Small Format Retail Chain: The case of Subhiksha

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Beginnings

Retail sector in India has the predominant presence of the unorganised sector comprising mostly the kirana stores which offer personalised service to customers. Against this background, Subhiksha Trading Services (Subhiksha) was promoted in 1996 by R. Subramanian, an IIT-Chennai and IIM-Ahmedabad alumnus, through his Venture Capital Partnership Fund of the Vishwapriya Group which was in financial services. This was the period of the emergence of the organised sector in different formats in the country.

In 2000, ICICI Venture (IVen), a venture capital firm of ICICI Bank, invested Rs.15 crore in Subhiksha and acquired 15% stake which increased further later on. It had two nominee directors on Subhiksha's board. The company became public ltd. in 2005. Zash Investment (ZI), a fund promoted by Azim Premji, Chairman, Wipro, acquired 10% stake in Subhiksha from IVen for Rs.230 crore in March 2008, without a board seat. Overall, the promoters led by Subramanian held 60% stake, IVen 23%, other institutions 15% and 2% under the employee stock option plan.

The Model

Subhiksha is a chain of discount stores started initially with groceries, fruits and vegetables, and later on added medicines and mobiles to the product range. It started in Chennai based on a survey which revealed that supermarkets therein had less than 10% of the grocery sales. It is a hub-and-spokes model with central purchase system which dealt directly with companies to avoid multiple bills and negotiations with suppliers. Goods were stored in three godowns-one each for FMCG products, groceries and pharma products. These were linked with the stores through internet and supplied as per needs to optimise inventory. It got discounts through bulk purchases and cash payments which helped the cash-flows of suppliers as well. Store-sizes ranged between 800 and 1800 sq.ft. with smaller size in suburbs of metros and larger size in centres of low rent. The prices were low and the stores were open on all days of the year. Stores were computerised and the supply chain was cost-effective.

Premises were taken on 10-year lease, and about 2,500 fast moving and large volume grocery-products and 2,400 medicines were sold at an average discount of 8%. Store's furniture and equipment were vendor's responsibility which reduced costs by 5%. Self-service was not allowed to avoid pilferage which was 5-8% of retail losses in the industry. A composite bill was generated for customer's purchases at the pay-in counter. Then, the bill, with no details of the items bought was taken to the delivery-counter where the person received the bill number and entered item-details. Meanwhile, the items were collected by a shop assistant. When the data at the delivery-counter matched that at the cash-counter, a detailed bill was printed. On the average 12 minutes time was taken for a transaction[1]. Subhiksha was displaying the prices of products offered by some companies in smaller packs at low prices while for larger packs higher prices were charged. Similarly, tax rates varied for some products depending upon pack-size, with no taxes on smaller packs (e.g. tea). This information helped customers on buying decisions.

Growth

In 1997 Subhiksha had 10 stores which increased to 19 by March 1999 and reached break-even level. Its low prices were felt detrimental by the small retailers. The number of stores increased to 50 in Chennai by 2000, and to 140 in 30 towns in Tamil Nadu in 2002-03. Debt was Rs.15 crore and networth Rs.23 crore. In line with the Indian retail sector's growth, Subhiksha decided to spread to national level, and during 2004-07, it raised equity to Rs.160 crore, debt to Rs.220 crore and a bridge loan of Rs.125 crore to prepare for mobilising equity from capital market. From 160 stores in September 2006, the number went up to 670 by March 2007, 1,320 by March 2008, and 1,650 by September 2008. Revenue had risen from Rs.833 crore in 2006-07 to Rs.2,305 crore in 2007-08 and net profit from Rs.11 crore to Rs.39 crore. Employees numbered about 14,000. It became India's largest mobile phone retailer with an annual turnover of Rs.1,000 crore[2]. vJive Networks, a broadband company, had an arrangement with Subhiksha to sell its integrated out-of-home media solutions through their stores in India, which was the single largest digital signage. Subhiksha then had over 650 stores[3]. Subhiksha spread to 10 states (Tamil Nadu, Andhra Pradesh, Karnataka, Kerala, Delhi, Uttar Pradesh, Punjab, Haryana, Gujarat and Maharashtra) and Pondicherry. Exhibit shows the trends of growth of Subhiksha in terms of sales, outlets and selling area.

In 2007-08 Subhiksha's networth was Rs.250 crore and liabilities Rs.750 crore. Dues were Rs.45 crore to suppliers, Rs.20 crore to employees towards salaries and Rs.24 crore as store rentals. A bank assessed the company's working capital gap as Rs.504 crore, but as per the company the funded gap was Rs.360 crore as at March 2008, and unfunded gap Rs.230

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crore as at September 2008[4]. The company's fixed assets were Rs.188.38 crore and inventories Rs.363.92 crore based on audited balance sheet as on March 31, 2007[5].

The IVen made a profit on its investment when it sold 10% stake to (ZI). It had an estimated exposure of about Rs.106 crore in Subhiksha. ICICI Bank, a lender to Subhiksha, was in charge of drafting the revival plan for the retailer. The IVen approached strategic buyers to take over the defunct retail chain, but failed[6].

Subhiksha launched a national TV campaign in 2006 in Hindi, for larger audiences. It showed shoppers looking for lower prices and opting to shop at Subhiksha. Later, there were Telugu and Kannada versions of the campaign, aimed at adult shoppers. The company spent Rs.15 crore on the campaign in one year. It used print, outdoor and radio as well for campaigning. Based on customer-feedback the store-size was increased with more stocks and self-service model was adopted, replacing the system of the customer giving the shopping list and waiting for the staff to get it ready[7]. With a budget of Rs.2-3 lakh for a 1000 sq. ft. store, Shastri Nagar outlet was air-conditioned and interiors changed on pilot basis which increased sales by 90% in a year[8].

Onset of Problems

The company wanted to come out with a public issue since 2007 in which investors showed interest. The issue was deferred to keep equity low and opt for debt for better returns to shareholders as the stock market was in the boom. In June 2008 the stock market dip began. Lehman Brothers failed. Bridge loan matured for repayment in September 2008. Further lending was not available. Working capital was diverted for expansion. Security staff left and over 600 stores were looted during November-December 2008[9]. The company informed bankers for help to stop looting, but police were not reported. Cash crunch stalled operations since February 2009, and banks were approached for corporate debt restructuring (CDR) aggregating Rs.700 crore[10].

Indian Broadcasting Federation (IBF), apex body of television channels, wrote to Subhiksha to clear advertisement dues of Rs.7.8 crore. The company stated that some dealings were through agents and those handled directly with the channels had no dues. The IBF's letter related to media-agents with whom the agreements were confidential[11].

The Employees' Provident Fund Organisation (EPFO) served notice on IVen for payment of provident fund dues to Subhiksha's employees. On February 20, 2009 it had ordered Subhiksha to pay Rs.1.76 crore due to employees for the June-September 2008 period. In March 2009, a sum of Rs.80 lakh was received out of which Rs.73.87 lakh belonged to the personal PF account of Subramanian and the balance was from the company's bank accounts. Subramanian stated that the employees agreed to limit their contribution to Rs.6,500 effective June 2008, which is the salary ceiling as per the EPF & Miscellaneous Provisions Act, 1952. The company had also decided to reduce the expenditure on a bi-partite arrangement on PF contributions on higher pay[12].

The board meeting held on November 22, 2008, chaired by a director and not the Managing Director, questioned the company about the discrepancies in accounts, loans and outstandings. Deloitte, Haskins & Sells stopped audit after April 2007 as financial statements after March 2007 were not available to them and they did not get appointment letter for subsequent audit. The board decided to appoint KPMG for a detailed audit, appoint a CFO and wanted the company to finalise accounts as at June 2008 by December. The board's decisions were not implemented. Audit for 2007-08 was taken up by a firm and Deloitte was reappointed by the company but appointment letter was not given. The ZI gave a loan of Rs.50 crore on December 31, 2008 for operations. The two nominee directors of IVen on Subhiksha's board resigned. One of these, who was CEO of IVen resigned from IVen whose position was taken over by the CFO of ICICI Bank. ZI was a helpless observer. It learnt that Vishwapriya was banned twice by Stock Exchange Board of India (SEBI) to enter capital market finding it guilty of irregularities in allotments of shares of two public issues. It also stated that the 10% stake was taken when IVen told in January 2008 of the urgency for the amount as pre-IPO investment. The IPO plans were called off in December 2007 after the legal firm Amarchand Mangaldass refused to sign the draft red herring prospectus, and someone had prepared a dossier against Subramanian and Subhiksha and sent it to IVen and Deloitt. These were known to ZI only after it pumped money into Subhiksha[13].

In September 2008 Subhiksha approached IVen for a loan of Rs.50 crore for short-term liquidity which was provided, to be repaid by December-end 2008. During 2006-07 inventories were at Rs.279.32 crore and secured loans Rs.245 crore. In October 2008, legal notices towards outstanding payments were forwarded by the company to IVen and only then it came to know of the company's financial problems. Then, a team, including IVen's nominee on the company's board visited many stores and found the inventories as very low and that the sale of fruits and vegetables was stopped. It found the liquidity problem more serious than what was revealed by the company for the Rs.50 crore loan[14].

Investigations

Based on complaints from some investors and former employees about mismanagement of funds by Subhiksha, the Ministry of Corporate Affairs (MCA) instructed the Regional Office of the Registrar of Companies (RoC), Chennai, to inspect Subhiksha's accounts. The company was advised to submit requisite information and account books within a week[15]. The RoC submitted the report to MCA in April 2010. It found violations by the company viz., non-disclosure of transactions with related parties, improper role of Deloitte, indifferent or ignorant attitude of the board and callousness of banks, Findings of the report were sent to the company which stated thus: Subhiksha was linked to over 42 shell companies which were suspected to be used to route bank money. These have common directors, common shareholders or share addresses and the transfers of amount between some of them were only book entries. They have shares of other companies, making it difficult to find those who control the companies. Subhiksha showed higher revenue, profit and inventory figures to indicate growth. City Capital Foundation, in which Subramanian had interest, was keeping credit card sales proceeds of Subhiksha and remitting the same to the company only at month-end. Subhiksha was buying most of the grocery products from some companies and Subramanian claimed no relation with them for which he stated to have obtained legal opinion from a former chief justice, but relative copy was not shown to the investigators[16]. In July 2010, MCA instructed the Small Frauds Investigation Office (SFIO) to investigate the alleged misuse of funds by Subhiksha. The company contested the court's order, stating that the procedure followed by the government for investigation was improper and got a stay. After a year, in the first week of September 2011, the court vacated the stay on the SFIO investigation[17].

Court Cases

The Indian Chemists & Druggists Association went to the court against the discounts offered by Subhiksha on medicines, threatened the medicine-suppliers with boycott and agitated outside the stores. The verdict was favourable to Subhiksha which held license to buy medicines considered essential.

The IVen and ZI petitioned against Subhiksha claiming that they were not informed about its financial problems, liabilities and governance lapses. Subhiksha stated that IVen was also in control having stake in Subhiksha[18]. The IVen stated that its stake was 23% and to stop any special resolution at least 26% stake was required. Subramanian asserted that control meant taking all important decisions which rest with those running the board, and all key decisions, including about CEO/CFO, budgets or auditor were under IVen's control in which case the extent of stake did not matter. The rights of a private equity firm in a company, holding a stake, are based on security clauses in the shareholder agreement (e.g. valuations and exit options)[19].

During January-March 2009 Kotak Mahindra Bank Ltd., which lent Rs.50 crore to Subhiksha petitioned in Madras High Court for winding up the company being a willful defaulter alleged that Subramanian diverted company's funds to his other entities. A willful defaulter becomes ineligible for CDR. The court appointed a provisional liquidator (PL) who would have sent a notice to the company's directors to convene a meeting to evaluate and liquidate the company's assets to pay creditors. Subhiksha petitioned for suspension of the order which awaited issue, stating, "…the company is in a temporary financial distress and trouble at this stage, but the issues are recent, temporary and related to the global financial recession. Appointing a provincial liquidator will completely destroy the notion of a going concern." It also mentioned of finalising a revival plan. ICICI Bank, with an outstanding loan of Rs.155 crore to the company was working with a consortium of 13 banks and three major investors for CDR. The court maintained the appointment of PL but deferred paper notification. Subhiksha was given ten days time to settle with Kotak Mahindra Bank[20].

The lenders wanted Subramanian to contribute Rs.350 crore for the CDR. The two non-promoter shareholders expressed inability to contribute to additional capital. Subhiksha needed around Rs.300 crore to restart operations. The deadline for CDR ended on July 31, 2008, after the requisite 180 days period. The Cash and Carry Wholesale Traders Pvt. Ltd. (C&CWT), a subsidiary and shareholder of Subhiksha, filed a petition in the Madras High Court for compromise with creditors, proposing payment of half the principal amount owed from October 2008 as full and final settlement of dues. The amount was to be paid from the end of third year after the scheme gets enforced, in eight installments in 10 years. For unsecured lenders, principal amount's repayment was set for January-December 2011. The company contested the CDR process as incomprehensive which covered six out of 13 banks and, if completed, would not bind the remaining banks. It stated that non-sanction of the scheme would affect the company's survival, as the liabilities and provisions amounted to Rs.928.5 crore as at March-end 2008. Cash and bank balance were Rs.18 crore[21].

Subhiksha acquired 40% stake at par-value in Chennai-based Blue Green Constructions and Investments Ltd. (BGCI), with a paid-up capital of Rs.5 crore. It is a non-government organisation listed at Madras Stock Exchange. Promoters held 60% of the equity of BGCI and public held the balance. Merger of the two companies was proposed, with the merged entity to be known as Subhiksha Ltd., and the shares were expected to be listed on the National Stock Exchange, Bombay Stock Exchange and Madras Stock Exchange. Subhiksha also contemplated an open offer to the public to get another 20% shares as mandated by SEBI as per takeover guidelines[22]. Madurai bench of Madras High Court rejected Subhiksha's merger-proposal, stating that further raising of money for the merger would be against public interest and that Subhiksha was suffering from "multiple organ failure, was in a financial ICU and only a miracle could save it". The company was advised to stabilise its financial position, pay creditors and meet statutory liabilities (e.g. provident fund dues to employees). This paved the way for hearing the winding up petition against Subhiksha[23].

A Supreme Court bench opted out from hearing Subhiksha's petition for a stay on criminal case filed against it, Subramanian and two others in 2009, by Kotak Mahindra Bank in 2009, after a cheque issued to it was dishonoured. It stated "List before another bench to be nominated by the Chief Justice of **India**"[24]. Azim Premji commented against Subhikha on accounts, inventory, bills, and transfer of money to some other companies and said that ZI was ignorant of these when investing in Subhiksha. Subramanian had sent a legal notice to him claiming damages of Rs.500 crore for these comments[25].

Exhibit: Supermarkets in India, 2002-07

Year	Sales (Rs.crore)	Outlets	Selling space
2002	1,400	980	150
2003	1,850	1,200	200
2004	2,211 (12.0)	1,368 (142)	249 (13.4)
2005	2,830 (11.2)	1,683 (150)	332 (14.2)
2006	3,962 (17.4)	2,380 (450)	481 (41.8)
2007	6,933 (22.4)	3,600 (1000)	746 (92.9)
2002-07 CAGR(%)	37.7	29.7	37.8
2002-07 % growth	395.2	267.3	397.4

Note: Figures in brackets relate to Subhiksha's share in sales, number of outlets and selling space.
Source: Compiled from data of Euromonitor International[26].

Case Discussion:

This case can be used to discuss about business idea, business model, nature and size of a retail format, issues of growth in terms of product range, geographical spread and governance, debt-equity considerations, fund management and profitability, problems faced by the company and the court cases. Relevant questions are as follows.

1. Are the business idea and business model of Subhiksha viable?

2. What are the growth contours of Subhiksha ?

3. What are the problems faced by the company and could they have been avoided?

4. Will the court cases enable the company to have revival?

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Solution for Case Discussion as per Questions:

1. The business idea is unique considering the nascent stage of the organised retail sector in India in 1996. The business model aimed at the middle and lower classes, with low prices. Supply chain is efficient, margins are low and stores are small in size served by a distribution center. The model was successful as Subhiksha had break-even position in two years after inception with only 19 stores. Competition from kirana stores and vegetable vendors was faced with discounts. In a store in the organised sector customers expect freedom to select goods themselves with touch-and-feel experience which was not provided by the model initially. The model met the key requirements of a consumer interested in groceries viz., proximity, product-quality, price of branded items, product availability and discounts.

2. Subhiksha could have stabilised and consolidated instead of rapidly expanding using debt on a small equity base. Small stores had problems in scaling up range and quantum of goods. Upgradation of stores was experimented, but it was difficult with a small budget, and beset with problems of varying and small store sizes, shapes of stores and layouts. Product-range of stores was customized to meet ethnic needs. Competition was getting intense in the organised retail sector with the margins becoming thinner. Store-wise viability should have been examined when spreading to national level as issues of supply chain, distribution and logistics, customer needs and personnel management are crucial and differ significantly from operating at regional level.

Focusing on groceries would have been better rather than taking up sales of vegetables, fruits, and mobiles. Though the margin was the highest on medicines (17-20%) customers would have preferred going to full-fledged medical shops. Groceries provided profitable margins (8-10%), but sale of fruits and vegetables was stopped after some stage perhaps due to low margin (2%) and perishability. Low real estate costs, high inventory turnover and provision of information about low prices to customers enabled the company grow faster. Opportunity existed to raise equity when the capital market was in boom, and due to equity stake held by IVen and ZI, but the company missed to capitalise on it.

3. There were problems faced in terms of transparency, liquidity and governance, among others, when the chain became national from regional level. Operations were stalled due to dues to suppliers and staff and debt burden. Inventory increased significantly. There were credit defaults and stoppage of supplies. Stores were getting emptied and customers were lost. The stores were looted which could have occurred due to absence of security staff, dissatisfied vendors, staff and owners of premises and anti-social elements.

4. There are multiple cases in the courts. Small vendors to multinational banks have sued Subhiksha to recover funds and the company has also sued bankers, vendors, landlords, police and central government, among others. Taking into account the operational problems faced by the company and the court cases, there seems to be no possibility for the company to have revival.