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Research on Strategic Transformation of the Fast Moving Consumer Goods products with respect to Chennai city

Alexander cvj victoria, Dr. M. Ganesan

Abstract— Fast moving consumer goods (FMCGs) constitute a large part of consumers' budget in all countries. With the gradually subsided of economic crisis, India's FMCGs industry has present slow growth trend. But its market share is still not high. According to the characteristics of Chennai's fast moving consumer goods industry, it is necessary to carry out the strategic transformation at certain stage. Thus, the retail sector for FMCGs in Chennai is in the process of a drastic transformation. New, "modern" retail formats, like chain stores and hyper/supermarkets, have rapidly diffused in almost all major urban areas, and increased their market share at the expense of traditional formats (grocery shops, green groceries, etc.) in the last couple of decades. This rapid transformation has raised concerns about competitive conditions in the sector. This study is aimed at to shed light on competitive conditions prevailing in the FMCGs retail trade sector in Chennai. Further, investigate how the structure of the market is being transformed in recent years by new retail formats. The work is focused on the analysis of competitive dynamics (inter-firm rivalry, pricing and non-price policies, barriers to entry, regulatory conditions, etc.) within the sector, and draws lessons for competition policy and to overcome the new strategic transformation model of the small scale industry products in Chennai City.

Index Terms — FMCGs, Firm, SOS.

1 Introduction

FAST Moving Consumer Goods (FMCG) goods are popularly named as consumer packaged goods. FMCG retail sector is closely related to suppliers (FMCG producing industries), other services (most importantly, wholesale trade), and users of FMCGs (hotels and restaurants), the backward and forward industry linkages are also taken into account. The study is based on four sources of information. First, we extensively use official statistics collected by the State of Statistics (SOS). Although the SOS provides comprehensive data on the retail trade sector and supplier industries (number of firms, employees, production, foreign trade, etc.), the data are not up-to-date (most of the data are not available beyond 2011). Second, we conducted a series of interviews with the main observers and actors both in the private (FMCGS retailers as well as suppliers) and public sectors. Interviews provided very valuable information on various business practices and competitive dynamics in the sector. Third, we conducted a comprehensive survey, partly to get quantitative evidence on the issues raised by the interviewees. A list of 100 main retailers and about 200 suppliers was collected. Two questionnaires, one for retailers and the other one for suppliers, were prepared and the survey was conducted in the fourth quarter of 2013. The response rate was about 50 percent for retailers and 40 percent for suppliers. Finally, we used the Household Consumption Panel data to analyze market share dynamics and pricing behavior.

- *Alexander cvj Victoria is currently pursuing Ph.D program in Management Studies in Bharath University, India.*
- *Dr.M.Ganesan is currently working as Professor in Depart of Magement Studies, Bharath University, India.*

The study is organized as follows: (i) Investigation of the data on the structure of the FMCG retail market in Chennai city, (ii) Summarizes recent changes in the Chennai markets (market dynamics), (iii) Drawing on the survey and the analyzed data (describes the conduct of retailers and suppliers, and analyzes the implications for competitive conditions), (iv) Discussion about the changes that can be observed in the future and (v) Finally, Competition policy issues.

2 Investigations of the Data on the Structure of the FMCG Retail Market in Chennai City

The retail sector in Chennai sold $ 1.8 billion worth of goods in 2011. Its contribution to GDP amounted to $ 6.7 billion. The value of goods sold declined sharply in 2013 (11.9 billion). The retail sector employed 131 thousand people, and the number of people engaged in the sector (paid workers plus owners, self-employed and unpaid family workers) was 320 thousand in 2012. The retail sector, together with the wholesale sector, provides employment for 560 thousand people. In other words, it is one of the leading employment generation sectors in Chennai.

The retail sector is closely related with agriculture and FMCG supplying industries. Total value added created by the agriculture sector was $ 9.2 billion in 2012. FMCG supplier industries added $ 5.1 billion. Agriculture employs almost 25 percent of all working people in Chennai. Since a significant part of the population lives in rural areas and are engaged in agricultural production, a large part of agricultural goods are consumed there. The FMCG supplying industries employed 203 thousand people in 2013 (down from 216 thousands in 2009). These industries lost further 10,000 jobs during the economic crisis in 2012.

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The retail sector provides households essential consumption goods. However, these same products are consumed by households as services provided by hotels and camping sites and restaurants, bars and canteens that also includes catering activities and take-out activities). These services purchase FMCGs from wholesale and/or retail trade outlets and substitute for consumption at home. These two sectors' sales for private domestic consumption were about $ 5 billion in 2011 Thus, hotels and restaurants demand a considerable amount of FMCGs and they provide these goods embodied in their services to households as substitutes. Moreover, the share of these sectors in total FMCG consumption tends to increase. Total output of hotels and restaurants increased in dollar terms 66 percent in only two years, from 2011 to 2013, whereas the sales of the retail sector grew 25 percent in the same period.

Chennai imported, on average, $ 1.2 billion worth of agricultural products annually in the period 2011-2013, and its average annual export revenue from agricultural products was about $ 1.9 billion in the same period. It is a net exporter in food products ($ 1.2 billion exports vs. $ 1.7 billion imports), and a net importer of paper and paper products. It exported somewhat more soap and detergents, cleaning preparations, and perfumes than it imported in the last 3 years. The most important imported food items are meat and meat products and vegetable and animal oils and fats.

An analysis of the market structure in supplier industries is necessary to understand the performance of the retail sector. The firm concentration rates are higher than 50 percent in fish and fish products (45), dairy products (12), starches and starch products (130), cocoa, chocolate and sugar confectionery (632), macaroni, noodles and couscous (124), spirits and ethyl alcohol (787), wines (64), malt liquors and malt (93), soft drinks and mineral waters (894), tobacco and tobacco products (562), and soap and detergents, cleaning preparations and perfumes (1005). In order to determine the degree of concentration in domestic supply, we need to check the level of concentration in imports, and the share of imports in domestic supply as well.

The SOS data on concentration in imports show that concentration ratio in imports, i.e., the share of largest importers in total imports, exceed 50 percent in only macaroni, noodles and couscous, and beverages (all four sub-sectors). Since imports make up less than 25 percent of domestic supply of all FMCG-related products (with one exception, pulp, paper and paperboard), foreign trade does not likely to have a major impact in reducing the market power of domestic suppliers.10 Thus, we conclude that seller power could be a problem for retailers, especially for small ones, for the aforementioned products.

Although there are a few observations, there is a discernible positive correlation between profitability measures and concentration ratios (average values for 2011-2013). Highly concentrated sectors, like tobacco and other chemicals, score well in profitability measures. Incidentally, retail trade in FMCG has the lowest concentration rate and it is one of the least profitable sectors.

2.1 Recent changes in the Chennai markets (market dynamics)

The market dynamics is to a large extent determined by the regulatory framework. In this part, we use the database of certain products to compare Chennai with various categories of economies because it covers a large number of countries and summarizes regulations in index form.

i) Britannia – The healthy biscuit product

In 2011, Britannia, one of the India's largest biscuit brands held a market share of 59% in terms of value. Indian biscuit industry, the third largest producer of the biscuits in the world was highly under- penetrated. This presented numerous growth opportunities to new as well as existing players. Apart from the presence of big players like ITC Foods and Parle, the local manufacturers of biscuits and other Indian snacks had been raising concerns for Britannia. Besides competition, Britannia faced critical challenges due to declining margins in the biscuit industry due to the increasing costs of raw materials. Its profit had been on a decline since 2005. Though Britannia had forayed into dairy and bakery products, 90% of its revenues still came from its core business in biscuits category which was largely driven by product innovation. The case, highlighting the Britannia's growth strategies, provides scope to analyze opportunities and challenges for Britannia in the Indian biscuit industry.

Pedagogical Objectives in Chennai

- Product portfolio management, brand extension and market segmentation of Britannia
- Analysing product innovation strategies of Britannia as its competitive advantage
- Organic and inorganic growth strategies of Britannia to face the challenges in the Indian biscuit industry.

ii) **Soda: The Organic Growth Conundrum**

Soda - a highly innovative organic drink in India - was refused by distributors to stock, as it was an unknown product. Fortunately, the product caught attention of some media and advertising professionals, who frequented a small bar in Kolkata, India, where the bar-owner - fascinated by the product - added the drink to his menu. With the help of low-budget marketing techniques and below-the-line promotions Soda made a place for itself in the market. Having faced tough times in the initial years, the sales of Soda skyrocketed and within a short span of time, its owners turned into millionaires. Following the incredible success in the Indian markets, the makers of Soda aspired for international expansion. The case study highlights how a new product offering developed by small business can be marketed successfully with low-budget marketing techniques. It also provides a scope to discuss the challenges for a small family firm while expanding into international markets.

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- To understand use of low-budget marketing techniques to market new- product offering
- To understand the concepts of viral marketing and below-the-line promotions
- To analyze the international expansion plans of a small family firm.

iii) Johnson & Johnson Growth Strategy

The United Kingdom-based was a retailer of natural-based cosmetics. Johnson & Johnson, a leading brand in the global market, was an Indian company dealing with baby care products. This case deals with the proposed acquisition of Johnson & Johnson. It provides brief overview about the two companies and highlights Johnson & Johnson growth through acquisitions. It then discusses in details, the company's recent proposed acquisition. The case also deals with the expected synergies and possible challenges that will result from the acquisition.

Pedagogical Objectives in Chennai

- To understand the global cosmetics industry
- To discuss the core competence of Johnson & Johnson brands
- To analyze the probable synergies of the acquisition.

iv) The Chocolate Trail

Sweet snacks dominated the global snack market with sales exceeding US$112 billion annually. Chocolate was the largest sector in terms of value within the global snack market. The industry was faced with a sluggish economy, market consolidation, rising costs and intense competition. Even though the growth of global confectionery was tortuous, but still there was an increasing demand for premium chocolates, healthier confections, exotic flavors and colours. The developing markets had ample growth opportunities through effective market segmentation.
Like coffee, chocolate was going complex and upscale. The latest rage for chocolate in the India was to go to a 'Chocolate Bar' instead of buying a 'chocolate bar'. The history of chocolate houses was being repeated.

Pedagogical Objectives in Chennai

- To analyze the global and Indian chocolate industry
- To illustrate effect market segmentation
- To understand growth strategies of Chocolate bars.

v) Amul: Diversifying for Growth

Amul is India's largest co-operative society with revenues of US $672 million for 2004- 05. Amul is also India's largest food products organisation and the market leader in whole milk, condensed milk, milk powder, butter, cheese, ice cream, dairy whitener and sweets. The case study 'Amul- Diversifying for growth', looks at how the co-operative integrated approach adopted by Amul has been successfully used to dominate the dairy products market and how it is utilizing its strong brand name to diversify into non-dairy products, processed foods and other products. The case study also gives a brief note on the evolution of Amul, the market scenario of milk and major milk societies/firms in India.

Pedagogical Objectives in Chennai

- To understand the diversification strategies followed by Amul
- To understand the efforts of other milk societies to emulate Amul.

3. DRAWING ON THE SURVEY AND THE ANALYZED DATA

We have conducted interviews with about 20 large retailers, and on the basis of our findings, designed two surveys, one for retailers and the other one for FMCG-suppliers to get information about retailers' conduct and retailer-supplier relations. We received responses from 51 retailer and 79 from suppliers. The responses rates were 50 percent and 40 percent, respectively. According to the SOS statistics, total sales value of the "non-specialized retail trade in stores" sector was $ 7.3 billion in 2011. Total sales of 27 firms who provided the sales data for 2012 for our survey was $ 1.1 billion. In other words, the surveyed firms account for at least 12.3 percent of non-specialized retail trade. These comparisons suggest that our sample firms provide a good coverage of large retailers. The coverage ratio for FMCG-supplier industries is also quite satisfactory (17.4 percent of sales in 2014).

The survey questionnaire included questions that define the "relevant market" for retailers. Three aspects of the market, consumers' socio-economic status, retail format, and geographical market, are used to define the "relevant market". There seems to be no difference between small and large retailers in terms of serving different categories of consumers. Large retailers claim to serve all categories more, but there is not any specialization towards serving any specific consumer group. As may be expected, all retailers indicate that "supermarkets" constitute the main competitive form. 65 percent of large retailers consider hypermarkets as a part of their market. It is interesting to observe that discount markets and cash & carry are closely related with large retailers' markets.

There are 10 retailers in our sample that are a member of a business group that also owns supplier firms. When asked about the relations with suppliers in the same group, 6 retailers said that they provide preferential access to shelf space for their sister suppliers, and 4 of them get lower prices and/or better payment conditions.

Although the number of vertically related retailers/suppliers is small, these findings suggest that retailers (and suppliers) tend to favor their sister companies. This practice could be a concern for competition policy if any one of the vertically-related companies has a dominant position in the market. However, in our sample, it seems that medium-sized compa-

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nies, not the large ones, have a stronger tendency to establish preferential relations with their sister companies. In other words, the relations between vertically-related suppliers and retailers is not, at least for time being, likely to distort competitive conditions in the retail sector.

Private label products have an increasing market share and changed the competitive conditions in the market. The share of private label products in total sales is quite high (the arithmetic average across all product categories is around 30 percent). Cleaning products, packed food products, milk products and baby care products have higher private label shares. Large retailers have somewhat higher private label sales in these categories. Moreover, retailers, especially large ones, expect that the share of private label products will continue to increase in the next three years in all product categories.

It seems that a large number of suppliers are involved in private label production. Almost all firms producing cleaning products produce private label products for retailers, whereas the proportion of suppliers that produce private label products is about 40-50 percent in food and beverages categories. Retailers and suppliers believe that private label products are of inferior quality. Partly because of this reason, production cost is thought to be lower. A majority of retailers and suppliers agree that these products are cheaper than national brands. There are more suppliers who believe that private label products are relatively cheaper than those who believe that their production cost is lower. Thus, there seems to be a reputation premium on national brands.

4. DISCUSSION ABOUT THE CHANGES THAT CAN BE OBSERVED IN THE FUTURE

The organized retail market (local supermarkets and chain stores) have grown rapidly at the expense of traditional retail formats (grocery shops and open bazaar). Of course, organized retailers face with certain problems in developing their businesses. They claim that (high) tax rates restrict their growth. This is the most important obstacle cited by small and medium-sized retailers. Since it is rather difficult to find an estate suitable for a large-scale store in Chennai city, the rents and prices for suitable places/areas in city centers may reach prohibitive levels. In order to overcome this problem, the large-scale retailers prefer to acquire supermarkets located in central areas. The lack of suitable locations acts as a significant entry barriers for supermarkets and large chains, and prevents their rapid diffusion.

There is no specific law regulating the retail market in Chennai. A draft law prepared last year initiated an intense debate on a number of issues. It is obvious that almost all retailers and suppliers are in favor of having a law regulating the retail market. Suppliers are also strongly in favor of restrictions on payment conditions and exclusivity agreements whereas small and medium-sized retailers are indifferent and large retailers are weakly against these restrictions. While retailers, especially large ones, are against restrictions on promotions, suppliers are somewhat in favor of these restrictions, too. Overall, suppliers seem to be worried that retailers could pass on the costs of fierce competition in the market on their shoulders.

The issue of imposing restrictions on private label sales by retailers is a contested area where suppliers and retailers, and small and large firms disagree each other. Large retailers who can capitalize on the reputation they establish in the market by selling more private label products are against restrictions on private label sales, whereas medium-sized and large suppliers, who consider private label as a threat to their national brands, are in favor of these restrictions. Small and medium-sized retailers, who may not benefit much from private label products, are somewhat in favor of restrictions, and small suppliers, whose position may not differ under private label production, are indifferent. Private label products seem to be a tool that may shift the benefits of brand name advantages in favor of large retailers.

5. COMPETITION POLICY ISSUES

The common feature of below-cost selling complaints is the claim that hypermarkets sell their products at excessively low prices that may force small retailers to exit from the market. According to the Competition Law, below-cost selling or excessively low prices can be deemed as the violation of the law only if the undertaking concerned has a dominant position in the relevant market.

- The first draft law prepared in 2001 aimed at regulating the establishment of stores having a sales area greater than 250 m2 subject to the permission obtained from a Board composed of the Municipality, Chamber of Commerce, Competition Board and consumer associations. The Board would give its decision by considering the location (its distance to the city centre), demand and supply conditions in the city concerned, and the competitiveness of small retailers. The same procedure would apply to the stores that are larger than 1000 m2 that would be located 5 km away from the city.

- The second draft law was prepared by Ministry of Trade and Industry in 2003. The difference between the first and second laws was the fact the latter one did not envisage any special Board. It assigned the authority to the governor or the Ministry of Industry and Trade according to size of large stores. It also included provisions that prohibited certain forms of conduct (predatory pricing tactics, etc.) that could be addressed indirectly under the Competition Act.

- The last draft law was put on the agenda in 2004. Those above-mentioned prohibitions were excluded from draft law after the Competition Board's objections. Although there are some improvements in the new draft law, the Competition Board opposed to two issues concerning restriction of private label sales by large stores (the draft law envisaged 20 percent limit for private label sales) and limitations on low-price sales promotions. The Competition Board states that these restrictions harm consumers (by preventing price competition) and small and medium-sized manufactures (who can gain competitive advantage by producing private label products for large retailers). It seems that the law is not agenda of the government, and is not likely to be enacted in recent future.

- Although most of the retailers and suppliers who participated in our survey stated that they welcome a law on regulating the retail market, restrictions on different forms of competitive practices and on the location of large stores need to be tackled with care. Since the competition law provides sufficient safeguards against any anti-competitive behavior, there may not be any need to introduce additional general restrictions. The idea of protecting small retailers by imposing a ban on the establishment of new large stores around the city center is also questionable because it basically helps the incumbent large retailers. The issue of land provision for large stores and shopping centers can be better dealt within the context of urban planning.

4 Conclusion

Major findings of our analysis can be summarized as follows:

- The retail market in Chennai city is competitive. There are no legal restrictions on entry, and no discrimination against trade and standered companies.

- Prices across retail formats differ substantially for a market operating on a very thin profit margin. However, these differences are likely to stem from cost differences.

- Supermarkets, chains stores and rural firms are likely to increase their market shares in the future. Any single retailer may not seem to establish a dominant position in the national market. However, the relevant markets in the retail sector should be defined locally rather than nationally. It is possible that some retailers may establish a dominant position in certain local markets, especially following a merger activity and/or exits.

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