The fully integrated financial services business model of future capital holdings...

 PANTALOON Double or Quits Kishore Biyani is India’s most successful retailer to date. And he wants to stay that way. Even if it means wagering everything he has built so far. Is Kishore Biyani a retailer or a fund manager? That question might well be asked of him in the not too distant future.

Over the last few months, Future Capital Holdings (FCH), led by CEO Sameer Sain, has stitched together a fully integrated financial services business model. FCH has already become the fastest growing start-up in the alternative asset management business in India with almost $830 million in assets. Now, it has big plans in insurance, retail lending and forex services. “ Whether we have a consumer who wants to leverage future income to realise his aspirations today, or wants to save and invest, or buy protection for his family, we want to be a part of it,” says Sain.

He believes that in 5-7 years, FCH’s bottom line will be bigger than the retail business! In the insurance business, the Future Group has managed to wrest a 74 per cent stake in a joint venture by investing just Rs 100 crore (its JV partner invested the same amount for a 26 per cent stake). “ Italian Assicurazioni Generali, ranked 21 on the Fortune 500 list, is a good fit for us because they derive almost 17 per cent of their sales from mall assurance. They have also partnered another retailer in the Philippines,” says Sain.

Biyani estimates that with just a 1 per cent footfall conversion rate, the insurance business would have over 2 million customers. That would earn him huge fees on distribution and catapult the company to amongst the largest private insurance players by way of number of policies sold. FCH has promoted an integrated retail financial services distribution company christened Money Bazaar that will be housed within all Future Group stores and malls. It will market credit cards, personal loans, mortgages and consumer durable loans. Raman Mangalorkar, ead (consumer and retail practice), AT Kearney, says that a study in the Americas found that the cards business contributed most of the value of the retail business of large American and Canadian retailers as the core business was characterised by cut-throat margins. Perhaps Biyani is motivated by similar expectations. FCH will also distribute forex products and mutual funds. For its sub-prime financing business, it is in talks with potential partners who will hold a minority stake while pumping in money and contributing expertise. Also on the anvil is a $200 million-250 million hospitality fund.

This will set up a chain of 30-40, three and four star hotels pan India. FCH will also launch hedge funds in addition to Kshitij 2, a domestic real estate venture fund, estimated to be around $80 million in size. It will also undertake corporate finance and advisory work and has set up Future Capital Special Situations (Investment) to do proprietary investments. The first such proprietary investment is a 47, 000-sq. ft building in Peninsular Corporate Park at Lower Parel in central Mumbai, part of which will be self occupied. We are putting investors on notice. That’s a surprising statement from a man who is about to raise funds for a high-risk Rs 4, 000crore expansion. Kishore

Biyani, 44, who controls the country's biggest retail group, should be talking up his share price, not spooking it. But as he steers the Rs 1, 993-crore Pantaloon Retail (India), or PRIL, into its next phase, Biyani, more than anyone else, knows there is no point trying to camouflage the scale of his wager. He is buying up more retail real estate than many Asian biggies. He is attempting a quick fire launch of 18 formats and over 3, 340 new stores by 2010. (He has four formats and 140 stores now. He is getting into risky and capital-intensive businesses, which include lending to his customers and selling insurance. And he is planning an advertising blitzkrieg that he claims will make him one of the top three advertisers in the country. And Biyani is planning his biggest and most audacious moves at a time when PRIL is starved of resources — it has a Rs 395-crore negative cash flow from operations and investment, and a cash crunch is looming large. Last year, the stock underperformed the Sensex by a wide margin. This has cast a shadow over Biyani's fund-raising ability.

Besides, if he manages to expand as much as he is planning to, he will need hordes of trained managers at every level. Industrywide, there is a shortage of talent and Biyani has no clue where he will find people. Meanwhile, profit margins, already a wafer thin 6-7 per cent, are coming under more pressure. Of course, Biyani had taken huge gambles even earlier. And he had shown a remarkable ability to come roaring back each time he was written off. The difference this time is that he is taking a make-or-break gamble when he actually has lots to lose. He has built his group to a respectable size.

But now, he is putting all that at stake. Why does he need to do this? Deep inside, Biyani had known that one day it could come to this. tried his best to thwart such a scenario. A few months ago, he explored the possibility of collaborating with Reliance Retail by engaging with Mukesh Ambani. He had But the talks failed. A top Reliance executive, who spoke on condition of anonymity, is brutal in his assessment: “ With our the retail sector will see a bloodbath. ” Biyani, as the biggest and, perhaps, the only independent one, is vulnerable. That was probably the real trigger for this ‘ high-growth, high-risk’ plan.

Today, he is caught in the middle of one of the fiercest corporate battlegrounds of the decade. Besides Reliance, several like the Aditya Birla Group and Bharti are eyeing this sector. the retail arm of the $17. 8-billion Tata Group, has expanded into hypermarkets. Shoppers’ Stop is expanding. South Africa’s Shoprite is already here via the franchisee route. UK’s giant Tesco, according to consultant AT Kearney, is in talks with Homecare Retail Marts, owners of the upcoming Magnet hypermarket chain. And Wal-Mart is straining at the leash, waiting to be allowed. “ What happened in 25 years in the US will happen years here,” says B.

S. Nagesh, managing director, Shoppers’ and vice-chairman, HyperCity hypermarket. Suddenly, despite all that he has built so far, Biyani will get marginalised in the retail game unless he grows to many times his size in the next couple of years. He wants to remain a significant or, as some say, at least an attractive target for an acquisition. His to turn PRIL into a $7-billion integrated retailer with over $1 billion profits by the year 2010 (see ‘ What Biyani Wants To Be In 2010…’). To do that, Biyani’s empire — recently renamed the Future Group to be ‘ everything, everywhere for everyone’. We should be able provide everything from a mochi’s (cobbler’s) services to that of a chaviwala (key maker), to a money changer," says Biyani. " We in the next one year what we have achieved in the last seven," Sanjay Jog, head (HR). Nothing illustrates his new risk appetite more than his real estate Till March 2006, he had occupied 2. 7 million sq. ft of retail space. over the last two-and-a-half years, he has booked 16 million sq. ft realty at an average Rs 45 per sq. ft. By 2010, PRIL's stores will occupying a total of 30 million sq. ft. That apart, Biyani aims to 40 million sq. t more under Pantaloon's real estate funds business by 2010. That's a total of 70 million sq. ft. And it dwarfs CapitaLand, one of Asia's largest mall management and listed property companies. CapitaLand currently oversees around 20 sq. ft of space. entry, retailer game players Trent, retailer for FDI in five Stop current player plan is in — has to will do adds plans. But of be have million " Biyani has moved fast and become the largest holder of retail real estate in the country. This will give him at least a two-year head start," says Akshaya Kumar, chairman, Colliers International.

At the moment, some retailers are struggling to find suitable properties. " Availability of large ground floor space like that suitable for our Spencer's Hypermarket is limited," concedes Harsh Goenka, chairman, RPG Enterprises. Could this be a source of competitive advantage? Perhaps, but only in the short term as there is plenty of mall supply coming up. In any case, PRIL has now taken on a huge realty risk. It is obvious that Biyani is trying to match Ambani in ambition, even though it calls for more capital and involves more risks. But the big question is: can Biyani match Ambani with hard cash?

Reliance Industries will spend more than Rs 25, 000 crore ($5. 6 billion) on retail. This is where Biyani's cookie begins to crumble. By his own estimates, the group plans to invest Rs 4, 000 crore over the next four years. But even this may be quite a stretch. Put that figure in perspective — PRIL's current market capitalisation is only Rs 4, 109 crore. Cash Crunch To achieve $7 billion in sales, Pantaloon needs money to launch new formats and expand existing ones into new locations. " If we had restricted ourselves to only food and fashion retailing, our sales would expand only at 30-40 per cent.

But we want to grow at 80-90 per cent, which categories like home and communication and durables will allow us to do," says Prashant Desai, head (knowledge office), PRIL. Of the Rs 4, 000 crore needed, about Rs 2, 100 crore will be used for capital expenditure and Rs 1, 900 crore for working capital. Where could this money come from? " We expect internal accruals of Rs 1, 800 crore and can raise debt for 75 per cent of our working capital needs," says Biyani. This would leave a net deficit of around Rs 775 crore, to be funded largely by equity. There are two problems here.

First, PRIL's negative cash flow from operations and investment, a result of its breakneck pace of expansion, is unlikely to change soon. The sales cycle in the fashion part of the business is almost double the credit period received. The only way to change this is to increase the share of food sales. " But that would depress our EBITDA (earnings before interest, tax, depreciation and amortisation) margins, which we want to maintain at 7-8 per cent levels," admits Desai. Biyani is also counting on the group's financial services business to generate significant cash flow for him (see ' Kishore Biyani, Fund Manager').

It currently manages a little under a billion dollars in assets and could earn annual asset management fees of around $20 million. And if the funds achieve the targeted 30 per cent internal rates of return, it could earn another $60 million in profits. Meanwhile, raising the Rs 775-crore equity (or more if the expected accruals don't kick in) isn't going to be easy. Unlike Ambani, who will put in $2. 24 billion in equity, Biyani will depend on the market for funds. But he isn't getting much support there. " Runaway growth is not a good idea. There are inherent risks.

Biyani is a first generation entrepreneur. He does not have a proven blue-chip management," says Abhay Aima, country head (equities and private banking), HDFC Bank. " Currently, investors are sceptical about funding this sector because they want to see what happens when Reliance launches fully," adds Ullal Ravindra Bhat, managing director, Dalton Capital Advisors India. Moreover, Biyani may not issue fresh shares if he does not get a premium high enough to protect his family's shareholding from falling too much below the current 44. 24 per cent, especially when he personally holds only 3. 13 per cent.

Finally, foreign institutional investors' (FII's) holding in retail companies has been limited to 24 per cent of equity. In PRIL, FIIs held 28. 25 per cent stake as of end March 2006, creating a supply overhang. Effectively it also rules out fresh issue of shares via GDRs (global depositary receipts), ADRs (American depositary receipts) or FCCBs (foreign currency convertible bonds), all of which hold the possibility of issuing equity at a premium to current market price. But Biyani thinks he has come up with a solution. He plans to split his businesses and raise money separately for each.

All the new businesses are being carried out under separate legal entities. PRIL will seed the business with equity capital. Later, it will hawk stakes in these companies, hopefully at fat premia, realising both value and much needed hard cash. “ I have lots of pieces to sell and we may not need to raise any fresh equity from the market,” says Biyani. For example, he is in talks to sell a little under 20 per cent stake for around Rs 180 crore in Home Solutions Retail India, the company that will launch Home Town stores, a large format one-stop shop stocking everything from plumbing and cement to consumer durables and furnishings.

Similar plans are also afoot at Future Media and Future Logistics. In fact, two of Biyani’s biggest formats could be hived off as separate companies. “ Central, which aims to provide a premium shopping destination built around big brands, is being made into a separate company; Big Bazaar could follow too,” he says. The Pressure Points For all his bravado, there is no doubt that Biyani is under extreme pressure. Occasionally, though, he lets his guard down. “ We don’t say that we will be the No. 1 retailer in India, but we will be dominant,” says Biyani.

Perhaps he realised his own frailty when he lost Raghu Pillai, who was to head Home Solutions Retail, to Reliance. Pillai was the architect of the RPG Group’s retail business. He had built many successful formats like Foodworld, Spencer’s Hypermarket, etc. Biyani had lured him with much fanfare. But in only a few months, Pillai moved over to the Mukesh Ambani camp foregoing employee stock options for a significantly higher fixed salary. The scale and scope of Biyani’s plans will also require a lot of senior managers. “

Management bandwidth is a problem," says Dalton's Bhat. And good talent is hard to come by in the retail sector.

Biyani has already taken on board this criticism. He has now hired a second line of management to run the company while he and the rest of his family like cousin Rakesh (oversees IT strategy and new retail formats like Central and Fashion Station), and uncle Gopikishan (participates in overall strategy) focus on ' strategy and relationships'. " We have been working with McKinsey over the past six months to ensure that we are ready for 2010. We have identified 10 members of the top management and will shortly be announcing a management board and a management council to lead the organisation," he says.

But competition is intensifying. Big Bazaar, Pantaloon's most successful format, was built on a price platform. Its core proposition is ' Is se sasta aur achha kahin nahi' (nowhere is it cheaper and better than here). That brought in huge volumes, but it also meant low margins. And some rivals may be in the process of discovering a more profitable model. HyperCity, launched by the Rahejas, is perhaps one example. HyperCity in Mumbai buzzes with activity as consumers prefer its layout and merchandising and do not seem to mind its slightly higher prices.

It has already crossed the millionth customer mark in the first quarter of its opening. But Big Bazaar will continue to fight on price. So will Reliance. That could result in profit margins dropping to 5-6 per cent. In preparation, Pantaloon is squeezing suppliers Wal-Mart style to get better deals. " We have obtained 5 per cent lower prices this year on food and FMCG products.

We believe there is more scope to extract lower prices," says Biyani. The company is also establishing bases in the Middle East, Hong Kong and China to source globally as compared to its current model where over 80 per cent of sourcing is local.

Such pressures have forced Biyani to rethink his business model. The ' Own Everything' Business Model During his early years, Biyani preferred an asset-light, capital-light business model. He didn't control real estate. Rarely did he lock up more than what was necessary. He did not even control all the merchandise in his stores. But now, he wants to control everything. He wants to control the real estate, so he has set up realty funds. He wants to control his vendors, so he has set up a private equity fund to invest in them.

He wants to control his merchandise, so he is creating his portfolio of branded products. He wants to control the consumer, or at least how much she spends, so he is setting up a lending arm. He wants to control his supply chain, so he is building 2 million sq. ft of warehousing space and is setting up a logistics business. He is even setting up his own advertising company to monetise footfalls by exposing them to in-store advertising. " Whatever is required in our malls or in our stores should be directly or indirectly controlled by us," says Biyani.

That is the mandate of the new Future Group. Realty is the first building block in the new model. " If the malls you need aren't ready on time, then you simply cannot expand," says Ved Prakash Arya, COO, PRIL. That's why the group has also set up a real estate funds business. These days, it is not uncommon for Biyani to lease out entire malls. (The new mall being built in place of the once popular Milan Cinema in suburban Mumbai is one example.) He will use part of it. The rest he will lease out to others, at a profit. This way, he also locks out competitors.

Second, Future Capital will provide GE Money-like counters insider Pantaloon formats to help fund purchases through loans, credit card offerings, etc. " Financing can help expand retail into segments that wouldn't otherwise buy, despite aspiring to consume," says Roopa Purushothaman, chief economist and strategist, Future Group. This, though, is fraught with risk. " Net margins on loans have come down from 11 per cent to almost 3-4 per cent even in areas like credit card financing, and while the number of cards has grown, usage per card has hardly grown. So, we would FOR COMPLETE REPORT AND DOWNLOADING VISIT HTTP://PAKISTANMBA. JIMDO. COM