brand stores welcoming anyone in the world to innovate in Indian retail market with 100% ownership, but imposed the requirement that the single brand retailer source 30 percent of its goods from India. Indian government continues the hold on retail reforms for multi-brand stores. In June 2012, IKEA announced it had applied for permission to invest $1.9 billion in India and set up 25 retail stores. An analyst from Fitch Group stated that the 30 percent requirement was likely to significantly delay if not prevent most single brand majors from Europe, USA and Japan from opening stores and creating associated jobs in India. On 14 September 2012, the government of India announced the opening of FDI in multi-brand retail, subject to approvals by individual states. This decision was welcomed by economists and the markets, but caused protests and an upheaval in India's central government's political coalition structure. On 20 September 2012, the Government of India formally notified the FDI reforms for single and multi brand retail, thereby making it effective under Indian law. On 7 December 2012, the Federal Government of India allowed 51% FDI in multi-brand retail in India. The government managed to get the approval of multi-brand retail in the parliament despite heavy uproar from the opposition. Some states will allow foreign supermarkets like Wal-Mart, Tesco and Carrefour to open while other states will not.
2. Literature Review

Economists’ interest in retail firms has been somewhat limited in its scope. Most studies select retail firms to provide ‘realism’ for one particular feature of a theoretical model which may be relevant in retail environments. These studies range from Hotelling’s work on skatial competition (1929) and Chamberlin’s work on monopolistic competition (1946) to the recent literature on the economics of information with its search for the lowest priced store (Stiglitz, 1979) or the temporal shifting of storage costs (Varian, 1980). Other studies have explored narrowly defined problems specific to retailing, such as the assortment problem (Baumol and Ide, 1956), resale price maintenance (Gould and Preston, 1965, and Perry and Porter, 1986), or clearance sales (Lazear, 1986). Our analysis differs from these studies in one important respect. We develop a model that offers a comprehensive framework for understanding the operations of a retail firm, including the role of many of the particular aspects emphasized in the previous literature, as an economic institution. Hence, our contribution follows in the tradition started by Coase’s (1936) classic paper on the nature of the firm. Indeed, one of our most important insights is the identification of the nature of retail firms and, consequently, of their essential economic function.

Different kinds of distribution costs that consumer can incur and, then, by presenting five types of service outputs that retailers provide to reduce these distribution costs. This section can be characterized, following Nelson and Winter’s (1982) terminology, as appreciative theory. It contains the fundamental insights on the nature of retail markets revealed by our research. These insights are somewhat reminiscent of, and to some extent were inspired by the work of Bucklin (1972) characterizing the main function of marketing systems. Other sources useful in developing our conceptualization were Kotler (1984), and Ingene (1984). The idea of household production goes back to Lancaster (1966) and Becker (1965). Our formulation is an extension of the two stage procedure in Deaton and Muellbauer (1980). Interestingly enough, some of our results for the first stage on the impact of distribution costs are anticipated in a detailed analysis of a single household’s demand for storage and shopping trips by Harwitz, Lentnek and Narula (1983). Their approach differs from ours in that the role of the retailer in determining distribution costs is only implicit in their model.

The incentives of retail firms to become complex organizations through vertical integration have not been recognized in the literature. Indeed, Williamson’s (1985) recent book devotes two chapters to vertical integration and even addresses retailing explicitly in his discussion of forward integration (chapter 5).
3. Challenges in Indian Retailing

A McKinsey study claims retail productivity in India is very low compared to international peer measures. For example, the labor productivity in Indian retail was just 6% of the labor productivity in United States in 2010. India's labor productivity in food retailing is about 5% compared to Brazil's 14%; while India's labor productivity in non-food retailing is about 8% compared to Poland's 25%. Total retail employment in India, both organized and unorganized, account for about 6% of Indian labor work force currently - most of which is unorganized. This about a third of levels in United States and Europe; and about half of levels in other emerging economies. A complete expansion of retail sector to levels and productivity similar to other emerging economies and developed economies such as the United States would create over 50 million jobs in India. Training and development of labor and management for higher retail productivity is expected to be a challenge. In November 2011, the Indian government announced relaxation of some rules and the opening of retail market to competition. Based on the literature review, researchers develop the objective of the article is to understand the basic economics of retail especially in India. Also based on the understanding of retail economics, researcher suggests four important retail success factors to improve the business of Indian retailers. The following paragraph focuses on retail economics in India followed by researcher’s suggestions.

4. Retail Economics in India

Many business groups in India are welcoming the transformation of a long-protected sector that has left Indian shoppers bereft of the scale and variety of their counterparts in more developed markets. B. Muthuraman, the president of the Confederation of Indian Industry, claimed the retail reform would open enormous opportunities and lead to much-needed investment in cold chain, warehousing and contract farming. Organized retailers will reduce waste by improving logistics, creating cold storage to prevent food spoilage, improve hygiene and product safety, reduce counterfeit trade and tax evasion on expensive item purchases, and create dependable supply chains for secure supply of food staples, fruits and vegetables. They will increase choice and reduce India’s rampant inflation by reducing waste, spoilage and cutting out middlemen. Fresh investment in organized retail, the supporters of retail reform claim will generate 10 million new jobs by 2014, about five to six million of them in logistics alone. Organized retail will offer the small Indian farmer more competing venues to sell his or her products, and increase income from less spoilage and waste. A Food and Agricultural Organization report claims that currently, in India, the small farmer faces significant losses post-harvest at the farm and because of poor roads, inadequate storage technologies, inefficient supply chains and farmer's inability to bring the produce into retail markets.
dominated by small shopkeepers. These experts claim India's post-harvest losses to exceed 25%, on average, every year for each farmer. Unlike the current monopoly of middlemen buyer, retail reforms offer farmers access to more buyers from organized retail. More buyers will compete for farmers produce leading to better support for farmers and to better bids. With less spoilage of staples and agricultural produce, global retail companies can find and provide additional markets to Indian farmers. Walmart, since its arrival in India's wholesale retail market, already sources and exports about $1 billion worth of Indian goods for its global customers. Not only do these losses reduce food security in India, the study claims that poor farmers and others lose income because of the waste and inefficient retail. Over US$50 billion of additional income can become available to Indian farmers by preventing post-harvest farm losses, improving transport, proper storage and retail. Organized retail is also expected to initiate infrastructure development creating millions of rural and urban jobs for India’s growing population. One study claims that if these post-harvest food staple losses could be eliminated with better infrastructure and retail network in India, enough food would be saved every year to feed 70 to 100 million people over the year. Supporters of retail reform, The Economist claims, say it will increase competition and quality while reducing prices helping to reduce India's rampant inflation that is close to the double digits. These supporters claim that unorganized small shopkeepers will continue to exist alongside large organized supermarkets, because for many Indians they will remain the most accessible and most convenient place to shop. Amartya Sen, the Indian born Nobel prize winning economist, in a December 2011 interview claims foreign direct investment in multi brand retail can be good thing or bad thing depending on the nature of the investment. Quite often, claims Professor Sen, FDI is a good thing for India. Much has been made of the recent changes in the competitive and economic landscape for retailers. Consolidation, increasing competition, market saturation, increasing customer demands and accelerating product cycles are among the things retailers now have to navigate to remain successful. Accepting this basic view of retail economics, the primary task for a successful retailer is to get the “economics of the box” (store) working. If the retail concept is working, each store produces acceptable gross margins on product sold. These margins cover the cost of store labor and other store overhead, and the store overall contributes margin to cover corporate overhead. This is the fundamental building block of healthy retail economics, and without it, all other strategies will eventually wither. If the economics of the box work, the next question is one of profitable scale. How many stores are required to support the corporate overhead? How fast can the store base grow? When and how are investments made to streamline corporate overhead and make it scale more efficiently? If all three concepts are working, a retailer’s economics are sound. If one aspect isn’t working, it is sometimes possible to temporarily cover up for it using the other levers:
Adding more stores can cover up for declining margins. Reducing overhead can cover up for slow growth. Having an exceptionally good year at picking merchandise covers up for excesses in overhead expenses. But none of these cover-ups lasts forever. Only the retailer that successfully manages its economics holistically can expect to win in the long run. As many retail formats begin to approach saturation in the next five years or so, the lack of square-footage growth opportunities will have important ramifications for earnings growth and thus valuation. Besides the direct adverse impact on the top line, retailers will experience aging store bases and slower same-store sales growth rates further constraining earnings-growth opportunities. Compounding this, are raising operating expenses in areas such as employee benefits and utilities. As such, it becomes imperative for retailers to search out additional opportunities to bolster the bottom line. So under such economic situation, Indian retailer really faced the growth in their business. Hence researcher suggests four important retail success factors to improve the business of Indian retailers as follow,

5. The Four essential for Retail Success

5.1 The Insight-Driven Enterprise

How are smart retailers preparing for the future while maintaining current growth? To move the organization forward, retailers need extraordinary visibility into forecasts, results patterns, and trends. In other words, they need much more than mere data – they need insights. With insights, the retailer can begin to pursue next-generation, customer-centric merchandising strategies that merge the art of merchandising with the science of accurate customer-demand forecasting. The right insights enable merchandisers to tailor assortments to provide localized merchandising that best meets the needs of consumers in each geographic area. Customer centric merchandising leverages systems that are “smart and dark”: that is, the necessary transaction systems combine with other applications that use demand forecasts fueled by algorithms to enhance all aspects of the merchandising process. This aligns the financial plan, sales plan, and inventory plan including assortments, allocations, pricing and markdowns, by company and store so every area of the business is synchronized with what matters is consumer demand for the products. As a result, employees at all levels have the information to make better business decisions. That optimization and alignment happens through insights that occur at key points of the decision process. Decision-makers have the information and empowerment to not merely execute their core responsibilities, but find ways to maximize sales and gross margin opportunities:

• They can optimize assortments to tailor merchandise to the needs of specific customer segments and plan product assortments by seasonal or social needs.
• They can optimize visual space and layouts of individual stores to cater to the preferences of the customer base for each store. For instance, you can place popular items in locations that drive traffic into the store (with complementary items situated nearby) or position last-minute convenience items in locations that customers pass on the way to check-out.

• They can optimize pricing and markdown strategies by closely aligning them with the inventory plan to reduce over-stocks and ensure each store is profitable. The bottom line: planning and merchandising that’s driven by smart insights into customer demand directly improves net margins.

The Insight-Driven Enterprise – The insight-driven enterprise combines the art of merchandising with mathematical analysis to accurately predict customer demand. This enables both customer-centric merchandising initiatives (such as localized merchandising) and sophisticated optimization of assortment plans, allocations and replenishments, store layouts, and pricing. The result: peak financial performance from every business decision.

What It Means: Increased sales, improved margins, increased growth and market share, greater customer loyalty

5.2 The Agile Supply Chain

Retailing economics of course, reaches upstream to suppliers. A complete, consumer-aware, sensing and responsive supply chain network properly encompasses trading-partner collaboration, product information management, global-data synchronization, and advanced inventory planning with time phased replenishment. In such an environment, the retailer, its suppliers, distributors, transporters, and warehouses all coordinate their activities using a single synchronized plan for inventory, delivery, execution, promotion, events, and more. That helps ensure the right amount of inventory is available in the right place at the right time. A lean inventory flow does NOT mean a higher risk of stock outages and backorders. It means optimizing the flow of inventory around customer expectations to get material where and when consumers want it. The objective is to make the inventory flow transparent: “enablers” in the enterprise systems and processes streamline inventory flows as part of standard practices. The tools and disciplines that make this possible encompass store-inventory-management, advanced inventory planning, RFID, transportation management, and product lifecycle management – all of which help fine-tune the inventory flow and distribution-channel participation. The bottom line: A leaner, more agile supply chain wrings out costs out of the retailing process.

The Agile Supply Chain – The agile supply chain is a single, well-integrated network of internal resources and external trading partners that creates and supports a responsive supply chain and lean inventory flow. The retailer, its suppliers, distributors, transporters, and
warehouses all coordinate using one synchronized plan for inventory, delivery, execution, promotions, events, and more. This ensures that the accurate amount of inventory not too much, not too little reaches the right stores to meet customer demand and maximize profitability.

What it Means: Reduced supply-chain costs, improved inventory turns and asset utilization, improved speed-to-market and responsiveness

5.3 A Superior Customer Experience

Retailers must never lose sight of the ultimate goal: ensuring that customers have pleasant, memorable buying experiences that build loyalty and repeat sales. Today, that increasingly means providing customers with added flexibility and convenience – allowing them to shop (and return goods) anywhere and simplifying purchase processes. It also means defending the retail brand by ensuring that the brand promise is executed for every customer at every touch point in every channel. Some experts call this “store fusion” where your inventory becomes interchangeable among all channels. If a product isn’t in one store, a sales associate can find the product through the retailer’s Web site or call center and have it shipped to the customer. Or a customer could order a product online and pick it up from a nearby retail store. When it comes to managing inventory, newer technologies, such as store inventory management, RFID, and advanced inventory planning help retailers know exactly what merchandise is in which stores – on the sales floor or in the back room – so they can get the right products to consumers more efficiently. Better inventory plans, and replenishment cycles, reduces out-of-stocks and the dreaded overstock situation. One related aspect of creating a memorable experience that delights the customer: the workforce. From attentive salespeople on the floor to responsive service managers in call centers, the customer experience still comes down to having the right people – with the right skills, training, and facilities – to execute the strategy. With most retailers spending tens of millions of dollars in employee turnover costs, maintaining a stable and smart workforce is both a major cost advantage and a necessary prerequisite for delivering a memorable experience for the customer that creates loyalty and repeat purchasing behavior. The bottom line: A superior customer experience driven by a seamless inventory system that connects merchandise with buyers and a stable, well equipped workforce – increases sales.

A Superior Customer Experience – This technology-enabled strategy integrates sales channels (store, call center, e-commerce, catalog, and partners) and seamlessly connects the supply chain and enterprise to those channels to provide a better shopping experience. By making inventory interchangeable among all channels, retailers and customers have greater flexibility. For example, a customer may order an item online, but pick it up at a nearby store.
If an item is out of stock at one store, a sales associate can fulfill the order through the retailer’s Web site and have the item shipped directly to the customer.

What It Means: Increased comparable-store sales, stronger customer loyalty, greater associate productivity, lower store expenses.

5.4 Global Information Integrity

Today, most retailers will confess that they often face seas of inaccurate data stemming from functional and/or regional information silos. Different departments and business units use different technologies or databases, creating intractable redundancies and inaccuracies. The implications are inescapably obvious: suboptimal decisions that reduce profitability. Retailers now need enterprise applications supported by an infrastructure that provides one accurate view of product, customer, and competitive information. They need to ensure that the entire company works off the same systems and plans to increase efficiency and cost effectiveness. To overcome these traditional inefficiencies, retailers must simplify operations by:

- Extracting ongoing value from technology investments – Implement systems that can easily work with existing and future systems, so you don’t waste time or money.
- Implementing retail-ready tools – These systems must accommodate, reflect, and manage the inherent characteristics of retail businesses.
- Deploying enterprise-wide middleware and applications — Retail-specific applications should be supported by a global technology infrastructure that unites the company, its standards, brand, and processes across geographies. The bottom line: A consistent, accurate view of information across all regions will lead to increased profitability.
- Global Information Integrity – This discipline reduces fragmented data silos and the associated business costs of maintaining redundant and inaccurate data. Global information integrity helps retailers simplify their operations by extracting ongoing value from technology investments through systems that are easy to implement, integrate, and maintain. It also helps companies gain a broader view through middleware and retail-specific applications that are supported by a global technology infrastructure that unites the company.

What It Means: Reduced general and administrative costs, increased employee productivity, greater business agility.

6. Conclusion

Each retail imperative drives compelling, specific, and measurable benefits that positively effect the retailer’s bottom line. The insight-driven retail enterprise accurately predicts
demand by combining the art of merchandising with science, and uses the acquired insights to make better business decisions and create a customer-centric-merchandising strategy to increase sales, margins, growth, market share, and customer loyalty. The agile supply chain unifies internal resources and external trading partners to create a responsive supply chain and lean inventory flow. That reduces costs, and improves turns/asset utilization and speed-to-market. Through multi-channel retailing, retailers can integrate sales channels and seamlessly connect the supply chain and enterprise to provide a better customer shopping experience. That vision increases comp-store sales, customer loyalty, and associate productivity while simultaneously reducing store expenses. Finally, global information integrity simplifies retail operations through a global technology strategy that creates a consistent and accurate view or your information from any region.

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