

Shopping For **CHANGE**

Spencer's is overhauling its retail operations to get back in the black

by Vishal Krishna

THE ORGANISED RETAIL SECTOR IS A BRUTAL playing field. It respects neither age, nor pedigree. And most of the pioneers in the field — from Pantaloon to Reliance Retail to Shopper's Stop — have had to introspect, do course corrections, and change strategies several times over the past few years. Spencer's — which can trace its history back 150 years — is now doing the same. In 2006, the RPG group, after the break up of its joint venture with Hong Kong-based Dairy Farm International, relaunched the new avatar of Spencer's Retail with the clear aim of becoming a leader in the booming organised retail industry. It created five different formats — Daily, Fresh, Express, Super and Hyper — to straddle every segment of the market. Now, after the experiences of the past three years, it has decided to prune down the number of formats, the number of stores and generally, completely rethink its business.

The five-format strategy was clearly not working because each format had differing requirements in everything from stocking to logistics. That apart, RPG had also gone overboard with its expansion — going from 48 stores in 10 cities to 350 stores in 50 cities in just three years. As a result, when the economic downturn kicked in, the company suddenly found itself caught on the wrong foot.

It had made the mistake of focusing too hard on small, neighbourhood stores, an arena where organised retail has found the going tough against traditional *kirana* (mom-and-pop) stores. Intense competition from retailers such as Kishore Biyani's Big Bazaar and



STOP AT NOTHING: Sanjiv Goenka, vice-chairman of RPG Enterprises at a Spencer's store in Kolkata

Mukesh Ambani's Reliance Fresh did not help things, either. To top it all, it had lost its entire top management to rival Reliance Retail.

Not surprisingly, the company's bottom line suffered. Losses almost doubled from Rs 89 crore in FY08 to Rs 177 crore in FY09. That, despite its revenues growing at a steady clip, driven mostly by its largest format stores, the hypermarkets (see 'Inversely Proportionate').

Spencer's management, though, takes things philosophically. "We are not struggling; we are evolving," says Sanjiv Goenka, vice-chairman of RPG Group. "Sustainable retail businesses take some time to build and we have just started."

Running Too Fast?

In a span of three years, the Spencer's new top management pushed the company beyond its traditional southern bastion to the north, west and east of India. "Expansion was necessary," reasons Vineet Kapila, president of Spencer's Retail. "It creates brand presence. Look at the mineral water industry; it took 20 years for people to accept it." He asserts that despite the industry currently making losses, modern retail is here to stay.

The fact that the company earns the highest revenues per sq. ft in the industry proves that not all of its strategies were wrong. But it did not manage its costs well (see 'Too Many Highs'). According to CLSA Asia Pacific Markets, its staff cost of Rs 919 per sq. ft is almost double the industry average of Rs 500. Also, to counter competition, Spencer's ended up paying the highest rentals for its stores, averaging Rs 762 per sq. ft. Spencer's administrative costs, too, were the highest — Rs 1,228 per sq. ft compared to Rs 550 per sq. ft for Pantaloon and Rs 847 per sq. ft for Shopper's Stop. Such chinks in strategy made Spencer's struggle with the lowest gross margins — generating only Rs 1,679 per sq. ft, while its peers generated over Rs 2,300 per sq. ft.

"The Indian consumer is experimenting and modern retailers have had it tough," says Samar Sheikhwat, vice-president of Spencer's. Even its competitors have been badly hit by the "experimenting" consumer. For instance, Pantaloon Retail — which owns Big Bazaar — has lowered its turnover estimates for 2009 to Rs 8,000 crore from Rs 10,000 crore.

The Indian retail industry is facing its worst phase; its net income to sales, which was 3.8 per cent in 2003, came down to a paltry 1.3 per cent in FY09. But that does not absolve Spencer's of its strategic errors, the biggest being its focus on small stores, where it had three formats. The Daily format (4,000-7,000 sq. ft), the Fresh format (2,000-4,000 sq. ft) and the Express (less than 2,000 sq. ft) were logistically difficult to handle. Most of these stores generated little revenue, but added hugely to Spencer's costs.

The strategy to be an alternative to *kirana* has not worked for others either. Pantaloon Retail, which has over 160 Food Bazaars, does not want to expand this format because it is making losses. Reliance Fresh (800 stores) and Aditya Birla Retail's More (600 stores) are also struggling in this format. The only plus point of having smaller stores is that they help in brand recall. "The smaller store format has not worked in India so far and does not have strong back end to support it," says Ajay D'Souza, head of Crisil Research. "It is expensive to run such a format."

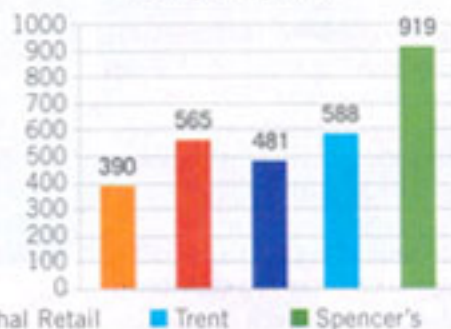
Despite lack of volumes in its small stores, an industry source says, Spencer's kept many of them open for almost a year. Goenka, though, backs his management team to the hilt, refusing to blame them for Spencer's troubles. "For any organisation to succeed, a combination of understanding consumers and a good management team is needed," he says, adding that his management's ability was important going forward. That ability will be severely tested, as Spencer's attempts to overhaul its business.

Too Many Highs

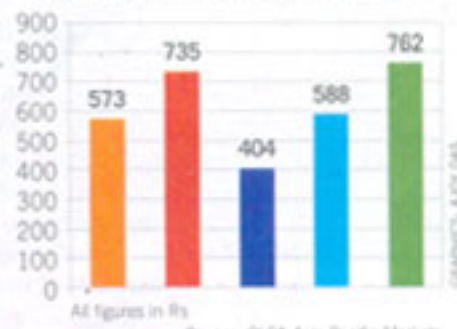
Spencer's has the highest revenues per sq. ft per year...



...but it also has the highest staff cost per sq. ft...



...besides paying the highest property rentals in the industry

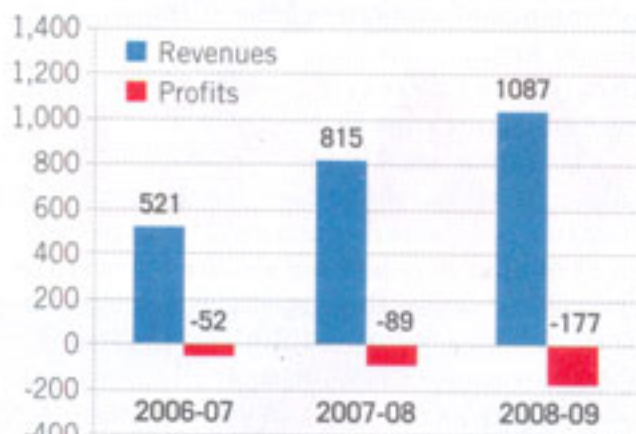


All figures in Rs

Source: CLSA Asia Pacific Markets

Inversely Proportionate

Spencer's losses have mounted even as its revenues have risen



Figures in Rs

Source: Company

Changing Track

As a first step, the company has closed 150 stores — mostly of the neighbourhood format — and fired over 1,000 people. It has also decided to do away with three formats and stick to just two — hypermarket (above 25,000 sq. ft, called Spencer's hyper) and supermarket (below 10,000 sq. ft, called just Spencer's). "We have a clear idea of what we are looking at," says Goenka. "So, assessing the success of our formats and evaluating them are not problems." The company will invest Rs 100 crore towards expanding its presence in these two formats. Goenka says sales must increase and costs must drop substantially — rentals are still very high, despite dropping by an average 20 per cent.

"Companies need to improve internal efficiencies, such as controlling their operating expenses," says Pinaki Ranjan Mishra, industry leader, retail and consumer products practice at Ernst & Young, which recently came out with a report that said top retail companies were shifting focus from an expansion-driven strategy to an optimisation-driven one.

Spencer's has recently brought down its costs by Rs 7-8 crore a month, and plans to reduce it by Rs 100 crore in a year. This will be largely through signing lower rental properties. Spencer's has been renegotiating and signing new properties in seven tier-I cities, including Hyderabad, Bangalore and Pune. To help find the best locations, the company is performing active market analytics. "We study the volume dynamics of stores in potential geographies; this tells us the viability of opening new stores," says Sheikhwat, adding that eight out of 10 properties were rejected recently by pure market analytics.

In many ways, Spencer's is going against the industry's strategy to counter the slowdown. First, it is expanding at breakneck speed, aim-

ing to double its floor space from the current 1.1 million sq. ft by the end of FY10. Even market leader Pantaloon, which is scouting for private equity partners, is slowing its expansion this year and will not add more than 2 million sq. ft. Others, such as Shopper's Stop and Reliance Fresh, have also trimmed their expansion plans.

Second, a KPMG report says, retailers are expected to focus on value retail in the coming months and will shift away from lifestyle goods. But Spencer's, apart from focusing on premium retail in its stores, is also in the process of opening 15 licensed lifestyle stores for two brands — Beverly Hills-Polo Club and Ladybird. That might not be a bad idea, as the hypermarket format, which focuses on high-value products, has worked for Spencer's. "The customer that we want to target has higher income and has knowledge of modern retail trade," says Nihar Ghosh, senior vice-president, HR, Spencer's.

That strategy has certainly worked. Vikram Sanyal, an analyst in Kolkata, says he shops in Spencer's hyper because it has a wider range of products, and the stores appeal to the eye. Graham Ned, an expat businessman in Bangalore, says the in-store experience and wide choice of international products remind him of stores in his home country, the UK. Not surprisingly, in its current expansion drive, Spencer's will focus aggressively on hypermarkets and tier-I cities.

Third, it will hive off its meat and fish departments into separate entities, a first for the industry, with Reliance Fresh and Pantaloon staying away from keeping non-vegetarian food products in their stores.

And fourth, unlike most retailers, Spencer's is building its own supply chain for its food business, which generates 65 per cent of its sales. It has created four clusters — Hyderabad, Bangalore, Pune and Hoskote — to source fruits and vegetables directly from farmers in 50 villages. "We want harvested fruits and vegetables to reach the customer under 25 hours," says D.V. Ramakumar, vice-president, food and agriculture, Spencer's. Strong supply is essential for the company to turn profitable in the long run, he says.

If all goes well, that may not be too far in the future. The company's management expects Spencer's to operationally break even by 2011. To fund its expansion plans, the company is looking at diluting 10 per cent stake through private equity. "We are in negotiations with more than one private equity player," says Goenka. "There can be a public offering once the company is profitable." When will that actually happen, is the question.

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