# SUBHIKSHA – GROWTH & DECLINE
## (A CASE STUDY ON SUBHIKSHA RETAIL OUTLETS)

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**ABSTRACT**

*Subhiksha, from its first store in 1997, had reached a number of 1600 store by 2009, making itself the largest and fastest growing retail store chain in India. With a focused strategy towards targeting the middle class customers, low-cost operations, aggressive pricing, etc, it achieved a remarkable place in retail industry. But, with these bright aspects, there was a darker side also. Customer service not up to the mark, empty shelves, an improper debt-equity ratio causing the paucity of funds, later leading to defaults in payment to suppliers, employees and other parties, became the catalysts in decline of this chain.*

***KEYWORDS:*** *Retail Chain, Asset Securitization, Retail Market, Structural Costs, Organised Retail, Subhiksha Model*

When R Subramanian became an entrepreneur and started a retail chain called Subhiksha, there were not many entrepreneurs in India. In his family too, there were no entrepreneurs.

After obtaining an engineering degree from the Indian Institute of Technology-Madras, he decided to join Indian Institute of Management-Ahmedabad as he was sure about one thing -- that he would not leave India to go abroad. He was one of the few students who didn't go to the United States for higher studies. Going to the US never fascinated him. He had always been doing unconventional things, so it was kind of offbeat not to go to the US.

He preferred doing something in front of his own people rather than going to a foreign land because this gave him more satisfaction and recognition. And the sense of achievement is far greater than doing the same thing in a far-off land. In his own words, "Even the US was not the same US in the mid-eighties. Being one among the many workers and researchers there did not fascinate me. India is your country and you will get as much opportunity as anybody else. If you don't do well here, you have only yourself to blame."

To him an MBA seemed a logical corollary because hardcore engineering was not really his cup of tea. Even when in IIT, he went and did Economics, and took electives like Accounting and kept topping those subjects. He was always doing different things from what everybody wanted to do. So, he joined IIM-Ahmedabad.

At that time, his intention was to get into a good company like Pond's in Chennai and probably work in its marketing department. After his summer training at Pond's, they offered him a job too. But he got interested in the investment bank department of Citi Corp and he was one among the three who were recruited by them from IIM-A. But, after working there for 3-4 weeks, he realized that this was not the place where he wanted to work. In his words, "You are cut off from the world and living in a world of trading. You are doing more and more of the same and earning more and more money." That was not what he wanted to do in life.

The thought of doing something on his own came to his mind then. It was 1989 and there were no VCs (venture capitalists) to fund your ideas and investors chasing in those days. There was no precedent in his family for him to dream of becoming an entrepreneur. His father used to work for the Reserve Bank of India and his uncles too were in government service. His cousins, after studying at various IITs, went abroad. That was how it was.

He called Mr Viswanathan of Enfield who had given him an offer when he was a student of IIM-A and asked, 'Is your offer still on?' He said, 'Yes.' He resigned from Citibank and came down to Chennai. His family in Chennai was shocked. Resigning from Citibank to join a sick company was unthinkable. What he saw was this: it was a manufacturing company which would have all spectrums of job. He was with Enfield for two years from 1989-91.

He wanted to start a company of his own and told Mr Viswanathan about it. Mr Viswanathan got interested, provided the money, and asked RS to run it for him. As long as Subramanian could run the company, it was fine with him. In 1991, RS set up his first company called Viswapriya. He got a galaxy of very good people on board. They basically did three things. They bought debentures from thousands of people who had them in very small numbers and consolidated as 1 lakh (100,000) or 2 lakh (200,000) debentures and invested in mutual funds. And the investors got a monthly income. Every time the money went to lakhs of investors, it went from Viswapriya and that way the company's name became popular.

It was a good business to start and they were the pioneers in it. After they started, all the big guys got into the business. So it proved a good fun.

### STARTING ASSET SECURITIZATION

Today, everybody is talking about 'asset securitization,' but in 1992, it did not exist in India. When the Viswapriya released a project to do asset securitization, it was a huge hit. As they were the first guys, it was noticed; some small company in Chennai starting something like this for the first time in the country. It was making money, it was making them survive and also, it made people notice them.

**THE BIG BREAKTHROUGH**

The big breakthrough nationally came in 1994 when they started a new product IPO financing, which they called Prime Advancing. They created the first loan anywhere in the world for a guy who applied for shares without collateral, without guarantee. This industry and Viswapriya, both, boomed. Customers were making tons of money, and they were also making tons of money. So it was a win-win situation for everybody.

In 1994-95, it lent Rs 200 crore (Rs 2 billion). In 1995-96, it lent Rs 1,200 crore (Rs 12 billion). The net profit zoomed to around Rs 25 crore (Rs 250 million). Of course, competition came soon. And then in 1996, the stock market collapsed.

**ENTERING THE RETAIL MARKET**

There was no great logic behind entering the retail market in 1997. The organization made a study of two areas: software and retail. Between software and retail, it thought it was a bit late for software as Satyam, Infosys, Wipro, TCS, etc had already established by then. They didn't want to be a small and late entrant.

In retail, it would be one of the early entrants, so it would have the learning curve much to its advantage. It allocated a Rs 5 crore (Rs 50 million) corpus to it and entered the retail business. There was a lot of thought process behind it. They wanted to attract not the top end customer but the *Aam Aadmi*. From the research of three months, it was found that consumers prefer buying groceries from closer home. So, it was decided to set up 1,000 sq ft shops all across the city and not a 10,000 sq ft big store at one location in Chennai.

The next question was why would he come to the new store abandoning the existing store? It had to be the price, because ultimately there is no difference between the branded products like say Boost or Surf or such things. So, it was decided to sell branded products at a lower price.

**ON STARTING SUBHIKSHA**

"We looked at all sorts of names; and finally we chose the Sanskrit word Subhiksha (prosperity) because it reflects the Indian ethos and it is a word that can be understood all over India. What we were trying to do was different from the western model; our model is truly Indian. Our theme was, why pay more when you can get it for less at Subhiksha?" said RS.

In March, 1997, Subhiksha opened its first store in Thiruvanmiyoor in Chennai with an investment of around Rs 4-5 lakh (Rs 400,000-500,000). It was opened with the clear idea that it is part of a larger system.

It was thought the day it is opened, there would be a stampede because the prices were low and the store would sell goods of Rs 30-40 lakh (Rs 3-4 million) by the month end. But there was nothing of that sort! It sold goods of only Rs 5-6 lakh (Rs 500,000-600,000) in the first month. Yes, consumers were very surprised, and they gingerly looked at the products and asked, are they seconds or old stock or defective products? In the first year, Subhiksha opened ten stores in Chennai.

Subhiksha also started selling medicines at a discount. On the third day of opening the pharmacy, there were about 100 people outside our store in the morning. "We thought all of them were waiting to buy from our store. What we were expecting on day one happened on day three, we thought happily. But we soon found that they were not there to buy anything; they were chemists from the neighbourhood who had come to do a *Dharna* (protest) saying we could not sell medicines at a discount."

Finally Subhiksha had to go to court, and it was only in 1999 that the Supreme Court gave a ruling that it could sell medicines at a discount. It was doing quite well on the pharma front and enjoyed all the attention it got. "Another thing is the medicines that we were selling at a discount were bought mainly by the elderly who have no fixed income and they welcomed any discount. We were quite happy to be able to help them in some way. Medicine retailing is more of a service than business for us. Of course, it is good business for us too. But our main motto is service."

**EXPANSION**

By March 1999, Subhiksha started expanding rapidly. From 14 stores, it expanded to 50 stores by June 2000. In the next two years, it had 120-130 stores across Tamil Nadu. Another big thing was, in 2000, ICICI Venture invested in the company. Very soon, it had 145 stores all over Tamil Nadu.

Subhiksha saw to it that the moment it got into a city, it started as many stores as possible there. Only that made business sense. Then, till 2004, it made sure that it has to consolidate before expand, though there was a lot of pressure on them to expand nationally. Subhiksha decided to look at every part of India which is significantly literate and is a significant consumption market. They wanted to be everywhere. They looked at the telecom companies as their role model, which employed capable regional managers and expanded. "Our business is also extremely local. We can't sit in Chennai and run a store in Chandigarh. We decided to have very good quality people to run the region, area, town and the store." said RS.

In 2004-05, Subhiksha decided to have 420 stores in places like Gujarat, Delhi, Mumbai, Andhra and Karnataka by 2006. In 2005, it started recruiting people in various regions. By Feb 2007, it had 500 plus stores in all the places that were planned. Subhiksha was already India's largest retail chain store with 500-plus stores by Feb 2007. It achieved the distinction of setting up its 1,000th store in October, 2007 (later reaching 1600 by Jan 2009). You were more likely to walk into a Subhiksha store in some cities than into a post office. The pace of Subhiksha's rollout had been breathtaking.

Subhiksha then set its eyes on tripling the number of its stores to 3,000 by early 2010. The magic number of 1,000 stores held special significance for the retail chain's promoters as they had decided to consider going to public for raising further capital resources only after crossing this milestone. Apart from promoters, Subhiksha was partly (24%) owned by ICICI Venture Capital Limited. Subhiksha had planned to go to public for raising capital through IPO by March, 2008. Subhiksha required about Rs. 900 crore for its expansion (3,000 stores), was expected to dilute 10% of its business valuation estimated at around Rs. 3,500 crore, through public offering of its shares at premium. This would have brought down promotors' holding in the company to 60%.

Subhiksha remained steadfast in its philosophy of creating a chain of plain, simple, non-glossy, functional and small, stores. It goes to the credit of Subhiksha that many big retailers like the Future group also began looking at no-frills, non air-conditioned chains as one of the formats for their retail expansion strategy. "India is a large country and there are still opportunities to avail of. Though now, the thought of opening stores outside India is not tempting because there are enough opportunities in India. We may look at overseas markets too. Maybe later, after we open 2,000 or 2,500 or 3,000 stores in India." said RS in Feb 2007. "We are not mad risk takers. We are not producing movies. We do a lot of research before starting business in an area, and we have back-up plans in place. We work with very good people, and if something goes wrong, we try to take corrective steps... The big advantage we have is, we are not creating products. So there are no worries about whether it would succeed or not. Consumers are smart and they are all price-conscious and they want to finish the work as fast as they can. They don't go to a provision store for fun," He added. On the entry of MNCs and Reliance in the retail market... Everybody has been asking me, are you worried about Wal-Mart coming to India? Ultimately Wal-Mart is also going to be run by people like us. The point is you need not worry about anybody's entry. There is a huge potential for growth in India. There is potential for another ten people to come in. Ultimately the share of the unorganised kiranas will come down and the share of organised sector will go up because of the efficacy in buying and distributing. Also, this is an extremely low margin business. Ultimately, everybody has to sell within the cost. It is not that we are geniuses; we have been in the business for ten years, and we have made enough mistakes and learnt from them." He added "I don't think any child will learn to walk without falling down first, however good the parent is. We made our mistakes when we were small. The bigger you are, the mistakes will cost you more."

## THE SUBHIKSHA MODEL

### Think Middle Class

Subhiksha's target clientele is the middle class households with income in the 50-90 percentile range. The logic was simple. The top 10 per cent don't spend very much more on food and groceries than those in the income categories below them, nor do they account for large numbers. But they do expect more in terms of ambience, variety and service. Catering to this group, then, wasn't really worthwhile for Subhiksha. Instead, with functional outlets no bigger than 1, 200-1, 500 sq ft - and no frills like air-conditioning - Subhiksha had set itself up in direct competition with the kiranas.

It may not be easy, though, as the kirana is a high-service format with social capital the organised sector will find hard to match. Price and range became the key elements. In India the small store model works altogether differently from the way it does overseas, where convenience stores actually charge a premium over supermarkets.

Of course, Subhiksha was prepared to take on the kiranas, and not just on price and range. A basket of goods at its stores is about 10 per cent cheaper than at most corner stores and it offers about 1,500 stock-keeping units (SKUs) at its stores, compared to 750 SKUs at most corner stores. But where it hoped to score more was with its home delivery option. And then, unlike kiranas, customers at Subhiksha outlets can browse through the offerings - stores are designed such that the exit is reached only after walking through most of the aisles -which will help in impulse purchases.

### Size and Speed

Ultimately, though, Subhiksha's USP was its price - cheaper than the kiranas, and cheaper than the hypermarkets. If it has to keep dishing out discounts, the chain needs to keep its costs down to the minimum. Hence its tearing hurry to build scale quickly: so that procurement costs fall and overheads can be absorbed over a larger base. Stratospheric real estate prices notwithstanding, Subhiksha has opened close to 42 stores every month in the period March'06 to Oct'07 across 20 cities.

The momentum seems justified when you consider how close the competition was. The Future Group entered the small-store arena in Aug'07; planning to roll out 1,000 KB Fair Price shops very soon. Reliance Fresh, too, although not catering to the same clientele, expanded. But where the Future Group, Reliance Retail and Bharti Retail will have both large and small formats, Subhiksha stayed with the small store model. That was making it harder for the chain to scale up. Raman Mangalorkar, head, retail practice, AT Kearney, stated, "Although the small-store format is not in any way logically flawed, the ability to scale up with only a small store format is less than it is for a chain that has both large and small formats."

For its part, Subhiksha was convinced that small is the way to go. "We intend to dominate the small store segment. We are already ahead of the pack and while others may be rolling out both large and small stores, our costs are lower," asserted Subramanian. The trick was to leverage purchase efficiencies, since costs for an organised chain are higher than those for a kirana.

### Cost-side Story

As AT Kearney's Mangalorkar points out, typically, small stores have higher structural costs in terms of rent, labour and overheads. Subhiksha thought that as new stores are rolled out, store costs (people, electricity, furniture and so on) will increase in a linear fashion, while non-store costs (technology, sales and marketing) will rise by just about 35 per cent for a 100 per cent increase in the turnover. At Subhiksha, people accounts for 40% of costs, while rents are only 20% The chain keeps a lid on rentals by opening stores in middle-class localities, most of which are off the more expensive, main roads. Also, the stores aren't air-conditioned, which slashes electricity costs substantially. It is able to offer far higher discounts than the bigger stores.

The way to save is to sell a larger proportion of store labels. That way, any disadvantage that the retailer has while procuring from big, branded suppliers can be effectively neutralized. The chain already started doing that. It was sourcing from contract manufacturers for a variety of products, including soaps, toothpaste and instant noodles. While Subhiksha didn't own the Tatva, Bix and Zoop brand names (some of the private labels it sells), it had exclusive rights over them and also enforced quality.

## THE DARK SIDE

### Challenge - Out of Stock

More than costs, though, the supply chain was Subhiksha's biggest challenge. With customers often not able to get what they are looking for in the stores, the retailer risked putting them off forever.

A store has to deliver on time and in the right quantity, otherwise it will lose customers. As it is, the customer base for a neighbourhood store is a highly loyal one and it is difficult to wean away customers from the local kiranas. It has been an issue, with availability of stocks down to a low 68 per cent. It improved a little bit in between but further declined.

The problem appeared to lie in its decision to keep inventories lean - just 18 days against an industry average of 30-35 days. At times, it's "too lean, almost skinny", as an industry watcher points out. Some consumer product suppliers took time to adjust to its quicker schedules.

### Show Me the Money

Subhiksha's operated on margins much lower than the industry norm. While chains like TruMart plan to operate consistently at gross margins of 20 per cent or so, the Subhiksha model pencils in a gross margin of only 15 per cent. It was thought that net margins will improve from around 1.5 per cent (post-extraordinaries) to about 2.8-3 per cent as costs get absorbed over a larger base. From revenues of Rs 811 crore (Rs 8.11 billion) in the year ended March 2007, Subshikha was aiming for Rs 5,000 crore (Rs 50 billion) by March 2009.

### Service? Not Available!

Incompetence of staff at Subhiksha stores, non-availability of medicines and other items, bare shelves, 'private-label' quality not being consistent and other complaints got its way. Look at one blog put by a regular Subhiksha visitor.

> ***Subhiksha Departmental Stores Complaints – Very Poor Customer Service***
>
> *Posted: 2007-10-23 by M Shanthi*
> *(on website complainsboard.com)*
>
> *I have been visiting Subhiksha for the past 6 months for my monthly provisions needs. I am residing at Nanganallur, Chennai, Tamilnadu.*
>
> *In Nananallur Subhiksha, I used to notice, people are always lazy, lethargic and irresponsible. Particularly the people those who are working in billing counter are very rude.*
>
> *They don"t help people who buy for large amount to get the products. They compel the people to get the products by themselves because it is a self service shop. Even they don't know which products are available and the number of products to be delivered. For all enquiries they don't reply properly.*
>
> *There are two entrances in Nanganallur shop. At one entrance security stands and at the other entrance billing counter works but at the most of the time at the billing counter side nobody will be available. They never care about the security of the products.*
>
> *On 19th October 2007 I went there to buy products for rupees 700/-. They asked me to do all the work including packing of the products and left the place without checking whether I pack the right number of products.*
>
> *For any business, customer service is very important and the right qualified people should be appointed as employees and then only they can survive.*

### The IPO Issue

Subhiksha Trading Services Ltd, planned (in Oct 2007) to raise about Rs 350 crore (Rs 3.5 billion) in an initial public offering (IPO) by early 2008 to fund its expansion plans. This was the time when Sensex continued to reach new highs indicating an appetite for stocks among investors. The company appointed Enam Securities Pvt. Ltd, ICICI Securities Ltd and Kotak Mahindra Bank as lead managers and plans to file a draft red herring prospectus (DRHP) as early as January 08. Subhiksha's valuation at that time was around Rs 3,500 crore (Rs 35 billion) and the firm thought of adding about 10% additional shares for the IPO.

But, by the end of Dec 2007, Subhiksha indefinitely delayed the planned initial public offering (IPO). The reason as told by the company was that it had enough money to fund its expansion and will look for a listing at a "later point of time" as the stock market builds on its highs. It preferred bank borrowings to plug any funding needs that may crop up.

"At this point of time we (are) looking at a stronger (stock) market getting stronger rather than a stronger market becoming weaker," said R Subramanian in Dec '07, "We will take a call (and) we are not in a rush to do the IPO. We will do an IPO at some point of time, but we don't need to rush into it saying 'hey the budget is coming which is going to be bad or elections are coming which is going to be bad so we should do before that,' there are no event triggers... we will figure the right time... Whatever stores we do by March 08 will be financed and today financing is not a problem."

But this over-confidence cost Subhiksha high. The rapid expansion and lack of fresh funding (equity or debt) made things tight. Everyone was waiting for equity to be raised and then bank debt to come. But when the equity raising didn't happen, Subhiksha was caught flat-footed. The loans started becoming lean by March '08. By Aug-Sept 08, banks were not even lending to each other; forget lending to Subhiksha. In a business like retail, stock and cash are like blood. So the blood supply got choked, making it difficult for firm to survive. They did not budget for a time when no money is there.

**No Money to Pay (to Suppliers)**

Subhiksha, according to some of these wholesalers, usually paid on time, but things started souring in March 2008. In NCR, many vendors, who have not been paid their dues, say they have stopped their supplies to the retailer. The result of the stopped supplies was that many Subhiksha outlets across NCR either downed shutters, or started doing little business.

Some vendors also accuse Subhiksha of offering to settle dues if the suppliers were ready to take a cut in the total amount. "They are asking us to forego 50% (of our dues) and take 50% of the payment," said Sanjay Aggarwal, chairman of Dev Bhumi Cold Chain Pvt. Ltd. "They say, 'Otherwise you can go to court'."

**No Money to Pay (to Employees)**

A cash crunch made it difficult to pay even the salaries of employees. Defaults started from Aug '08 and its 15,000 employees have been (officially) unpaid since October 2008. It has been directed by Employees Provident Fund Organisation to pay the assessed dues at the earliest.

**No Money to Pay (to Others)**

It grappled with several lawsuits from landlords for not paying rent for months. Tata Teleservices Ltd cut all fixed line and mobile phone corporate connections to Subhiksha offices and employees due to unpaid bills.

## THE POSTMORTEM

Subramanian attributed the "collapse" to a strategy of debt-led rapid expansion on a small equity base. The growth to 1,600 stores and nearly a Rs 4,000 crore annual revenue rate was achieved through a high level of debt. Subhiksha had expanded rapidly; most of the growth was debt-led. It had built on a tiny equity base of just Rs 32 crore, and even including share premiums, etc., the company had raised only a total of Rs 180 crore as shareholder funds.

The firm's inability to raise cash in a difficult economic environment led to the current crisis. The company said it planned to raise cash through placement of equity on a preferential allotment basis and was close to doing so in September 08 but was unable to proceed due to tough economic conditions. Lack of funds led the company's trading cycle to "collapse" as the company ran out of cash in October, bringing its operations to a "standstill. Since August 08, it tried to juggle between repaying debts to banks and keep its stores operational, which prompted it to delay rentals and staff salaries. While announcing that all its 1,600 stores would remain closed at least till May 09, the company, burdened under a huge debt.

In spite of this, Subramanian is confident that the company could be nursed back to financial health but would need fresh capital (of Rs 300 crore) that could either come through debt or equity. Around 59% of the company is owned by promoters, 23% owned by ICICI Securities Ltd and 10% by software billionaire Azim Premji of Wipro Ltd, which he had bought last year from ICICI Securities for Rs 230 crore.

Analysts, however, feel Subhiksha will find it challenging to raise funds. It's fairly tough raising capital for a business that is clearly not stabilized. The restart plans include closing about 10%, or 160 stores, and relocating many others, negotiating lower rentals and shelving plans to roll out a consumer electronics chain. "We are now engaging in getting the restart plan approved by the financial stakeholders and then get the liquidity so that we can continue from where we left," Subramanian said.

It would be interesting to watch whether the chain can bounce back, which seems very difficult now. The growth of Subhiksha stands in support of the innovative and aggressive style of business. On the other hand, its decline gives a message of sticking to the basics of financial planning, reconsolidation before expansion, and customer service as the core of every business.

## QUESTIONS FOR DISCUSSION

1. Discuss the growth and decline of Subhiksha in the context of business environment of India for organised retail sector.
2. What key learnings do you extract from the above case? Suggest measures to revive Subhiksha.

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