Deloitte’s point of view on the Indian Retail Market

E-Commerce market
A snapshot of India

The world’s largest democracy, India has a total of 29 States and 7 union territories. The country has a federal structure with Governments elected in each State.

- **Fastest growing economy**
  USD 2.3 trillion GDP growing at >7%

- **Large, young population**
  Population of 1.3 billion, second largest country by population with 77% population under age of 44

- **Significant service sector**
  65% of GDP contributed by services sector

- **Growing urbanization**
  483 million urban population by 2020, up from 430 million in 2015

- **Attractive investment destination**
  USD 60 billion FDI inflows in the period 2016-17

- **Improving lifestyle**
  2 million passenger vehicles sold in the period April 2015 – March 2016

- **Second largest smartphone market**
  300 million smartphone users in India expected to reach 650 million by 2019

- **Conducive Government policies**
  'Make in India' and 'Digital India' initiatives to increase innovation and manufacturing
Changing Consumption Patterns

As India's middle class grows, households are increasing discretionary spending

### India’s middle class population to be comparable with the total population of the U.S. (2014)

<table>
<thead>
<tr>
<th>Country</th>
<th>Population (M)</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>1,366</td>
</tr>
<tr>
<td>EU</td>
<td>503</td>
</tr>
<tr>
<td>US</td>
<td>318</td>
</tr>
<tr>
<td>Brazil</td>
<td>203</td>
</tr>
<tr>
<td>Russia</td>
<td>146</td>
</tr>
<tr>
<td>Japan</td>
<td>127</td>
</tr>
<tr>
<td>UK</td>
<td>64</td>
</tr>
</tbody>
</table>

India’s middle class is expected to increase to ~547M by 2025

### Indian household consumption pattern (% of total expenditure, 2007–2025)

<table>
<thead>
<tr>
<th>Category</th>
<th>2007</th>
<th>2015</th>
<th>2025</th>
</tr>
</thead>
<tbody>
<tr>
<td>Food, Beverages and Tobacco</td>
<td>40%</td>
<td>34%</td>
<td>25%</td>
</tr>
<tr>
<td>Housing and Utilities</td>
<td>12%</td>
<td>12%</td>
<td>10%</td>
</tr>
<tr>
<td>Transport</td>
<td>19%</td>
<td>19%</td>
<td>13%</td>
</tr>
<tr>
<td>Healthcare</td>
<td>5%</td>
<td>6%</td>
<td>9%</td>
</tr>
<tr>
<td>Apparel</td>
<td>10%</td>
<td>11%</td>
<td>14%</td>
</tr>
<tr>
<td>Personal Products &amp; Services</td>
<td>6%</td>
<td>9%</td>
<td>5%</td>
</tr>
<tr>
<td>Education &amp; Entertainment</td>
<td>4%</td>
<td>5%</td>
<td>5%</td>
</tr>
<tr>
<td>Apparrel</td>
<td>5%</td>
<td>5%</td>
<td>5%</td>
</tr>
<tr>
<td>Furnishing</td>
<td>5%</td>
<td>5%</td>
<td>5%</td>
</tr>
</tbody>
</table>

**Note:**
1. A family with an annual income between INR 3,40,000 to INR 17,00,000, estimated population of 267 Mn by 2015-16

Sources: Economic Survey Report 2004–05, UN; CIA WorldFactBook; Eurostat; NCAER; IEMS; Deloitte Analysis

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The profile of a typical urban middle class consumer is evolving due to increasing urbanization, changing lifestyles and the entry of international brands into the market.

### Is health conscious
- Goes for regular health check-ups and engages in activities including attending the gym, yoga and other exercise classes

### Focuses on work-life balance
- Goes for a week long vacation once or twice a year to a premium Indian destination or budget foreign location
- Typically eats out with family or friends twice a month

### Is conscious of social status
- Is aware of latest global trends, awaits new product launches and buys premium to affordable luxury brands

### Is technology savvy
- Owns a smartphone and tablet, with high-speed broadband connectivity

### Has multiple source of income
- Has an annual household income of more than USD 35,000 with both partners working

### High discretionary spend
- Consumers spend 20% on loan EMIs, 15% on food, 10% on healthcare and education and rest on other discretionary spending

### Is highly educated
- Holds a degree from top Indian institute or foreign institute

### Has respectable corporate/professional stature
- Holds a mid-to-senior level management position in a corporate organization or is a small-to-medium enterprise owner

### Maintains a good standard of living
- Lives in sub-urban residential areas, has all household amenities and owns a mid-value car (USD 12-15,000)
Overview of the Indian retail market

Modern retail has emerged as one of the fastest growing sectors in India. Many categories, including automobile accessories and spares are still sold through unorganized retail in India.

India Retail: ~US$ 1,200 billion Market by 2021
All figures in US$ billions

Modern Retail (~US$ 85 billion), by segment

Home and interior forms 5% of the modern retail. Automobile aftermarket products are not sold through modern retail in India.
The opening up of retail sector for foreign investments in 2012, led to a steady growth in FDIs, with various foreign retailers investing in India.

FDI inflow in trade has consistently increased as a share of overall investments inflow.

The government opened up retail trade for FDIs in 2006, by allowing 51% FDI in single brand retail trade. Thereafter, consistent efforts and liberal measures have led to further expansion in the FDI policies for retail:

- **51% FDI in multi-brand retail**
- **100% FDI in single brand retail format**, for cash and carry (wholesale) trading and exports
- **100% FDI in multi-brand processed food retail** for marketing of food products produced and manufactured in India
- **100% FDI permitted in 'marketplace model'** for e-commerce through automatic route; but **no FDI for inventory led models**

Further, it abolished the Foreign Investment Promotion Board (FIPB) in 2017 to make the FDI clearance process more convenient and efficient.

Government is further exploring the possibilities of relaxing FDI regulations in multi-brand retail specifically related to food and grocery.

Major international retailers to enter India recently:

- Apple
- Texas Chicken
- Pasta Mania
- Yogurt Lab
- Lush Addiction
- Speaking Roses
- Wallstreet English
- Korres

Other brands eyeing entry into India include:

- Massimo Dutti
- Zara
- Uniqlo
- Adidas
- H&M
- Gap
- Burger King
- IKEA
Drivers for success of international retailers in India

International retailers have a less challenging environment to tackle as compared to earlier entrants

**Increasing Awareness and Technology**
Increasing awareness and technology has led to awareness about the fashion brands and market trends thus decreasing the effort required for brand push. Technology also provides an economical route for smaller cities.

**Desire for Global Products**
Indian consumers seek similar merchandise as in the other global markets thus limiting the need for customization as was required for earlier entrants in the market.

**Falling Real Estate Prices**
Mall owners are increasingly looking to improve occupancy rates and customer footfalls through addition of marque brands and are increasingly look at arrangements like revenue share.

**Better Control over Business**
Easing FDI has resulted in reduced dependence on local partners resulting in longer term view of the market and control on customer experience.
Key operational challenges in Indian retail

International Retailers operating in and/ or planning to enter India need to navigate through multiple challenges to succeed in the market

<table>
<thead>
<tr>
<th>Challenge</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Real Estate constraints</strong></td>
<td>Limited availability of good malls and high street locations, resulting in competition amongst retailers for good real estate</td>
</tr>
<tr>
<td><strong>Competitive environment</strong></td>
<td>Competition from Indian and other international brands and online retail which are also expanding rapidly in the Indian market</td>
</tr>
<tr>
<td><strong>Complex regulatory environment</strong></td>
<td>Retailers have to deal with a complex regulatory environment in India, including multiplicity of regulatory authorities (Central/ State/Municipal), policies and compliance requirements. E.g. • Mandatory clearances/ licenses issued by regulatory authorities • Local sourcing requirements • Store and employment related regulations which vary by states in India</td>
</tr>
<tr>
<td><strong>Attracting skilled manpower</strong></td>
<td>Attracting skilled manpower is a major challenge for existing players as well as for new entrants in the market owing to high attrition level at store staff level and low productivity of sales force (compared to developed markets)</td>
</tr>
<tr>
<td><strong>Challenging logistics infrastructure</strong></td>
<td>Overcrowded and sub-standard roads, train tracks and ports make bringing products to market a challenge; Requires significant effort in last mile delivery in order to overcome these challenges</td>
</tr>
<tr>
<td><strong>Taxation</strong></td>
<td>Current taxation regime and import rules are complex. India has recently implemented a major tax reform in the form of GST, which is expected to iron out some complexities</td>
</tr>
</tbody>
</table>
## Regulatory Changes in Retail Policy

Govt. is progressively liberalizing the FDI policy to encourage foreign retailers to enter the Indian market.

<table>
<thead>
<tr>
<th>Year</th>
<th>Key Events</th>
</tr>
</thead>
<tbody>
<tr>
<td>1997</td>
<td>• FDI in Cash and Carry permitted with Government approval</td>
</tr>
</tbody>
</table>
| 2006 | • 51% FDI in Single Brand Retail permitted with Government approval  
      • 100% FDI in ‘Cash and Carry wholesale trading’ permitted under automatic route |
| 2010 | • Condition introduced that companies engaged in ‘Cash and Carry/ wholesale trading’ should not supply in excess of 25% of its turnover to group companies |
| 2011 | • 100% FDI allowed in Single Brand Retailing with stringent conditions on sourcing |
| 2012 | • Relaxed conditions on Single Brand Retailing  
      • 51% FDI allowed in Multi Brand Retailing |
| 2016 | • Relaxed e-commerce conditions in Single Brand Retailing  
      • Relaxed franchising and sub-licensing conditions in Single Brand Retailing |
| 2018 | • FDI in Single Brand Retailing allowed through automatic route  
      • Relaxation of sourcing conditions in Single Brand Retailing |
India Tax Considerations
Global and India Tax Perspective

• Typical characteristics of an jurisdiction analysis
  - Regional Headquarters
  - Ease in financing
  - Conducive framework of corporate and other laws
  - Tax benefits
  - Good tax treaty network
  - Flexibility in restructuring

• Tax implications
  - Withholding tax on dividends
  - Dividend distribution tax regime in India
  - Capital gains tax on disposal
  - Capital gains tax on structuring
  - Withholding tax on interest

Holding jurisdiction is not driven only by tax - many other factors relevant

Need to analyze proposed changes in tax treaties under BEPS (especially, PPT and LOB) and Indian GAAR
India Tax Considerations
Few common jurisdictions used

• Typical jurisdictions
  - Mauritius (GBL License 1 company)
  - Singapore
  - Netherlands
  - France
  - Luxembourg
  - Cyprus

• Need to consider – Tax regime of IHC; taxability of IHC in India in terms of tax treaty; and taxability of ultimate parent in IHC

India tax treaty with Mauritius and Singapore recently amended. No capital gains exemption for shares acquired after 1 April 2017.

Capital gains exemption still available under tax treaties with Netherlands and France subject to certain conditions.
India Tax Considerations

GST/Customs

Goods and Services Tax (‘GST’), introduced with effect from July 2017, subsumed all the indirect taxes of the erstwhile regime, except customs duty.

We are enumerating few discussion points / issues relevant to the wholesale and retail sectors in India:

1. Introduction of GST has resulted in an increase in recoverable customs duties.

2. There has been reduction of tax rates for several commodities vis-à-vis the tax rates prevailing in the previous regime. In order to monitor passing on the benefit of GST, anti-profiteering measures have been introduced.

3. Government has introduced the concept of e-way bills, generation of which is required for every movement of goods within as well outside the State, where the value of the consignment is more than INR 50,000/-.

4. In the erstwhile regime, warehouses, for the purpose of stocking of goods, were typically set up in different States, due to varied rates of tax in States, thereby adding to the cost of doing business. Under GST, a centralized warehouse can be set up in India for facilitating storage of goods, aimed at achieving an efficient and optimized supply chain model and also reduce effective cost.

5. An exercise requiring assessing the classification of the commodities / services dealt with is imperative. The HSN code to be used under GST is akin to the classification used in Customs and Excise tariffs. However, what needs to be noted is the description to be used under GST could vary vis-à-vis customs/ excise tariff.

6. Discounting policies/credit notes/debit notes/incentive schemes and agreements for procurement and supply to be analyzed, in view of continuing changes.

7. Union Budget 2018 introduced a new levy termed as ‘Social Welfare Surcharge’ @ 10% on all imports apart from few exempted items and few with concessional rate of 3%. This is levied on the Basic Customs Duty (‘BCD’) component.

8. Advance Ruling Authority mechanism made more effective.
Deloitte’s point of view on the Indian Retail Market

E-Commerce market
Indian E-Commerce Market Overview (1/2)

Indian e-commerce* market is expected to grow fastest in Asia as well as globally, at a CAGR of ~31% over 2016-21 period

E-commerce market in Asia (2016)

- Government initiatives gaining momentum: Government recently launched four major initiatives – Digital India, Skill India, Startup India and India Innovation Fund, to enable the growth of e-commerce

- Competition leading to consolidation: Increasingly surmounting losses and intense rivalry and competition amongst e-tailers is leading the investors towards consolidating businesses and acquiring smaller players to complement or expand capabilities

- Growth in smartphone adoption driving mobile based e-Commerce: India has the highest share of mobile based e-Commerce sales globally - 41%, due to affordability of smartphones and customer adoption

- Evolution of new payment solutions: Launch of electronic wallets and digital payment products to ease the payment process in e-Commerce; launch of UPI to further benefit e-Commerce

- Innovation in Logistics: Rise in third-party logistic providers and hyper local delivery players to manage last mile deliveries; India Post supporting e-commerce by leveraging its extensive reach

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Note*: E-commerce market here refers to sale of products and services through electronic transactions, Home Shopping is part of ecommerce

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Indian E-Commerce Market Overview (2/2)

While e-commerce is expected to grow at a rapid pace reaching USD 200 billion by 2026, currently it constitutes only 3% of the Indian retail market.

**Indian e-commerce market**
- by value (USD billion)

<table>
<thead>
<tr>
<th>Year</th>
<th>E-commerce</th>
<th>Total retail</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011</td>
<td>2.4</td>
<td>21.5</td>
</tr>
<tr>
<td>2012</td>
<td>84</td>
<td>2026f</td>
</tr>
</tbody>
</table>

**Increasing share of e-commerce in Indian retail market**

- **2016**: USD 21.5 billion
- **2021f**: USD 84 billion

**Key growth drivers**

- **Growing internet penetration**: Internet users in India are expected to increase from 432 million in 2016 to 647 million by 2021, taking the internet penetration from 30% in 2016 to 59% in 2021. Approximately 75% of the new internet users are expected to come from rural regions.
- **Rising number of online shoppers**: Number of online shoppers would increase from current 15% of online user-base (60 million) to 50% of online user-base by 2026.
- **Increasing usage of smartphones**: Smartphone users in India are expected to increase from 260 million in 2016 to around 450 million by 2021 which is also expected to drive the m-commerce sales from USD 10.5 billion in 2016 to USD 38 billion in 2020.

**Other factors include:**

- Favorable demographics—youngest population
- Focus on digital infrastructure

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**Note**: E-commerce market here refers to sale of products and services through electronic transactions, Home Shopping is part of ecommerce.
**Key challenges in the E-Commerce market**

Profitability and digital & transport infrastructure are the major challenges marring the growth of e-commerce in India

<table>
<thead>
<tr>
<th>Challenge</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Scaling operations and profitability</strong></td>
<td>E-commerce companies have raised noteworthy capital from investors for scaling operations. However, from profitability perspective, the losses have grown faster than the sales leading to an absence of long-term sustainable business models</td>
</tr>
<tr>
<td><strong>Internet security and counterfeit products</strong></td>
<td>Increased incidents of cyber and payments thefts pose a major threat to growth of e-commerce market. Further, supply if fake, counterfeit goods by the merchants is rising</td>
</tr>
<tr>
<td><strong>Lack of robust technology integration</strong></td>
<td>Lack of awareness in technology frameworks and inefficient technology and process integration leads to major losses and resource wastage</td>
</tr>
<tr>
<td><strong>Last mile delivery and reverse logistics</strong></td>
<td>Currently, the transportation infrastructure in India, especially for last mile delivery is highly inefficient. Further, reverse logistics owing to return of products results in high inventory and increased costs</td>
</tr>
<tr>
<td><strong>Regulatory hurdles</strong></td>
<td>Various e-commerce players, especially B2C aggregators, have faced business suspension owing to lack of clarity in regulatory framework. Further, tax collection at source remains to be a continuous challenge</td>
</tr>
<tr>
<td><strong>Unorganized and fragmented B2B market</strong></td>
<td>Nearly 95% of the B2B market is unorganized and dominated by local vendors, unaware or incapable of providing their services on online platforms</td>
</tr>
<tr>
<td><strong>Cash-on-delivery as favored mode of payment</strong></td>
<td>Preferring CoD payment mode leads to greater number of returns, which burden the operational costs of merchants and e-commerce players</td>
</tr>
</tbody>
</table>
Payments system in the E-commerce market

Indian economy is largely driven by cash transactions that account for almost 4/5th of all payments. The digital intervention and government’s efforts to promote cashless economy have given rise to the growth of other alternate payment methods.

While other emerging payment platforms are also scaling, m-wallets are still expected to stay in high growth zone for e-commerce purchases. However, innovation and collaboration are likely to remain key determinants of growth.
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