

ECONOMIC IMPACT OF RETAILING IN PAKISTAN

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Abstract

The Saturation of Retail markets in the developed countries and the growth potential of Asian markets are enticing the big retailing giants to enter the business markets of countries like Pakistan whose retail potential is expected to be \$42 billion.

Introduction

The retail industry is a sector of the economy that is comprised of individuals and companies engaged in the selling of finished products to end user consumers. Sales figures and economic data are sometimes reported separately for restaurants and automotive-related businesses, but by definition they are considered to be members of the retail industry as well.

The economic impact of retailing can be assessed by its contribution to US GDP, that is, 66 percent. Measured solely by revenue numbers, the U.S. is the undisputed leader of the retail industry. Wal-Mart is not only the largest global retailer; it is also one of the largest companies of any kind in the world.

Generally the literature discusses the global impact of retailing on the global economies as well as Pakistan retailing industry. This paper explores the potential of Pakistan retailing industry. Its main aim is to assess the impact of globalization on the global retailing industry and its implications on the Asian markets specifically Pakistan. The paper examines the current retailing trends, strategies viable to grow in recession and the prospects of entry of global retailing giants like Wal-Mart in Pakistan.

The paper has six sections. Section 1 highlights the current situation of retailing. The change in the retail space is outlined in section 2. Section 3 expounds the internationalization of retail chains, its implications on economies and citation of reasons behind Wal-Mart failure in Germany & South Korea. Section 4 summarizes the changes that the markets have undergone during recent turmoil. Section 5 discusses the growth of modern retail in Pakistan. This is

followed by a discussion that makes sense that why should global retailers come to Pakistan and how can they be successful.

Section 1. Retailing Current Situation

The transformation of the business markets and the consumers improved understanding of the economics and the business operations have made it more challenging for all the business industries. In addition, the economic downturn and the soaring inflation have also raised many issues for all the companies, large and small, across the continents. In the retail industry, the recession caused record-breaking declines in sales, inventories, and consumer confidence, and stock prices. Experts are estimating that the after effects of the recession will last from 18 months to 11 years.

Amidst the turmoil, there is one industry that has flourished. That industry is the retail industry. The retail industry contributes more than 12% to the global economy and employs more than 14% of the World labor (World Economy 2011). The success and strength of this industry is evident from its robust contributions to the strong economies like US, EU, China, Brazil, India & Russia. The retail chains like Wal-Mart have been successful in most of the countries because of their critical understanding of the consumer markets, their needs and the regulations. But even big retailers like Wal-Mart and Sears have felt the heat of this economic recession because of the squeezed profit margins and saturated Western markets.

This saturation in the Western markets has made retailers reform business strategies. Most of the big chains have started to come towards the Asian markets mainly because:

- Growth opportunities
- Market potential
- Market size
- Growing GDPs
- Increasing purchasing parity
- Increasing FDI
- Improved technological infrastructure
- Labor availability

All these factors have lured the retailers worldwide to enter the big Asian markets of Malaysia, India and Pakistan. This term paper discusses all issues related to this retail expansion into growing Asian markets from saturated Western Countries.

Section 2. Ever Changing Environment Of Retailing

In the retail industry, the recession caused record-breaking declines in sales, inventories, and consumer confidence, and stock prices. Experts are estimating the after effects of the recession will last from 18 months to 11 years.

The dynamic nature of retailing has never been demonstrated, experienced and seen better than now. Changes in environments — Economic, Political/Legal, Socio-cultural, Technological, Ethical and Competitive — within which retailers of all kinds operate, force adjustments in policies, methods and managerial strategies.

The retailer has to be very familiar with the environmental factors. Also, they have to remain watchful of the continuous change taking place in the environments since the change in these

factors has and will always have vital impact on survival, growth, profit making and ultimate success of the business. Therefore, as far as possible, all plans, objectives, strategies, policies have to be formulated and implemented, catering for and considering the changing environments and demographics.

Section 3a. retail internationalization

The geographic boundaries within which the retailers function have expanded. Throughout the 1990s and 2000s there has been a trend towards consolidation in retailing. The large retailers, led by Wal-Mart in the USA and Carrefour in the Europe, have driven growth in retail sales not only with increased locations but also through purchases of other large retailers. No longer are retailers selling in one country. Much of the retail consolidation is occurring across continents to survive in the recession. (McGurr, 2002).

While the economy in their home country is recovering, many U.S. and European retail chains are expanding globally, opening stores in emerging markets and in countries with thriving economies. India, China, and Dubai are fertile retail grounds that global retailers are working to cultivate in 2012.

Large retailers like Wal-Mart have made its sales format international. Wal-Mart, which is the world's largest retailer, derives 20-33 percent of its sales from retail locations outside the USA (Soo Chul Park, Halepete & Iyer, 2008). But internationalization is not limited to US-based retailers. Carrefour, the world's second largest retailer after its most recent acquisitions, is based in France. However, more than 38 percent of its sales arise outside France. These percentages are

expected to rise for stores like Wal-Mart & Carrefour after their acquisition of emerging Asian markets (McGurr).

One of the reasons behind the increasing attraction of the Asian retail markets to the global retailers is that the employee productivity of Asia-based retailers is much better than the Europe-based or US-based retailers (McGurr, 2002).

Section 3b. *Wal-Mart Failure In Germany And South Korea*

Wal-Mart entered the German market by buying 21 Wertkauf hypermarkets at the end of 1997 and 74 inters par hypermarkets a year later in 1998. Wal-Mart operated in Germany as a wholly owned subsidiary of the parent company (Bergoetzz & Laue, 2002).

There were delays in changing the name of the stores to Wal-Mart. Further, considering that several stores were in need to substantial renovation, Wal-Mart missed on renovating the stores immediately, which seems to have resulted in a poor image of the Wal-Mart brand. Customers began to associate the name of Wal-Mart with the image of run-down stores. Also, even though Wal-Mart constantly increased the share of store brands, they still accounted for only 15 percent of all articles and Wal-Mart never became a well-known brand name in Germany. The only difference cited between Wal-Mart and other retailers was that Wal-Mart's shopping bags were free. Furthermore, the lack of scale power resulting in Wal-Mart's failure to achieve price leadership. Whenever Wal-Mart reduced prices, competitors did so as well. The cultural factor affected Wal-Mart internally as well. Wal-Mart's American managers pressured German executives to enforce American-style management practices in the workplace (Gerard & Hahn, 2005).

Also, Wal-Mart did not sufficiently research the German market to tailor its merchandise mix. When Wal-Mart departed the German market, the revenue lost was just 0.8 percent of Wal-Mart's annual \$103 billion in sales (Iyer, 2008).

Wal-Mart entered South Korea in 1998 when the South Korean Government opened up retail markets to foreign investments (Ramstad, 2000). After specifically analyzing the Wal-Mart's entry into Korea, Wal-Mart seems to have missed fully understanding the local Korean retail culture which thrives as a festive and social setting. Also, the Korean retailers very astutely instituted campaigns such as "Buy-Korean" that encouraged Koreans to support their domestic industry, which hurt Wal-Mart (Park, 1999). The domestic retailers reacted very aggressively to Wal-Mart's discount pricing strategy by quickly offering lower prices. Finally, in 2006, Wal-Mart sold its South Korean unit consisting of 16 stores to the country's biggest domestic retailer in 2006 (Sanchanta, 2007; Economist Intelligence Unit Ltd, 2006).

Section 3c. Wal-Mart In India

The Indian economy is one of the world's fastest growing, with gross domestic product (GDP) expanding at an average annual rate of about 7.5 percent for the past three years and the retail market expanding 10 percent on average. The Indian retail market, an estimated \$250 billion annually, is the world's eighth largest market and is projected to grow by more than 7 percent annually. All these factors show the strong economic conditions of the country which is a pull factor for companies like Wal-Mart that are interested in expanding into the Indian retail market.

To circumvent the Indian market regulation, Wal-Mart has announced a partnership with Bharti Enterprises, an Indian business group that is the country's largest mobile phone company. The

joint venture between Wal-Mart and Bharti manage the supply chain together while Bharti Enterprises will be franchised to run the retail portion. This operating model in India will expose Wal-Mart to potential challenges on the ownership and internalization dimensions of the eclectic model. India's population is over a billion. Although large in size, the diversity and heterogeneity of the Indian market is tremendously complex. The above driver's importance is further reinforced by the competition that Wal-Mart will face from unorganized retail which includes “kirana stores” and small size family-owned stores. The 12 million small, local businesses in India, known as “kirana” stores, are spread across 5,000 towns and 600,000 villages throughout India. While Wal-Mart's joint venture with Bharti may help alleviate this problem, it would be very important for Wal-Mart to change, not only its offerings, but also its mindset to operations, to suit the Indian multi-dimensional and multi-characteristic consumer.

Section 4. Market Transformation Due To Current Economic Turmoil

As the current economic downturn has come into effect over the past 2 years, times have proven increasingly challenging for global retailers in developed markets. The current recession is most unique with regard to the duration of its recovery as it's the longest prevailing recession in the global economic history (Gascon, 2009). While the global economy is experiencing the worst recession in 70 years (Oliver, 2009), there are some economies that have remained relatively strong.

One of the most disturbing global indicators of the downturn is the decrease in real retail sales of the developed markets particularly in the USA and Europe. According to the annual report from the U.S. Census Bureau (calendar year 2009), the total amount of sales for the U.S. Retail Industry (including food service and automotive) was \$4.13 trillion. This was the 2nd

consecutive annual decline for the retail industry, both an effect and cause of the U.S. economic recession overall.

While some organizations view recession as a time to invest in new markets for expansion, many organizations immediately focus on cost saving measures and retrenchment strategy in times of an economic downturn (Srinivasan, 2005).

In February 2009, major Australian retailer, Pacific Brands, announced retrenchments of 1800 jobs and closure of its manufacturing operations over an 18 month period. This negatively affected the consumers' brand perception and sales (Sharp & Zappone, 2009).

Other retailers like iconic departmental store, Myer, and supermarket giant, Woolworths, have made strategic investments despite the downturn. Myers invested heavily in store refurbishments and loyalty programs that boosted the sales by 15 percent, while Woolworths reported 12.8 percent profits due to its investments in supply chain operations (Myers, 2009 & Gardener, 2009).

There are shifting trends in the global retailing now with which the retailers have to deal. There is increased brand proliferation nowadays. While the number of number of brands increased over the years, the number of stores also increased over the years. This has also caused the fight for shelf space, forcing the retail industry expand all over the world especially in Asia.

Consumers today are money-rich time-poor. While disposable income is reported to be on the rise, disposable time is on the decline. Major changes are happening across the country in terms of consumer preference for different retail formats for shopping. For instance, the wet markets in India and Pakistan are losing its popularity while consumer spending at neighborhood shops is

increasing. It is a reflection of consumer demand for increased convenience in terms of the time of shopping and ease of shopping.

Grocery shopping today is evolving into two different categories – one which involves shopping only and possibly should be done fast, the other involves shopping but with sufficient time in hand. Grocery shopping is no longer a necessity but also a source of entertainment for many. That is why supermarkets are laying more emphasis on shopping ambience to make shopping a pleasant experience for the customers.

Section 5. Emergence Of Modern Pakistan Retail

Pakistan's service sector accounts for about 53.3% of the GDP. The wholesale and retail trade constitutes about 30% of the service sector contribution to the GDP of Pakistan.

Pakistan is the sixth most populous country in the world with 175 million inhabitants (US Census Bureau, 2009). The population of Pakistan is predominantly rural (66 per cent) but with major urban centers such as Karachi and Lahore which are the 13th and 37th most populous cities in the world, respectively, (Worldatlas, 2009). Owing to economic growth and rising consumer spending the retail industry has surged; retail sales have risen 68 per cent by value between 2004 and 2008. As would be expected in a developing economy, grocery sales have risen at a somewhat slower rate of 60 per cent by value in the same period but remain the most important component in retail sales (Planet Retail, 2009).

There is concentration at the retail level in some sectors in Pakistan. The FIAS (2005) reported two clothing and footwear chains, Bata and Service, as having over 200 outlets each. Concentration in FMCG and grocery is, however, at a very low level as indicated in the same

report where Agha's is cited as the largest FMCG retailer by turnover yet having only one retail outlet. Whilst the growth of chains is not a major trend, the introduction of a supermarket style format is an important recent feature albeit that these continue to be operated largely as independent stores.

The supermarkets are referred to locally within the trade as “modern” or “organized” retail and thus differentiated from “traditional” and, by implication, disorganized stores. These terms are widely used in other developing countries (Sengupta, 2008 and Srivastava, 2008). The modern, supermarket format is in its infancy but has been introduced in the major cities of Karachi, Lahore and increasingly in the capital, Islamabad (Farrukh and Dever, 2000).

In late 2006 and in mid-2007, respectively, Makro and Metro entered the Pakistan market operating a cash and carry format. Makro entered through a joint venture between the House of Habib and SHV of The Netherlands as Makro Habib Pakistan Ltd. Metro entered without local collaboration. Lower cost land in city outskirts suffers from poor security, making retailers and potential customers wary of doing business there. The two businesses differ slightly, however, in terms of customers served and marketing communications.

The government is acutely conscious of the immense job growth opportunities in retail sector and has launched aggressive privatization of telecommunications, utilities and banking despite union *unrest*.

Section 6. Discussion

Like India and China, organized retailing in Pakistan is witnessing a radical transformation. The increase in the number of retail chains across the country is an indication that organized retailing

is emerging as an industry and will boom in a big way in a recent future. Pakistan is currently at a stage where customers need variety in products and retail formats.

Pakistan's retailing industry has the potential to generate \$42 billion per year by 2012. Population growth combined with an increase in disposable incomes is providing the impetus to this boom. Household groceries and apparel are the drivers in organized retail industry. Food retail in particular is the sunrise sector. Research reveals that food retail is expected to grow to grow more over the next five years. This means there is enough space for many big players. A number of factors such as income growth, changing demographic profile due to more urbanization, and the socio-economic environment are having its impact on retail scene. Pakistan retail is currently a virgin territory. This is more important in view of the large number of middle class population and available high-disposable income in the age group 25-35 years.

Successful Retail Chains like Hyperstar, Metro & Makro has opened the avenues for the upcoming retailers. In Lahore, large numbers of households do the grocery shopping at Hyperstar, Jalalsons, Alfatah, HKB, Metro, Makro and CSD. This shows the changing lifestyle and shopping preferences of the urban population of Pakistan. This retail growth is also supported by the increasing literacy rate in Pakistan; current urban population is more educated than their ancestors and has a better understanding of retailer influences on shopping as the larger retailer give quality assurances to consumers. This practice is very common in rural areas of India and Pakistan, where everyone purchase from a specified "Kirana" store. Even the food retail chains like Gourmet and Salt & Pepper have been successful.

With the current prevailing trends in Pakistan retail industry, it is high time for the foreign retailers to invest in Pakistan. Even as its efforts to enter the Indian retail market have been

rebuffed by regulatory constraints, Wal-Mart, the world's largest retailer, neither confirmed nor denied speculation that it was eyeing opportunities in Pakistan.

Wal-Mart has not comment on market entry speculation as yet. The Pakistani retail market, currently estimated at \$42 billion and rapidly growing, is viewed as an attractive opportunity for foreign investors. Pakistan is a very large and concentrated consumer opportunity. Karachi alone accounts for 40% of any consumer business.

Personally speaking, Wal-Mart will be very viable in Pakistan, Pakistan is rapidly urbanizing. Poor infrastructure in rural areas prevents investment. Nevertheless, many consumer goods companies are actively marketing to rural consumers, creating awareness about branded products.

Future Prospects

Consumers are different in different parts of the world. To be successful, it is important for companies to completely understand their consumers. Wal-Mart has always tried to keep their format standard in their international operations. Cultures that are similar to the American culture or those that are highly influenced by the American culture have accepted the Wal-Mart formats as is. But, countries like Germany and South Korea have not accepted this format. To be successful in India and Pakistan, Wal-Mart will have to learn from their German and South Korean experiences, and make suitable changes to meet the need of the Pakistan consumer.

If Wal-Mart is to be successful in Pakistan, it will need to compete not only on price, but also on other key levers.

It remains to be seen what value proposition from domestic or international retail chain stores will appeal to Asian consumers as their retail marketplace undergoes massive change in the next decade. With increasing purchasing power of the Asian consumers, mixed demographics (people belonging to all age groups), people belonging to all income groups and with the increasing literacy rate, Asian markets are the biggest play fields for the retailing giants all over the world.

Pakistan economy currently is going through a worst recession of its history. In order to come out of this economic depression, Pakistan requires foreign direct investment to flow into Pakistan. The country's retail industry has a potential and the market characteristics required to grow but to avail this opportunity, the global retail chains have to come to terms with many challenges.

In order to find a share from the squeezed pockets of the customers', the retailers not only need to deliver quality products and services but also need to deliver delightful shopping experience in order to achieve resonance with consumers. In addition to this, the growing trend of being a global consumer, that is, the consumer takes pride in using global brands as using made in US brand will make him feel like an American resident. Cashing on to this consumer perception will also help global retailers to succeed in Pakistan. Retailers can also learn from the successes of Australian & New Zealanders retail companies that expanded through investments in loyalty programs and supply chain operations.

Global retailing is still struggling due to the housing market crash, the financial meltdown, high gas prices, and chronic unemployment.

The successful retailers focus on these strategies in order to recover from recession:

- Lean inventories and strong cash flow
- Lower payroll
- Increase share of wallet with existing customers
- Improve the customer experience and customer loyalty
- Use multichannel shopping (in-store, kiosk, online)
- Reintroduce coupons
- Create private label brands
- Offer freebies

Finally, this can be safely said that the retail industries of countries like Pakistan, who has the potential to grow substantially. This will help stabilize the global economy in general and the national economy of Pakistan in particular as entry of global retailers in retailing industry of Pakistan would not only strengthen the retail industry of Pakistan but would also generate more jobs, foreign investments and revenues.

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