



Deloitte.

Consumer Business

China & India.

Comparing the world's
hottest consumer markets

Contents

First, the basic facts	2
Two economic paths ready to converge.....	4
Two paths toward retail modernization.....	5
Rules of doing business	7
Risks of doing business.....	8
Retailing 2015 in China and India	11

China & India: Comparing the world's hottest consumer markets

The integration of more than one billion Chinese and Indian workers into the global economy in the past quarter century was one of the most important economic events ever. Indeed, it can be argued that their addition to the global economy has, in part, been responsible for the spectacular rise in productivity growth in the West. Yet of even greater importance for the future are the rising incomes of Chinese and Indian consumers. The addition of more than two billion consumers to the global economy will contribute to global economic growth, and certainly to the growth of global food retailers and their suppliers.

The world's leading retailers have beaten a path to China and have spectacular plans for the future. Although in India the process started later and with more formidable obstacles, the world's leading retailers are now working hard to penetrate that market as well. Moreover, India's cash-rich conglomerates are attempting to pre-empt the global giants by starting their own massive modern chains. All are eager to pick the low-hanging fruit of high growth and minimal competition.

What happens next? In this report Deloitte offers a point of view on the evolution and future direction of the consumer markets in China and India. In addition, it will offer:

- Six rules for doing retail business in China and India
- Six risks of doing business in each market
- A view of the retail industry in 2015 in India and China

First, the basic facts

China

China had retail sales of \$785 billion in 2006 when measured using current exchange rates. This was up a staggering 13.7% over the previous year. The Chinese government's five-year plan anticipates retail sales growth of 11% per year until 2010 – and this figure is probably too conservative.

Although China remains fragmented compared to more developed markets, its retail industry is fast becoming more concentrated. In 2006, the top 100 retail enterprises in China had sales of roughly \$108 billion. Of this, the top 30 accounted for 75% while the top 10 retailers accounted for 48% of the top 100 sales.

The regulatory environment for retailers in China changed dramatically in 2004 when the government implemented new rules consistent with its obligations to the World Trade Organization (WTO). Of particular importance is that, according to these rules, foreign retailers may own a majority stake in local joint ventures, may operate in any part of the country they choose, and may purchase goods from local operations of foreign manufacturers. In addition, the new rules enabled retailers to enter China without a massive investment. This was critical for smaller specialty chains – especially those based in neighboring Asian countries.

Many foreign retailers are now active in China, and most have very aggressive expansion plans. The world's two biggest retailers, Wal-Mart and Carrefour, having been active in China for a decade, are now on an aggressive expansion path. This reflects a desire to take advantage of deregulation and rapid growth. It may also reflect their desire to get a large foot in the door before the Chinese government changes its attitude toward foreign capital. Indeed, despite deregulation, obstacles to entry continue

Income and Poverty	India	China
	2005	2005
GDP per capita, PPP* (current international \$)	3,452	6,757
GDP, PPP (current international \$) (millions)	3,779,044	8,814,860
Poverty headcount ratio at \$1 a day (PPP) (% of population)	34.3	9.9
Poverty headcount ratio at \$2 a day (PPP) (% of population)	80.4	34.9

Source: World Bank

* The current market exchange rate, which is subject to volatility, does not always reflect the true purchasing power of a country's currency. Therefore, economists use the Purchasing Power Parity (PPP) rate in order to convert GDP and per capita GDP from the local currency to US dollars. This rate reasonably reflects the true purchasing power of the local currency and, therefore, enables a meaningful comparison between countries.

to exist. Local governments can often cause massive headaches for foreign retailers through arbitrary enforcement of rules, as well as through corruption.

India

India had retail sales of \$395 billion in 2006 when measured using current exchange rates. Of this, it has been estimated that only 3% is represented by modern retailing (the figure for big cities is estimated at between 10% and 20%). Clearly India's 1.1 billion people do not yet possess the spending power of China's 1.3 billion. Moreover, most retail spending involves groceries. Of the \$395 billion in retail sales in 2006, \$264 billion was spent at grocery retailers.

As of 2003, depending on whose estimate is used, India had between 5 and 12 million retail enterprises. About 78% of these are family-owned independents utilizing family workers. Most others are small enterprises that employ no more than three workers. The number of true chain retailers is extremely small. About 96% of stores have less than 500 square feet. The largest Indian retailer, The Future Group (formerly Pantaloon), had sales in 2006 of \$1.2 billion.

Already, accelerated growth of modern retailing has taken place this decade. For example, in the 1990s roughly one million square feet of modern retail space was added in India. Starting in 2001, this pace increased dramatically. In 2003 alone, roughly 10 million square feet were added. Most analysts now expect modern retailing to achieve between 6% and 10% of retail sales by 2010.

Although the rules governing foreign direct investment in India have been substantially liberalized in recent years, the retail sector remains closed to majority foreign direct investment with the exception of those foreign retailers present in India before

new restrictions imposed in 1997. Foreigners may enter Indian retailing only through franchising or wholesaling. Germany's Metro, for example, has been able to gain entry because it is considered a wholesaler. However, single brand retail trade was thrown open to foreign investment in January 2006 with an investment cap of 51%. Thus, vertically integrated specialty chains can now directly invest in the Indian market.

The current government has been eager to relax the rules but faces serious opposition from its Communist party governing partner. Moreover, small shopkeepers are an effective lobby against liberalization. Their cause is supported by the otherwise reform-minded opposition BJP party. The government argues that liberalization will lead to greater employment, lower prices, and improved productivity in the distribution sector. In addition, the government hopes that foreign investment in retailing will have a positive impact on productivity and income in the agricultural sector. Foreign retailers have argued that modern food stores will bring cold storage facilities and better distribution of perishable products.

Despite the restrictions, some foreign retailers are starting to trickle into India. Wal-Mart plans to operate in India through a joint venture with conglomerate Bharti that will operate the supply chain. Stores, to be owned by Bharti, will be operated by Wal-Mart under a franchise agreement. Political opposition to this venture is intense, however. Other large global retailers are known to be seeking similar arrangements to enter India.

A number of other restrictive regulations affecting the efficiency of the retail sector include laws limiting the movement of goods between states, tax laws placing onerous costs on retailers, and laws that restrict opening hours/days. In addition, restrictive labor regulations make it difficult to dismiss employees.

Two economic paths ready to converge

China has the fastest growing large economy in the world and India has the second fastest. Together they accounted for a disproportionate share of global GDP growth in the past few years. Today they are both experiencing double-digit growth. The result is that tens of millions of people in both countries are moving from poverty to middle class affluence. Yet that is where the similarities end. These two giants have followed decidedly different paths to success. The result is that they maintain a very different footprint in the global economy. Yet these differing paths are about to converge, as each country moves in the direction of the other.

China

China started to grow rapidly in the early 1980s following market opening reforms in the agricultural sector. In time, foreign investment in low wage manufacturing was permitted and encouraged in order to develop strong export growth. Investors from Hong Kong, Taiwan, and South Korea moved sizable parts of their manufacturing production capacity to China. The result is that China has become something akin to the world's factory, churning out more manufacturing value added than any country other than Germany, Japan, and the US. Its exports are now the third highest in the world.

China also grew rapidly due to high internal savings that have been invested in infrastructure and manufacturing capacity. Today, investment accounts for roughly 44% of GDP. This is far higher than the norm in most countries and, uniquely, is higher than China's level of consumer spending (41% of GDP). Indeed while investment has contributed to growth, much of it has

been wasted on building up the productive capacity of inefficient state-owned enterprises. Given the level of investment, China should probably have grown even faster than it did. One result of excessive and inefficient investment is that China is plagued by an enormous quantity of bad debt held by its banks. The degree to which China can manage the unraveling of this problem will determine the stability of its future economic path.

Perhaps the most controversial issue concerning China's economy today is the exchange rate of its currency. To keep its exports competitive, China has purchased the dollars entering China in order to prevent the renminbi from rising in value. The result is that China's government now holds a vast quantity of foreign currency reserves (over one trillion dollars). In order to acquire this booty, China has had to boost its own money supply, thereby creating a risk of consumer price inflation or asset price bubbles. In any event, this situation is probably unsustainable – which brings us to the future.

China will follow a different path going forward. It will probably revalue its currency further, thereby increasing the purchasing power of its consumers. Growth will shift away from exports and investment and toward consumer spending. As China continues to grow, and as its wages rise, it will shift away from low value added manufacturing toward higher valued added production, as well as toward services. This is already happening in China's big coastal cities. Finally, to resolve the bad debts of its banks, China will accelerate the process of privatizing state-owned enterprises. This will cool investment, boost consumer spending, and render the remaining investment more productive.

Macroeconomics		
	India	China
	2005	2005
Foreign direct investment, net inflows (BoP, current US\$) (millions)	6,598	79,127
GDP (current US\$) (millions)	805,714	2,234,297
GDP growth (annual %)	9.2	10.2
Exports of goods and services (% of GDP)	20.5	37.5
Trade (% of GDP)	44.7	69.3
Inflation, GDP deflator (annual %)	4.4	3.9
Gross capital formation (current US\$) (millions)	268,719	970,916
Total debt service (% of exports of goods, services and income)	19	3

Source: World Bank

This process does entail risk for China. Privatization means shutting inefficient factories and dismissing workers, thereby creating social unrest. Indeed, this is already happening on a large scale – although it is not well publicized outside of China. Currency revaluation means that many coastal factories will become uncompetitive. Again, this means dismissal of workers. It could also mean shifting capacity toward China's interior or to other countries – such as India. Finally, China's shift toward affluence has meant deepening of financial markets. This has included a big increase in consumer credit and a big increase in household ownership of shares. In both cases, historical experience suggests that excesses will emerge leading to sizable personal losses for millions. Such an eventuality could give rise to anti-reform sentiment.

India

India has followed a different path and shows a growth model unique among emerging markets. While most emerging markets grow by exporting goods, India has grown in large part by exporting services. While most emerging markets witness a migration of farm workers to the cities to populate factories, India's large population of educated English speakers has been absorbed into a modern, information technology service exporting sector. Finally, while most emerging markets grow rapidly through a high level of investment relative to GDP, India's investment has been rather modest. Instead, it has maintained a fairly high level of consumer spending relative to GDP.

Interestingly, India's high growth is fairly recent. The substantial economic reforms it undertook in the early 1990s did not immediately result in substantially higher growth. Instead, very rapid growth only came in this decade, mostly in the last few years. This raises the question as to whether India's rapid growth represents a structural change in the country's economy, or whether it is merely a temporary spell of good luck. The answer is that it may be too early to say.

The revolution in IT-related service exports, while important in propelling India's economy, cannot fully account for the strong growth as this sector remains relatively small. Moreover, India may lack sufficient educational resources to push this sector to become much larger. Consequently, India's future success may depend on its ability to shift toward strength in manufacturing. The good news is that India already possesses much manufacturing strength. Yet sizable obstacles remain. These include poor infrastructure, insufficient investment in new infrastructure, and regulations that create rigidities in the labor market. Thus, much needs to be done.

A best guess is that India's reform process will progress with strong, but not breakneck growth. As India opens further to the outside world, this should stimulate further growth in consumer spending and further liberalization of the consumer market. On the other hand, unlike in China consumer spending in India is already a relatively high share of GDP (India's consumer is 61% of GDP compared to 41% in China). Therefore, it is unlikely that, as in China, consumer spending will grow faster than the overall economy. In fact, it could actually grow more slowly.

Two paths toward retail modernization

Both China and India are experiencing massive investment in their retail sectors. But due to their differing degrees of economic development, as well as substantial differences in government policies, they are at very different points in retail development.

China

China started to allow large-scale foreign investment in its retail sector in the 1990s. First to come were Europe's large supermarket chains, as well as Wal-Mart from the US. At that time, relatively few Chinese consumers had sufficient incomes to support more than basic shopping. Hence, food and general merchandise retailing worked well. Specialty and upscale department stores performed poorly. In this decade, however, things changed. The number of middle class and affluent consumers skyrocketed, especially in the big coastal cities. Foreign specialty retailers undertook substantial investment in China, largely in the apparel and home improvement categories – the latter driven by the privatization of China's housing stock. Upscale stores started to attract shoppers, not just observers.

At the same time, many of China's state-owned retailers were partially privatized. China's government encouraged the merger of some retailers in order to create critical mass. In addition, some significant retailers developed through entrepreneurial effort. Perhaps the most notable is Gome, the electronics retail chain which has generated headlines all over the business world.

Today, China's retail sector is at a crossroads for several reasons. First, the government is keen to accelerate the growth of consumer spending as part of a larger effort to restructure the economy. Several policy initiatives in the near future will contribute to this effort. These include further revaluation of the currency (which will lower import prices), deregulation of banking and accelerated development of a market for consumer credit, and efforts to develop a social safety net. The latter is critical as it could have the effect of lowering China's unusually high rate of personal savings.

Urban Development		
	India	China
	2005	2005
Improved sanitation facilities, urban (% of urban population with access)	59	69
Improved water source, urban (% of urban population with access)	95	93
Population in urban agglomerations > 1 million (% of total population)	12	18
Urban population	314,145,321	527,018,000
Urban population (% of total)	29	40

Source: World Bank

Second, China's government is likely to accelerate the process of privatizing state-owned enterprises. This will surely include state-run department stores, the dominant retail format in many parts of China. As this process unfolds, it will result in a redeployment of assets. Some stores will be closed, some sold or licensed to foreigners, and some will become shopping centers that lease space to modern retail specialty chains. Moreover, some of these privatized organizations will invest in developing modern formats as has already transpired in the big coastal cities.

Third, a significant amount of retail space is being added in China through the development of large malls. China already is home to the world's largest mall (although that will soon be eclipsed by a mall in Dubai). It is also home to countless construction sites where large multi-use malls are under development on the outskirts of big cities. The amount of space added thus far may be too much for the market to bear, and many malls at this time are not fully occupied. Still, given the expected large increase in retail spending and the continuing surge in the number of middle class households, it is not unreasonable to expect that these malls will become fully active.

Finally, China's system of consumer credit is evolving. Mortgage debt has ballooned, but other forms of consumer credit are not well developed. This reflects a banking system biased toward industrial lending and a consumer biased against assuming debt. This could change in the near future, with more consumers willing to take on debt provided it is offset by rising wealth associated with homes. Such debt could finance large-scale purchases and thereby stimulate discretionary spending.

India

Unlike China, India is merely at the beginning of a process that could radically alter its retail landscape. Foreign investment remains minimal as does chain retailing in general. More important than the ambitions of foreign retailers are the plans of some of

India's giant conglomerates. Often flush with cash, these family controlled behemoths are eager to take advantage of the expected boom in consumer spending in the coming years. The rise of middle class consumers and the expansion of consumer credit are making the market attractive. Hence Reliance, India's largest industrial enterprise with extensive interests in the energy sector, plans to open stores in 1,500 Indian cities and reach annual sales of \$20 billion by 2010 – after starting from scratch just this decade.

In addition, India's retail chains, modest in size by global standards, are now planning to expand rapidly. For example, The Future Group, India's largest retailer, intends to increase its square footage six-fold by 2011. Tata, another giant Indian conglomerate with interests in retailing, also plans to roll out many stores in the next few years. Optimism about retailing abounds in India.

Where will growth take place? As in China, shopping centers will play a significant role. Indeed there are over 200 retail shopping centers under construction in India. Roughly 75 of these are in the New Delhi area. By 2010 there are expected to be 600 malls in India. These malls will offer venues for the rising number of chain stores. Such retailers are popping up in response to the increasing demands of middle class shoppers. Moreover, they offer an important venue for the distribution of increasingly popular branded products. The first major mall in India was the Crossroads Mall in Mumbai that opened in 1999. It offered 150,000 square feet of shopping space – small by recent standards, but revolutionary at the time. By 2005, there were 27 million square feet of mall space in India. Roughly 10.6 million of that is in the Delhi area. Other big mall centers include Mumbai, Bangalore, Hyderabad, Calcutta, and Chennai.

Among the malls under construction are some very big ones (as much as 1.3 million square feet). On the other hand, there are a number of regulatory obstacles to further mall development. These include high taxes on the transfer of property, zoning restrictions,

and rent controls. Furthermore, restrictions on foreign investment by retailers (as opposed to mall developers) will inhibit the ability of malls to attract world class retail organizations. Still, foreign direct investment in real estate is completely unrestricted. Consequently, foreign mall developers could soon become active in India.

It is likely that further modernization will entail growth of specialty concepts and department stores located in malls and supermarkets and hypermarkets either appended to malls or in stand-alone locations.

Finally, India's consumer sector benefits from a sizable market for consumer credit. In India, non-mortgage consumer debt is roughly 5% of GDP compared to 2% in China. India's private financial sector is better developed than in China and is more geared toward the needs of consumers than China's industry-oriented banking system.

Rules of doing business

Since it is likely that most of the world's leading retailers and suppliers will look carefully at China and India in the coming years – if they're not already active in those markets – we offer six rules of doing retail business in those countries.

China

Pick low-hanging fruit in second-tier cities

The largest coastal cities in China have been inundated with modern retailing from afar. Now big foreign retailers are turning their attention to the second-tier cities where there remains little sophisticated competition. In many of these cities, consumers must choose between state-owned department stores and street markets. The arrival of foreign hypermarkets and convenience stores offer consumers an exciting alternative. For the foreign retailers, this is low-hanging fruit.

Look for opportunity in China's interior

Another form of low-hanging fruit comes from the interior of China. The coastal cities have received most of the attention because that is where most of the economic growth has taken place. Indeed, incomes in the coastal regions are far higher than in the Chinese interior. On the other hand, the retail industry is relatively under-developed in the interior and remains dominated by highly inefficient state-run stores. In addition, there has been massive investment in infrastructure, thereby rendering the interior more accessible for purposes of modern distribution. Thus, an opportunity exists to pick low-hanging fruit by locating in the interior. Big foreign retailers are already doing so aggressively.

Tap into affluence in big coastal cities

A famous American bank robber was once asked why he robbed banks. "Because that's where all the money is," he replied. In China, most of the money is in the big coastal cities. So, although there are opportunities to develop new markets outside the big coastal cities, opportunities to tap into affluence remain on the coast. Although these cities are nearing saturation when it comes to big food retailing, they remain attractive places to locate nonfood and/or upscale stores. The rising middle class now has discretionary income to spend on things other than food and household products. They are spending on personal and home fashion, electronics, books and music, home improvement products, and furniture. As for the latter two categories, these have been driven by the privatization of the housing stock and the rapid increase in property values.

Remember that price is not the issue

Chinese consumers care about price, but not as much as you'd expect in a country that remains relatively poor. Chinese consumers can easily find low prices at street markets due to the low overhead and the low income of street merchants. Major food retailers simply cannot compete with street markets when it comes to price. Instead, they focus on other attributes in order to attract consumers. Moreover Chinese consumers, although price sensitive, appear to be willing to pay a premium for quality or for a recognized brand. Thus the key to success in China is not simply minimizing cost. Success requires a reputation for quality and a positive shopping experience. The latter can entail range of merchandise, ease of shopping, good hygiene, and even something simple like reliable air-conditioning. When it comes to food retailing, the best formula for success is to replicate the ambience and excitement of a street market combined with safety, cleanliness, reliability, breadth of products, and air-conditioning.

Leverage the power of brands

Chinese consumers are brand shoppers. There is a history to this. When the economy opened in the 1980s, Chinese consumers were eager to purchase foreign brands which were deemed better quality than those products made in China's state-owned factories. When those factories improved their quality in the 1990s, China's patriotic consumers became smitten by local brands. Today, as many Chinese become affluent (or at least aspire to affluence), many are eager to purchase brands that suggest affluence, regardless of country of origin. When it comes to fashion, however, European brands still rule. The important point, however, is that Chinese will pay a premium for a reputable brand. For example, premium brands for home fixtures are quite popular in large home improvement stores even though lesser priced brands are available in neighborhood wholesale outlets.

Act regionally, not nationally

China is not a single economic entity. This may change in the future, but today China is an amalgamation of local and regional economies. Indeed prior to the era of economic reform (begun in 1978), each major city had its own factories for consumer products producing local brands. Thus historically China did not even have national consumer brands. That is changing, but only because of the influence of foreign companies. In addition, China's transportation infrastructure has only begun to offer opportunities for national distribution. Finally, even when the infrastructure is complete, China will still have vast differences in language and consumer culture. For retailers, this means developing different plans for different regions. It probably means creating regional clusters rather than rolling out stores nationally.

India

Find a partner

Clearly, global retailers cannot enter India directly given the regulatory environment. Yet even if that environment changes (and it might), it would probably be wise to undertake investment in India with a partner. Local conglomerates possess local knowledge and local connections. Past experience elsewhere suggests that deep pockets and superior systems are not sufficient to crack a foreign market alone. Local know-how is usually critical. This is probably especially true of India.

Focus on food

India's poor cannot afford to buy much more than food. Indeed two thirds of retail sales take place at grocery retailers. And while there is a sizable and growing middle class, the opportunity to develop retailing on a very large scale (whether large stores or large numbers of stores) exists mainly in the domain of food and household products.

Focus on the nonfood needs of the middle class

On the other hand, there exists a huge opportunity to service the needs of those with money. Indeed the rising middle class in India is not spending incremental money on food and household products. Instead, it is spending money on electronics, apparel, furniture, and home products. Yet retail distribution of these products is highly fragmented and inefficient. An opportunity exists to offer a better shopping experience for the rising middle class.

Focus on the young

India has good demographics for retailing. Nearly 60% of the population is under the age of 30 (compared to a little more than 40% in China). In the next few years, the number of young adult

households will rise rapidly, thereby stimulating retail spending. Young households tend to spend more on goods rather than services, tend not to save much, and tend to spend heavily on apparel and products for the home. The degree to which the financial system supports the growth of consumer credit will determine the scope for big ticket spending by young households.

Leapfrog the competition

If a foreign retailer wants to make a splash in India, simply competing on the same terms as locals will not suffice. A foreigner can succeed by offering a difference. Foreign retailers have deep pockets, but so do domestic conglomerates keen to create large retail chains. What foreigners offer, however, is experience in managing highly efficient systems of distribution and positive shopping experiences for consumers. Efficient distribution will lead to competitive prices, as well as better in-stock inventory positions. Focusing on in-store experience will enable consumers to enjoy a higher level of service.

Invest for the long-term

In terms of retailing, India is today where China was nearly two decades ago. That means plenty of low-hanging fruit. Yet it also means plenty of time on the learning curve and an inadequately sized market for discretionary spending. Therefore, investment today will, in part, be geared toward getting a foot in the door in anticipation of a much bigger market in the future. If China is today's big thing, then India is tomorrow's.

Risks of doing business

In general, there are far fewer risks of doing business in emerging markets than used to be the case. We have had nearly a decade without a financial crisis in an emerging market that spread to other emerging markets. This is not simply an historical accident. Since the last major crisis in 1997-98, emerging market countries have done a number of things to improve their economic management and, therefore, reduce the risk of crisis.

In the past, many emerging economies maintained overvalued currencies in order to squelch inflationary pressures and to make imported capital and consumer goods cheap. They usually ran current account deficits and, in the process, accumulated large external debts. The resulting paucity of foreign currency reserves meant that, when external debts became excessive, countries lacked the resources to support their currencies and were forced to devalue and, in some cases, default on foreign debts. This usually pushed countries into crises as overseas investors lost money and confidence. Draconian policy measures were required in order to stem a rapid outflow of capital. Interest rates rose,

incomes plunged, and it took years to regain lost ground. This scenario happened often – Mexico in 1982 and 1994, Southeast Asia in 1997, and Russia and Brazil in 1998 to name a few.

Today, these countries either allow their currencies to float or keep them undervalued – the latter in order to maintain the competitiveness of exports. The result has been rapid export growth and a massive accumulation of foreign currency reserves. China alone has accumulated well over one trillion dollars in such reserves. Moreover, these countries have relatively small foreign debts. In addition, they have much more efficient financial sectors and relatively transparent financial information. Consequently, the risk of crisis is minimal. Moreover, if a crisis were to happen, it is far less likely to result in cataclysmic economic contraction or global contagion. The world is, indeed, a safer place. And China and India are probably far safer than most emerging markets.

That is not to say that bad things cannot happen. They can. In addition, doing retail business in China and India still entails risk. Here are six risks of doing retail business in China and India:

China

The government restricts foreign investment

Foreign investment in China's retail sector is relatively free. This is due largely to commitments made by China when it joined the World Trade Organization (WTO). The law today allows foreign retailers to operate without a partner, to open stores wherever they want, and to source merchandise from foreign owned local factories that, in the past, were obligated to export most of their output. Yet there are rumblings within China about the growing power of foreign retailers. As giant retailers such as Wal-Mart and Carrefour rapidly open new stores and acquire local retail companies, concern is rising that the sector will ultimately be dominated by foreigners as is true in disparate emerging countries such

as Poland, Thailand, and Brazil. The risk exists that the government will impose restrictions or, more likely, create a hostile environment for foreign retail investment. Indeed it is possible that the furious pace of such investment today is aimed at obtaining a large footprint in China before the government has a change of heart.

The government imposes arbitrary rules

One way that the government may inhibit foreign investment is to become arbitrary about the enforcement of existing regulations. For example, China today has many of the same restrictive rules governing labor market relations as India. Yet unlike in India, these rules are rarely enforced. What if that changes? What if the rules are enforced for foreigners rather than domestic retailers?

Accidents, scandals, and pollution

In China the press has been privatized. As in other countries, newspapers love a scandal. Yet in China there are obvious restrictions on the ability to aggressively report on the government. Yet no such restrictions exist when it comes to reporting about foreign companies. The result is that any misstep by a foreign retailer is likely to get considerable negative publicity – if only because it will sell newspapers. Consequently, if a box falls on a customer's head the retailer in question will suffer more than a one-off problem. The same applies to financial scandals, worker mistreatment, failure of product safety, or environmental pollution. And given the ubiquity of corruption in China, there is considerable scope for such problems. For retailers this means vigilance in monitoring and securing all aspects of the enterprise.

Local retailers succeed

One of the risks of any foreign investment is that local competitors will perform very well. That risk is magnified in China because the government is keen on seeing local retailers do well. Hence the playing field is not necessarily flat. While foreign retailers have many

Information Technology	India	China
	2005	2005
Information and communication technology expenditure (% of GDP)	5.8	5.3
Households with television (%)	32	89
Internet users (per 1,000 people)	55	85
Fixed line and mobile phone subscribers (per 1,000 people)	128	570
Mobile phone subscribers (per 1,000 people)	82	302

Source: World Bank

advantages, including modern systems, vast experience, and deep pockets, the risk exists that local players will become much better and will do so with help from the government.

China fails to rebalance its economy

The future success of retailing in China will depend, in part, on the degree to which China's growth shifts away from exports and toward domestic demand. What if this doesn't happen? What if China fails to revalue its currency, fails to improve consumer credit, and fails to improve the social safety net? The end result would be slower growth of consumer spending. The risk would then exist that a global economic slowdown would especially hurt China by stemming export growth.

Problems finding and retaining managers

When asked what keeps them awake at night, several foreign food retail executives in China pointed to the hiring and retention of good workers – especially workers at the management level. There is a shortage of skilled labor relative to the growing demand. Moreover, many young educated Chinese are eager to put employment with a foreign retailer on their resumes before looking for work with local companies. They are easily poached with offers of higher pay. In addition, managers who depart often take their team with them. Loyalty is often aimed at the manager rather than the company.

India

The government places new restrictions on foreign investment

Foreign direct investment in the retailing sector in India is strictly forbidden in most cases. Yet that has not stopped large foreign retailers from entering the market through the back door. Wal-Mart, for example, will have a joint venture to operate the supply chain and will franchise its store operations to a local company. Others are likely to follow suit. Yet Wal-Mart has yet to open a store and already there are politicians loudly complaining. The prospect of other global retailers entering India in the same manner has caused alarm in some circles. Hence, the risk exists that, either formally or informally, new restrictions on foreign entrants could emerge. This would certainly suit the needs of India's indigenous chains, eager to roll out modern stores without having to deal with foreign competition.

The government fails to modernize infrastructure

The modernization of retailing in India will depend, in part, on the development of better infrastructure in transportation, communication, and electric power. Failure to make strides in this arena could severely restrain the modernization of the industry. This is a serious risk as the government is cash strapped owing to a large budget deficit. The deficit reflects sizable subsidies which would be politically difficult to cut. The government is attempting to tackle this problem through privatization of infrastructure.

Local retail competition

Even if foreign retailers can get their feet in the India door, they could still face serious competition from locals. Although India's retailers remain small, much future growth will be undertaken by large conglomerates with deep pockets. These retailers will be in a position to poach foreign retail talent, exploit local technology talent, exploit political connections as well as supplier relations, and better understand the needs of the Indian consumer. They could, therefore, be formidable.

Economy slows

India's economy is growing rapidly. Yet it is not clear to what degree this can be sustained. Already rapid growth is creating concerns about inflation. Government efforts to halt inflation could cause an economic slowdown. Moreover, structural problems in the economy could restrain growth. These include human resource constraints in the IT industry, poor infrastructure, onerous regulations, and cutbacks in offshoring on the part of global companies. If growth slows, it would have a harmful effect on retail sales and profitability.

Finding and retaining managers

As in China, talent is a huge issue. In India, the problem is compounded by the fact that talent is migrating toward information technology and professional services industries. Retailers face difficulties in competing for talent, especially given the relatively high compensation offered in service exporting industries.

Creating a national chain

Like China, India is a collection of disparate regions with different languages and cultures. Like China, India lacks a national infrastructure for the distribution of consumer goods. Unlike China, however, India has the added problem of highly independent state governments which collect taxation on the movement of goods between states. Thus, it would be highly problematic to create a national retail chain at this time. Instead, foreign investors would be wise to think in terms of creating a group of regional chains.

Retailing 2015 in China and India

What will be?

Despite the risks – and there are many – the likelihood exists that both China and India will continue to grow rapidly and will continue to experience rapid retail modernization. Both markets are and will be attractive to the world's major retailers and suppliers. Navigating these risky waters will be challenging. We already know, however, that success is attainable in China. India remains uncertain, but probably worth the gamble.

By 2015

- Both countries will be much richer. A large part of China will be middle class. In India, while the middle class will grow, there will still be considerable poverty. After all, over 80% of India's population today lives on less than \$2 a day. It will take time to change this substantially. Thus, China will be the more important place to sell discretionary and luxury goods and India will be the place to focus on food and household products.
- In China, modern retailing will be the dominant form of consumer goods distribution, especially but not exclusively in urban China. Moreover, urban China will represent a majority of the population. In India, the informal sector will remain very important, thus creating headaches for suppliers eager to improve the efficiency of distribution. Moreover, the cold chain in India will remain problematic.
- In China, foreign retailers will probably be the dominant players in modern retailing, although some indigenous chains will be important. Government efforts to create local giants through forced mergers will result in larger but not necessarily more efficient enterprises. In India, on the other hand, there will be more of a mixture of foreign and local giants. Local conglomerates will create large chains, sometimes in partnership with foreigners, often without.
- In China, consumer spending will grow faster than the overall economy. In India, this will probably not be the case. In China, however, consumer spending will shift away from goods and toward services owing to an aging population and rising affluence. In India, growth of consumer spending will be dominated by goods.
- The greatest risk to foreign investors in China will come from nationalistic government decisions. The greatest threat in India will come from a failure to accelerate the process of economic reform.

Where should you invest?

Where retailers and their suppliers invest depends on the circumstances of a retailer or supplier. Most global retailers invest in multiple countries and thus any global retailer would be wise to have a strategy for both countries. Yet those strategies are likely to be different. Determining the appropriate strategies will require careful understanding of the opportunities and challenges in each country.

Consumer Business Contacts

For Deloitte Touche Tohmatsu and its member firms

Author

Ira Kalish
Director, Deloitte Research
Deloitte Services LP
Tel: 213.688.4765
ikalish@deloitte.com

Global Consumer Business Leader

Lawrence Hutter
Deloitte UK
lhutter@deloitte.co.uk

Marketing Contact

Karthryn Cordes
Deloitte Touche Tohmatsu
kcordes@deloitte.com

North America

United States

Pat Conroy
Deloitte & Touche USA LLP
pconroy@deloitte.com

Canada

Brent Houlden
bhoulden@deloitte.ca

Europe, Middle East, and Africa (EMEA)

EMEA Consumer Business Leader

Gilles Goldenberg
Deloitte France
ggoldenberg@deloitte.fr

Belgium

Koen de Staercke
kdestaercke@deloitte.com

Denmark

Henrik Knak
hknak@deloitte.com

Finland

Jussi Konkola
jkonkola@deloitte.com

France

Antoine De Riedmatten
Aderiedmatten@deloitte.fr

Germany

Peter Thormann
pethormann@deloitte.com

Greece

George Cambanis
gcambanis@deloitte.com

Ireland

Brendan Jennings
bjennings@deloitte.com

Italy

Dario Righetti
drighetti@deloitte.com

Netherlands

Pieter Peerlings
ppeerlings@deloitte.com

Norway

Marius Eriksen
meriksen@deloitte.com

Portugal

Joao Luis Silva
joaolsilva@deloitte.com

Russia

Graham Povey
gpovey@deloitte.com

Slovenia

Graham Hayward
ghayward@deloitte.com

South Africa

Rodger George
rogeorge@deloitte.com

Spain

Juan Jose Roque
jroque@deloitte.es

Sweden

Lars Egenaes
legenaes@deloitte.com

Switzerland

J.N. Hill
jnhill@deloitte.com

Turkey

Ugur Suel
usuel@deloitte.com

Ukraine

Dina Nemirovich
dnemirovich@deloitte.com

United Kingdom

Richard Lloyd Owen
rlloydowen@deloitte.co.uk

Latin America and Caribbean (LACRO)

LACRO Consumer Business Leader

Francisco Perez Cisneros
Deloitte Mexico
fperezcisneros@deloitte.com

Argentina

Daniel Varde
dvarde@deloitte.com

Bahamas

Bruce Knowles
kbruce@deloitte.com

Brazil

Altair Rossato
arossato@deloitte.com

Chile

Juan Echeverria
jecheverria@deloitte.com

Colombia

Juan Carlos Sanchez Nino
jsancheznino@deloitte.com

Mexico

Omar Camacho
ocamacho@deloitte.com

Venezuela

Ariel Solano
arsolano@deloitte.com

Asia Pacific

Asia Pacific Consumer Business Leader

Yoshio Matsushita
Deloitte Japan
yomatsushita@deloitte.com

Australia

Andrew Griffiths
andgriffiths@deloitte.com

China/Hong Kong

Eric Tang
eritang@deloitte.com

India

Shyamak Tata
shyamaktata@deloitte.com

Japan

Yoshio Matsushita
yomatsushita@deloitte.com

Korea

Do-Sung Kim
dosungkim@deloitte.com

Malaysia

Yoon Chong Yee
ycyee@deloitte.com

New Zealand

Lisa Cruickshank
lcruickshank@deloitte.co.nz

Singapore

Alan R. Nisbet
anisbet@deloitte.com.sg

Taiwan

Ping Lee
plinglee@deloitte.com.tw

Thailand

Montree Panichakul
mpanichakul@deloitte.co.th

Disclaimer

The information contained herein is provided by Deloitte Touche Tohmatsu and is intended to provide general information on a particular subject or subjects and is not an exhaustive treatment of such subject(s).

Accordingly, the information is not intended to constitute accounting, tax, legal, investment, consulting or other professional advice or services. The information is not intended to be relied upon as the sole basis for any decision which may affect you or your business. Before making any decision or taking any action that might affect your personal finances or business, you should consult a qualified professional adviser.

The information contained herein is provided as is, and Deloitte Touche Tohmatsu makes no express or implied representations or warranties regarding the information contained herein. Without limiting the foregoing, Deloitte Touche Tohmatsu does not warrant that the information

contained herein will be error-free or will meet any particular criteria of performance or quality. Deloitte Touche Tohmatsu expressly disclaims all implied warranties, including, without limitation, warranties of merchantability, title, fitness for a particular purpose, noninfringement, compatibility, security, and accuracy. Your use of the information contained herein is at your own risk and you assume full responsibility and risk of loss resulting from the use thereof. Deloitte Touche Tohmatsu will not be liable for any special, indirect, incidental, consequential, or punitive damages or any other damages whatsoever, whether in an action of contract, statute, tort (including, without limitation, negligence), or otherwise, relating to the use of the information contained herein.

If any of the foregoing is not fully enforceable for any reason, the remainder shall nonetheless continue to apply.

About Deloitte

Deloitte refers to one or more of Deloitte Touche Tohmatsu, a Swiss Verein, its member firms, and their respective subsidiaries and affiliates. Deloitte Touche Tohmatsu is an organization of member firms around the world devoted to excellence in providing professional services and advice, focused on client service through a global strategy executed locally in nearly 140 countries. With access to the deep intellectual capital of approximately 150,000 people worldwide, Deloitte delivers services in four professional areas—audit, tax, consulting, and financial advisory services—and serves more than 80 percent of the world's largest companies, as well as large national enterprises, public institutions, locally important clients, and successful, fast-growing global companies. Services are not provided by the Deloitte Touche Tohmatsu Verein, and, for regulatory and other reasons, certain member firms do not provide services in all four professional areas.

As a Swiss Verein (association), neither Deloitte Touche Tohmatsu nor any of its member firms has any liability for each other's acts or omissions. Each of the member firms is a separate and independent legal entity operating under the names "Deloitte," "Deloitte & Touche," "Deloitte Touche Tohmatsu," or other related names.