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Sustainable Growth Rate Of Textile And Apparel Segment Of The Indian Retail Sector

By Ms. Nirali Pandit, Ms.RachanaTejani

Chimanbhai Patel Institute of Management and Research, Ahmedabad, India.

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SUSTAINABLE GROWTH RATE OF TEXTILE AND APPAREL SEGMENT OF THE INDIAN RETAIL SECTOR

Strictly as per the compliance and regulations of:

Sustainable Growth Rate Of Textile And Apparel Segment Of The Indian Retail Sector

Ms. Nirali Pandit[α] , Ms. Rachana Tejani[Ω]

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I. Introduction

For many years now, evaluators have been considering profits as the key tool to measure business performance. However, next to profits, is the growth rate (a more wholesome tool) which is becoming more famous as a measuring device for financial fitness of an organization. And related to this is the Sustainable Growth Rate (SGR) which is used in mainstream finance to analyze the maximum growth rate in sales that a firm can achieve while maintaining a relatively stable set of financial policies (Higgins, 1977). Sustainable growth rate model can provide an excellent structure to describe the growth path of private retail businesses. In pursuit of the same, the current paper first describes in detail the textile and apparel segment of the Indian retail sector followed with the meaning and utility of sustainable growth rate. The third section of the paper reviews the growth rate in retail sector at global and Indian level. And the last section analyses SGR of selected companies of apparel segment of retail sector in India followed with the discussion of analysis and conclusion drawn on the basis of the same.

About [α] : Assistant professor, Chimanbhai Patel Institute of Management and Research, Ahmedabad, India.
(Telephone: 98253 41336 e-mail : niralipandit@gmail.com)
About [Ω] : Assistant professor, Chimanbhai Patel Institute of Management and Research, Ahmedabad, India.
(Telephone: 98984 25559 e-mail rachana.101@gmail.com

II. Textile and Apparel Segment of the Indian Retail Sector

Traditionally retailing in India can be traced to the emergence of the neighborhood 'kirana' stores catering to the convenience of the consumers. However, in 1980s, India experienced a slow change as it began to open up the economy. During this decade, retailing through big showrooms was only limited to textile and electrical items. But in the latter half of the 1990s, Indian economy saw a fresh wave of entrants with a shift from manufacturers to pure retailers. For example, Food World, Subhiksha and Nilgiris in food and FMCG; Planet M and Music World in music; Crossword and Fountainhead in books plunged into pure retailing. Post 1995 onwards, there was seen an emergence of shopping centers, mainly in urban areas, with facilities like car parking and refreshments, that targeted to provide a complete destination experience for all segments of society. Then there was an emergence of super and hyper marts and at the end of the year 2000 the size of the Indian organized retail industry was around Rs. 13,000 crore. Today, with about 300 new malls, 1500 supermarkets and 325 departmental stores currently being built in the cities across India, the sector contributes 10% of the GDP, and is estimated to show 20% annual growth rate by the end of the decade as against the current growth rate of 8.5%. Some of the players present in the industry are Archies, Bata India Ltd, Big Bazaar, Crossword, Ebony Retail Holdings Ltd., Fabmall, Food Bazaar, Globus Stores Pvt. Ltd., Health and Glow, Liberty Shoes Ltd., MTR Foods Ltd., Music World Entertainment Ltd., Pantaloon Retail India Ltd., Shoppers Stop, Style SPA Furniture Ltd, Subhiksha, Titan Industries, Lifestyle, etc. And yet, there are new entrants like Reliance Retail Ltd, Wal-Mart Stores, Carrefour, Tesco, Boots Group, etc. waiting to penetrate the market. This retail sector comprises of various segments like textile and apparel, food and beverages, consumer durables, home solutions, jewellery and watches, books, music and gifts, pharma and other similar small segments. But textile and apparel dominates this retail sector with a contribution of 38.9% output.

With this state of growing textile and apparel retail sector, it becomes important to study whether the retailers in this segment through their malls and hyper marts will survive in the Indian market where the customer base is still composing of 300 million middle class Indians. The current paper reflects the financial sustainability and sustainable growth rate of the textile and apparel segment of the retail sector of India. This analysis has been done with the help of comparison of profit margin, earning retention rate and financial leverage of retail firms like Trent, Pantaloons, Koutons Retails, Kewal Kiran, Provogue, Vishal Retail, Shoppers Stop and Brandhouse Retails for the duration of last five years from 2005-06 to 2009-10.

III. Meaning and Utility of Sustainable Growth Rate

The sustainable growth rate model (Higgins 1977) is used in mainstream finance to analyze the maximum growth rate in sales that a firm can achieve while maintaining a relatively stable set of financial policies. Literature in past researches prove that sustainable growth is the rate of growth that is most realistic estimate of the growth in a company's earnings, assuming that the company does not alter its capital structure. In a nutshell, sustainable growth rate, or SGR, is the maximum pace at which a company can grow revenue without depleting its financial resources.

SGR is calculated by multiplying ROE, or return on equity, (using beginning-of period equity) by the company's earnings retention rate (1 – dividend payout ratio). This can be expanded as follows:

SGR = ROE * Earnings Retention Rate

= (Profit Margin * Asset Efficiency * Capital Structure) * Retention Rate

= [(Net Income/Sales) * (Sales/Assets) * (Assets/Beginning of Period Equity)] * (1– Dividend Payout Ratio)

This metric assumes that over the evaluation period: (1) the company will grow sales as rapidly as market conditions permit; (2) management is unwilling to sell new equity; and (3) the company maintains it current capital structure and dividend policy. As growth requires commensurate increases in assets for support — without equity issuance, any asset increases must be funded with added liabilities or from retained earnings. Thus if financial policies are unchanged, the rate of shareholder equity growth will limit sales growth. The sustainable growth rate is particularly valuable because it combines companies' operating (profit margin and asset efficiency) and financial (capital structure and retention rate) elements into one comprehensive measure. Using SGR, managers and investor can begin to gauge whether the firm's future growth plans are realistic based on their current performance and policy or not. In this way, SGR can provide managers and investors with insight into the levers of corporate growth. Industry structure, trends, and competitive positioning can then be analyzed to find and exploit specific opportunities.

IV. Review of Growth Rate in Retail Sector at Global and Indian Level

There is hardly any literature related to an empirical analysis of the potential differences in internal financial ratios across different sized private retail firms using the sustainable growth model (Higgins 1977) as a structural framework. Research work related to retail sector is hindered by the retail industry's lack of definitions. There is no single definition of retail format (Reynolds, 2003) – the term is used both in a generic sense and also to describe the specific offer of a particular retailer. Brown (1986) suggests that retailing as a sector lacks a single common basis for classification. For example, Retail Intelligence gives the following definition of department stores:

"Stores selling a wide range of goods including significant proportions of clothing and household goods, usually on several floors within one building, with sales area over 2,000 sq. m and at least 25 sales employees." (Retail Intelligence, 2000)

As development proceeded in the currently developed world and is proceeding in the developing countries of the world, markets shifted from fragmented local markets to larger centralized markets. The intermediaries or the channels between the customer and the manufacturer started diminishing. It was the beginning of the introduction of a new sector in an economy called the "Retail Sector". It started first in food industry and now can be seen worldwide even in the apparel segment.

The concept has its roots in the government intervention policy in grain wholesale and even retail marketing, such as Fair-Price shops in India and the Foodstuff Stores in China (Reardon et al, 2003). This intervention gradually continued till it developed into the recent rise of supermarkets to be dominated by Mom and Pop stores, street fairs, central markets and now huge shopping malls, each covering more than hundreds of acres of land. Supermarket operators are often perceived as the easiest to classify retail sector since they have been one of the most familiar retail formats around and appear to lend themselves readily to analysis (Reynolds et al., 2003). However there are various retail-formats of a single firm too, for example, Tesco. Supermarkets of retail business has become very famous across the globe because of its distinct winning features like 'one-stop shop' criterion, convenience, service, low-price offers and the like.

From the earliest to the latest adopters of supermarkets the regions range from Latin America to Asia to Africa, roughly reflecting the ordering of income, urbanization and infrastructure and policy that favour supermarket growth. However, the performance and growth of retail sector in the apparel segment has hardly been empirically analyzed. For example Reynolds et al. (2003) studied the consequences for the measurement of efficiency and performance of retail sector through an interview with UK clothing-retailer, who pointed out that, "Isn't efficiency (and productivity) all wrapped up in your brand positioning and therefore not really something for anyone to comment on? If French Connection wants to sell higher-priced things and spends lots of money on advertising – that's one brand positioning. If we are a value retailer – that's another brand positioning. Then perhaps it makes sense to disaggregate very simply by looking at higher-priced brands separately from value-priced brands? That might help to see whether selling more things at lower prices generates more efficiency than selling fewer things at higher prices". Several recent studies have made cross country comparisons of retail sector productivity. Most of the efficiency measurement studies related to retail sector have used labour productivity as a main tool to study the sector's efficiency. According to official Bureau of Labor Statistics' (BLS) statistics, the retail trade sector exhibited robust labor productivity growth over the 1990s (about 14 percent over a 10 year horizon). This labor productivity growth could reflect common productivity gains shared by all or most businesses in the sector so that reallocation dynamics are not particularly important.

Another robust international comparison of productivity in retail sector is the use of Purchasing Power Parity (PPP). But it had its own limitations of differences in service levels of various countries. Moreover, differences in labour productivity in different countries may be affected by differences in the use of other inputs or investment in physical capital etc. Thus, a broader approach to making retail sector productivity comparisons attempts to define and measure differences in the various inputs which contribute to output either at the individual firm level or in an aggregate of firms. The economic value of a sector's output is defined explicitly, as is (ideally) the economic cost of buying the inputs which generate that output (Reynolds, 2003). Recently economists and statisticians have taken to using firm-level data in an attempt to understand aspects of the retail productivity 'problem' that appear in top-down approaches. However, the quantity and quality of information available to measure firm or establishment productivity in the retail sector is much poorer than in manufacturing (Doms, Jarmin & Klimek, 2001). Another criteria used to assess retail sector efficiency is based on entry and exit of the firms. At the store level (rather than at the level of the firm), early studies in the US seemed to show that virtually all of the productivity growth in US retail trade during the 1990s was accounted for by more productive entering establishments over much less productive exiting establishments (Foster, Haltiwanger & Krizan, 2002).

However, from the retailer's or stakeholder's point of view, the efficiency and growth assessment of the retail sector should be by targeting sales, product range, service levels, availability, customer satisfaction (price-value-service-convenience components), employee contribution (often measured in terms of labour turnover) and operating & financial performance. Recent research by Vos et al (2007) suggests that, in general, enterprises whether belonging to retail sector or not, do not seek growth beyond their ability to control and sustain the business. Ou and Haynes (2003) found that most medium sized enterprises rely on internal sources of funds as opposed to external capital in financing their businesses operations. But one of the most important concepts spread through the corporate finance and strategic planning communities is the self-sustainable rate of growth. That is, the maximum rate at which the firm can grow without sales of new common equity. More than growth, the concept of sustainable growth rate has gained special prominence as an indicator of a firm's strategic robustness. A firm that has a high sustainable growth rate can execute its business strategy without having to dilute the interests of existing shareholders, and depicts how well a particular company manages its total investment or assets in pursuit of its strategic objectives. Sustainable organizations in the retail sector have the structure and incentives to repeat transactions.

Ahmed (2001) has suggested some indicators of financial sustainability like ratios, operating efficiency ratios and portfolio quality ratio. Most of the literature on financial sustainability deals with sustainability of MFIs, NGOs or immunization financing. Not much work has been done related to financial sustainability or sustainable growth rate related to retail sector or manufacturing sector or corporate service sector.

To bring about growth, The McKinsey Global Institute (2001) attributes much of the drive to adopt new technologies and organization practices in retail trade to the influence of one company, Wal-Mart. McKinsey finds that the competitive pressure of Wal-Mart encouraged other retailers to adopt its technological and organizational best practices. This growth performance is related to the combination of profitability, retention rate, asset turnover and financial leverage. If all these are stable and then show an upward movement over a period of time then it can be said that the company is utilizing its assets to the fullest and is being able to convert its earnings into more and more sales, thus, experiencing a sustainable growth rate. Thus, in order to bring about a sustainable growth in a business, generally there were many ideologies and strategies adopted by the firms. A few of them were joint ventures, increasing sales in existing markets, franchising, attracting angel investors, creating an international

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market plan, explode sales with internet marketing campaign, innovate the product or service, diversify or export. These somewhere involved more of equity raising. While there were other strategies that involved more of debt raising and not liquidating the ownership of the firm. But it has always been up to the entrepreneur to choose an appropriate strategy for maintaining a sustainable growth rate in accordance to his/her size of the business.

Thus, the review of the past work that has been done by various researchers highlights many financial as well as non-financial parameters to assess the growth and efficiency of the retail sector. But it is practically quite impossible to get the required data, as most data related to small and medium sized firms of retail (or any other sector), is grossly under-documented or not documented at all. Thus, keeping in mind such limitations the current paper uses SGR as the assessment tool for judging sector-efficiency and performance.

V. Analysis of Sustainable Growth Rate of Apparel Segment of Retail Sector in India

Analysis of seven retailing companies of the retails sector has been done here. This analysis is based on sustainable growth rate analysis.

Table 1 : Particulars Of Sustainable Growth Rate Of Retail Companies For A Period Of March 2005-06 To March 2009-10

PARTICULARS	TRENT	PANTALOONS	KOUTONS	KEWAL KIRAN	PROVOGUE	SHOPPERS STOP	VISHAL RETAIL	BRANDHOUSE RETAILS
Sales (S) (Net Sales after excise)	477.532	4725.66	720.93	140.314	313.73	1100.052	878.982	316.514
PAT (Reported net profit)	30.794	126.052	55.708	19.664	23.064	9.358	-75.478	8.592
Dividend (DIV)	11.568	10.726	0.734	4.192	2.908	4.17	0	0
Retained Earnings (RE)	19.226	115.326	54.974	15.472	20.156	5.188	-75.478	8.592
Net Worth (NW)	503.04	1698.87	292.59	142.264	416.706	280.756	83.026	76.926
Debt (D)	122.612	1665.87	392.56	20.814	124.194	148.758	469.622	71.006
Net Asset (NA) = D+NW	625.652	3364.75	685.14	163.078	540.9	429.514	552.648	147.932

(Source: www.moneycontrol.com)

Table 2 : Calculation Of Sustainable Growth Rate Of Retail Companies For A Period Of March 2005-06 To March 2009-10

	TRENT	PANTALOONS	KOUTONS	KEWAL KIRAN	PROVOGUE	SHOPPERS STOP	VISHAL RETAIL	BRANDHOUSE RETAILS
ACTIVITY	0.81606	1.45866	1.2727	0.851464	0.677022	2.505380883	1.741836	2.14258543
LIQUIDITY	6.48534	2.82792	8.0124	13.79758	7.545515	1.301935901	-5.388285	2.765516548
LEVERAGE	1.23667	2.05509	2.5616	1.149041	1.336145	1.538813764	2.117997	1.617510767
ROE	0.0658	0.08537	0.2834	0.135462	0.069702	0.020385678	0.307633	0.103105172
PROFITABILITY	61.9333	91.4004	99.082	79.13851	86.83374	75.11497764	100	100
SGR	4.11044	7.80232	28.168	10.71099	5.986997	0.610730234	30.76326	10.31051716

(Authors calculations)

The above table shows the SGR of eight Indian retail sector companies from apparel segment. Each company reflects its own peculiar growth rate. But each firm of the sector can be considered to have a sustainable growth rate only if the profits, activities, leverage, and liquidity are managed in such a way that they grow at the rate of the growth rate of SGR. Otherwise, their assets and funds are either over or underutilized, which is unhealthy for the survival of the firm and thus the sector. For example, sales of the firms in this sector are above the SGR. It means that the funds are excess and may lie idle. They should be channelized into higher activity or leverage.

Consistently SGR exceeding actual sales growth rate can prove to be detrimental to the company's health. The options available to them are either they decrease their actaual growth rate or they work on improving the SGR by increasing profitability, leverage, retention rate or operational efficiency by improving the asset utilization or decreasing costs. For example, the sales growth of firms like Shoppers Stop, Brandhouse Retail and Provogue is almost more than 50 times higher than their SGR while this difference is narrower in case of the remaining. It means these still can rectify on management of liquidity by optimum asset utilization or investments and asset building and grow at a sustainable rate.

In order to move up the ladder, firms in retail sector can even plough back more profits than they are doing currently. This will give the firm an opportunity to survive on internal funds without looking at outside equity. Though asset turnover ratio is sound in case of most of the firms, it needs to improve its asset utilization by various innovative business management practices. In case of Pantaloons and Provogue, though their sales have increased, assets also have steadily increased. Hence, the asset turnover ratio is low, which means that assets are underutilized for sales. Efforts should be made to increase sales with the same level of asset base. Remaining components of leverage, profit margin and retention rate are quite in line of growth with the industry standards. However, all these firms can grow at sustainable rate by a planned expansion of business with wide network of exclusive brand outlets, low-cost sourcing abilities, merchandising expertise; wide apparel range, IT infrastructure and robust growth in terms of regions covered.

VI. Conclusion and Recommendations

The firms in the retail sector are experiencing quite a robust growth rate. But this growth can be considered to be positive only if the overall growth is increasing at the rate of SGR. If it is not the case then the unrestrained growth may lead to less than optimal performance or even financial distress in the firms. Therefore, to survive this growth as well as sustain it, they need to concentrate on factors that have an effect on increasing sales even in the longer run. Retail – is a sector where the key business attributes are manpower (as it is a service industry) and customer satisfaction. The firms can experience growth by increasing manpower productivity. This in turn will increase the sales. The earnings from revenue should be utilized for further investment in increasing more number of retail outlets, providing a higher variety of products or brands under the same roof, improving infrastructure in terms of wider space and appealing ambience. This will attract more customers and improve the sales number thus, in turn, increasing profitability and growth. However, the fact that their SGR is growing to meet this standard calls upon their effort to make appropriate changes in the components of SGR. But this is possible only incase the firms identify the fact that there is an abnormal gap between SGR and sales growth and this gap needs to be narrowed more effectively by maneuvering asset activity and leverage.

If the firms want to maintain an orderly growth then there should be a consistent level in profit margins, asset turnover, leverage, and retained earnings and they should grow their sales by the SGR. If sustainable growth is less than actual growth over a protracted period, the company cannot sustain such activity without "funding" that growth. Either they need to plough more profits into the company, increase net profit margin or turnover performance, or "fund" from risky sources, such as increasing the debt level. When sustainable growth is greater than actual growth, the company has the potential of boosting growth by diverting the share of profits to stakeholders. Another view point of performance assessment of the sector is number of new firm entries into and exit from the market. The Indian retail scenario is such in the last five years there have been exit of firms like Subhiksha, Spencer, More For You (Aditya Birla group) and Vishal Retail is almost on the verge of exit. On the other hand, there is only one firm that is Brandhouse Retails that has been in new entrant in the last six years. Thus, it will not be unsafe to say that Indian retail sector is highly competitive and the member firms have to struggle hard to survive in the same. From the sector point of view, 2009 Global Retail Development Index findings, A. T. Kearney Study, India is ranked number one followed by Russia and China for being the most attractive country for retail investment. Thus, it tops the list of the most attractive emerging markets. Thus looking at the overall upbeat industry performance in terms of higher profit margins and increased investments the firms in this industry are also expected to have higher SGR and perform well.

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