GLOBAL IMPACT ON RETAILING IN INDIA

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ABSTRACT

A financial crisis refers to a loss of confidence in a country's currency or other financial assets causing international investors to withdraw their funds from the country. Financial crisis is applied broadly to a variety of situations in which some financial institutions or assets suddenly lose a large part of their value. In the 19th and early 20th centuries, many financial crises were associated with banking panics, and many recessions coincided with these panics. Other situations that are often called financial crises include stock market crashes and the bursting of other financial bubbles, currency crises, and sovereign defaults. Economists have offered theories about how financial crises develop and how they could be prevented, however, financial crises are still a regular occurrence around the world. It was all done in the name of innovation, and any regulatory initiative was fought away with claims that it would suppress that innovation. They were innovating, all right, but not in ways that made the economy stronger. Today we are all facing the repercussions of the crises.

The Indian government does not recognize retail as an industry. In India 98 percent of the retail sector consists of counter-stores and street-vendors323, with no large players, inadequate infrastructure and a small affording population that believed in saving rather than spending, Indian retail never attracted the interest of large corporations. That was till they realized that retail in India is a USD 320 billion dollar industry, growing at CAGR 5 per cent and contributing to 39 per cent of the GDP.

Introduction

The current global financial crisis is rooted in the subprime crisis which surfaced over a year ago in the United States of America. During the boom years, mortgage brokers attracted by the big commissions, encouraged buyers with poor credit to accept housing mortgages with little or no down payment and without credit checks. A combination of low interest rates and large inflow of foreign funds during the booming years helped the banks to create easy credit conditions for many years. Banks lent money on the assumption that housing prices would continue to rise. Also the real estate bubble encouraged the demand for houses as financial assets. Banks and financial institutions later repackaged these debts with other high-risk debts and sold them to world- wide investors creating financial instruments called CDOs or Collateralized Debt Obligations (Sadhu 2008). In this way risk was passed on multifold through derivatives trade.

Retail in India - The Past, Present and Future

Before the decade of eighties, India with hundreds of towns and cities was a nation striving for development. The evolution was being witnessed at various levels and the people of India were learning to play different roles as businessmen and consumers.

Retail-which literally means to put on the market, is a very important aspect of every city. Without a well organized retail industry we would not have our necessities and luxuries fulfilled. Be it our daily groceries or fashion accessories and everything in between, retail industry brings us the blissful experience of shopping. Though organized retailing industry began much earlier in the developed nations, India had not actively participated. However with its vast expanse and young population, India in the 21st century emerges as a highly potential retail market. The journey of retailing in India has been riveting and the future promises further growth. Here is a complete picture deciphering the past, present and future trends of Indian Retail Market.

The Organized retailing in India is also seeing the following changes in the future:

1. Indian Consumer

The Indian consumer has undergone a remarkable transformation. Just a decade or two ago, the Indian consumer saved most of his income, purchased the bare necessities and rarely indulged himself. Today, armed with a higher income, credit cards, exposure to the shopping culture of the west and a desire to improve his standard of living, the Indian consumer is spending like never before. Organized retail with its variety of products and multitude of malls and supermarkets is fueling his addiction. His new mentality, in turn, is fueling the growth of organized retail in India.

2. Young Shoppers

India‘s population is young, very young. Most consumers have grown up with television, the internet, and have been exposed to the standards of living and consumer culture abroad. This generation is also making money at a younger age and lots of it, thanks to call centers and other avenues of employment opening up that cater to students in college and schools. As a result they are ready to spend most, if not all of their income on apparel, accessories, and electronics.

3. Higher Incomes

Liberalization of the country‘s economy has brought a number of employments opportunities. With the entry of a number of multinationals and the expansion of domestic corporations, job prospects in the country are looking up. As a result, incomes and consumption are projected to increase rapidly over the next couple of years. This sets the stage for a very exciting and promising retail market in the future.

4. No Money, No Problem

The finance sector has already seen a huge expansion. Unlike a decade ago, credit cards and short-term loans have become easily accessible and have contributed to the emergence of a consumer culture in India. Credit card rewards schemes, flexible financing options and all the other common lures are tempting the Indian consumer to shop. With loans for everything from a home to an automobile freely available, the Indian consumer can start spending on big-ticket items that were traditionally within his reach only after years of savings.

5. Urbanization

Growing urbanization is also responsible for the changing consumer psyche334. As urbanization spreads beyond the major cities, it converts the local population from net savers to net spenders. This is consistent with what has been observed in developing countries like Thailand, Malaysia and developed countries like U.S.A and the U.K.

6. The Lure of Organized Retail

Another important factor to consider is the effect of existing organized retail in India in fueling consumerism. New malls and supermarkets with their modern decors and multiple products are enticing Indian consumers. This is one of the most direct factors responsible for the mentality change of the Indian consumer. As people see their relatives, friends, neighbors shopping at these new establishments, they are bound to jump on the bandwagon as well.

Reasons for Financial Crisis

The first hint of the trouble came from the collapse of two Bear Stearns hedge funds early 2007. Subsequently a number of other banks and financial institutions also began to show signs of distress. Matters really came to the fore with the bankruptcy of Lehman Brothers, a big investment bank, in September 2008. The reasons for the crisis are varied and complex. Some of them include boom in the housing market, speculation, high-risk mortgage loans and lending practices, securitization practices, inaccurate credit ratings and poor regulation.

- **Boom in the Housing Market:** Subprime borrowing was a major contributor to an increase in house ownership rates and the demand for housing. The house owners were unable to re-finance their loans reset to higher interest rates and payment amounts. Excess supply of houses placed significant downward pressure on prices. As prices declined, more house owners were at risk of default and foreclosure.
- **Speculation:** Speculation in real estate was a contributing factor. During 2006, 22 per cent of houses purchased (1.65 million units) were for investment purposes with an additional 14 per cent (1.07 million units) purchased as vacation homes. In other words, nearly 40 per cent of house purchases were not primary residences. Speculators left the market in 2006, which caused investment sales to fall much faster than the primary market.

- **High-Risk Mortgage Loans and Lending Practices:** A variety of factors caused lenders to offer higher-risk loans to higher-risk borrowers. The risk premium required by lenders to offer a subprime loan declined. In addition to considering high-risk borrowers, lenders have offered increas- ingly high-risk loan options and incentives. These high-risk loans included "No Income, No Job and No Assets loans." It is criticized that mortgage underwriting practices including automated loan approvals were not subjected to appropriate review and documentation.
- **Securitization Practices:** Securitization of housing loans for people with poor credit-not the loans themselves-is also a reason behind the current global credit crisis. Securitization is a structured finance process in which assets, receivables or financial instruments are acquired, pooled together as collateral for the third party investments (Investment Banks). Due to securitization, investor appetite for mortgage- backed securities (MBS), and the tendency of rating agencies to assign investment-grade ratings to MBS, loans with a high risk of default could be originated, packaged and the risk readily transferred to others.
- **Inaccurate Credit Ratings:** Inaccurate Credit Ratings: Credit rating process was faulty. High ratings given by credit rating agencies encouraged the flow of investor funds into mortgage-backed securities helping finance the housing boom. Risk rating agencies were unable to give proper ratings to complex instruments (Gregorio 2008). Several products and financial institutions, including hedge funds, and rating agencies are largely if not completely unregulated.
- **Poor Regulation:** The problem has occurred during an extremely accelerated process of financial innovation in market segments that were poorly or ambiguously regulated – mainly in the U.S. The fall of the financial institutions is a reflection of the lax internal controls and the ineffectiveness of regulatory oversight in the context of a large volume of non-transparent assets. It is indeed amazing that there were simply no checks and balances in the financial system to prevent such a crisis and "not one of the so- called pundits" in the field has sounded a word of caution. There are doubts whether the operations of derivatives markets have been as transparent as they should have been or if they have been manipulated.

Impact on India

Due to globalization, the Indian economy cannot be insulated from the present financial crisis in the developed economies. The development in the U.S financial sector has affected not only America but also European Union, U.K and Asia. The Indian economy too has felt the impact of the crisis though not to the same extent. It is premature to try to quantify the consequences of the crisis on the Indian economy. However the impact will be multi-fold.

1. **Information Technology:** With the global financial system getting trapped in the quicksand, there is uncertainty across the Indian Software industry. The U.S. banks have huge running relations with Indian Software Companies. A rough estimate suggests that at least a minimum of 30,000 Indian jobs could be impacted immediately in the wake of happenings in the U.S. financial system. Approximately 61 per cent of the Indian IT Sector revenues are from U.S financial corporations like Goldman Sachs, Washington Mutual, Citigroup, Bank of America, Morgan Stanley and Lehman Brothers. The top five Indian players account for 46 per cent of the IT industry revenues. The revenue contribution from U.S clients is approximately 58 per cent. About 30 per cent of the industry revenues are estimated to be from financial services (Atreya 2008). The software companies may face hard days ahead.
2. **Exchange Rate:** Exchange rate volatility in India has increased in the year 2008-09 compared to previous years. Massive selling by Foreign Institutional Investors and conversion of their holdings from rupees to dollars for repatriation has resulted in the rupee depreciating sharply against the dollar. Between January 1 and October 16, 2008, the Reserve Bank of India (RBI) reference rate for the rupee fell by nearly 25 per cent, from Rs.39.20 per dollar to Rs.48.86 (Chandrasekhar and Gosh 2008). This depre- ciation may be good for India's exports that are adversely affected by the slowdown in global markets but it is not so good for those who have accumulated foreign exchange payment commitments.
3. **Foreign Exchange Outflow:** After the macro-economic reforms in 1991, the Indian economy has been increasingly integrated with the global economy. The financial institutions in India are exposed to the world financial market. Foreign Institutional Investment (FII) is largely open to India's equity, debt markets and market for mutual funds. The most immediate effect of the crisis has been an outflow of foreign institutional investment from the equity market. There is a serious concern about the likely impact on the economy because of the heavy foreign exchange outflows in the wake of sustained selling by Foreign Institutional Investors in the stock markets and withdrawal of funds by others. The crisis resulted in net outflow of $ 10.1billion from the equity and debt markets in India till 22nd Oct, 2008 (Kundu 2008). There is even the prospect of emergence of deficit in the balance of payments in the near future.
4. **Investment:** The tumbling economy in the U.S is going to dampen the investment flow. It is expected that the capital inflows into the country will dry up. Investments in mega projects, which are under implementation and in the pipeline, are bound to buy more time before injecting funds into infrastructure and other ventures. The buoyancy in the economy is absent in all the sectors. Investment in tourism, hospitality and healthcare has slowed down. Fresh investment flows into India is in doubt.

5. **Real Estate:** One of the casualties of the crisis is the real estate. The crisis will hit the Indian real estate sector hard (Sinha 2008). The realty sector is witnessing a sudden slump in demand because of the global economic slowdown. The recession has forced the real estate players to curtail their expansion plans. Many on-going real estate projects are suffering due to lack of capital, both from buyers and bankers. Some realtors have already defaulted on delivery dates and commitments. The steel producers have decided to resort to production cuts following a decline in demand for the commodity.
6. **Stock Market:** The financial turmoil affected the stock markets even in India. The combination of a rapid sell off by financial institutions and the prospect of economic slowdown have pulled down the stocks and commodities market. Foreign institutional investors pulled out close to $ 11 billion from India, dragging the capital market down with it (Lakshman 2008). Stock prices have fallen by 60 per cent. India's stock market index—Sensex— touched above 21,000 mark in the month of January,2008 and has plunged below 10,000 during October 2008 (Kundu 2008).The movement of Sensex shows a positive and significant relation with Foreign Institutional Investment flows into the market. This also has an effect on the Primary Market. In 2007-08, the net Foreign Institutional Investment inflows into India amounted to $20.3 billion. As compared to this, they pulled out $11.1 billion during the first nine-and-a-half months of the calendar year 2008, of which $8.3 billion occurred over the first six-and-a-half months of the financial year 2008-09 (April 1 to October 16).
7. **Exports:** The crisis will sharply contract the demand for exports adversely affecting the country's growth prospects. It will have an impact on merchandise exports and service exports. The decline in export growth may sharply affect some segments of the Indian Economy that are export- oriented. The slowdown in the world economy has affected the garment industry. The orders for factories which are dependent on exports, mainly to the U.S have come down following deferred buying by big apparel brands. Rising unemployment and reduced spending by the Americans have forced some of the leading brands in the U.S to close down their outlets, which in turn has affected the apparel industry here in India. The U.S accounts for 55 per cent of all global apparel imports (Bageshree and Srivatsa 2008). The global recession will undermine other major export sectors of the Indian economy like sea foods, gems and jewellery.
8. **Increase in Unemployment:** One danger is of a dip in the employment market. The global financial crisis could increase unemployment. Layoffs and wage cuts are certain to take place in many companies where young employees are working in Business Process Outsourcing and Information Technology sectors (Ratnayake 2008). With job losses, the gap between the rich and the poor will be widened. It is estimated

that there would be downsizing in many other fields as companies cut costs. The International Labor Organization predicted that millions of jobs will be lost by the end of 2009 due to the crisis - mostly in "construction, real estate, financial services, and the auto sector." The Global Wage Report 2008-09 of International Labour Organization warns that tensions are likely to intensify over the issue of wages. There would also be a significant drop in new hiring (The Hindu 2008) All these will change the complexion of the job market.

9. **Banks:** The ongoing crisis will have an adverse impact on some of the Indian banks. Some of the Indian banks have invested in derivatives which might have exposure to investment bankers in U.S.A. However, Indian banks in general, have very little exposure to the asset markets of the developed world. Effectively speaking, the Indian banks and financial institutions have not experienced the kind of losses and write-downs that banks and financial institutions in the Western world have faced (Venkitaramanan 2008). Indian banks have very few branches abroad. Our Indian banks are slightly better protected from the financial meltdown, largely because of the greater role of the nationalized banks even today and other controls on domestic finance. Strict regulation and conservative policies adopted by the Reserve Bank of India have ensured that banks in India are relatively insulated from the travails of their western counterparts (Kundu 2008).

Conclusion

While there are growth-related challenges in the short to- medium term, there seem to be some opportunities for managing the bottom line for the rest of the year. The macroeconomic environment is depressing and has impacted the overall confidence in the sector from a market perspective. A US recession, in all probability, will last through 2009 and more, in making this period a challenging one for growth. Despite the foreboding financial crisis, the opportunities are massive. Making the growth vs. profitability trade-off early on during the slowdown is just one of them. Profitability levers are still available if growth is sacrificed where required, and managed well. All in all, the environment looks weakest in a long while, and yet there remain pockets of opportunity. These areas, if tapped intelligently, would enable the Indian industries firms to ease the blow of this financial crisis and help them tide through the tough times. The crisis has now spread globally, and further reduces room to maneuver. To conclude, we are tempted to use a popular aphorism; the Chinese character for "Crisis" represents two symbols "Danger" and "Opportunity" but the choice is ours.

The Indian retail sector is ready to take on challenges from global retail players such as Wal-mart and Carrefour because unlike them, they have a better understanding of the Indian consumer's psyche. Ultimately, a successful retailer is one who understands his customer. The Indian customer is looking for an emotional connection, a sense of belonging. Hence, to be successful any retail outlet has to be localized. The customer should feel that it is a part of his culture, his perceived values, and does not try to impose alien values or concepts on him. Indian customer is not keen to buy something just because it is sold by an international company. Ultimately, it boils down to how much localization and adaptation the company is willing to do for India. Other than tremendous money power, global companies have nothing extra or special that the Indian retail business does not have. Only two percent of India‘s retail market is organized.

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