Have Global E-tailers Missed the Bus in India?
Published: August 23, 2012 in India Knowledge@Wharton

Earlier this year, Kunal Bahl, co-founder of Indian e-commerce site Snapdeal.com, told India Knowledge@Wharton that he hoped to cross revenues of US$200 million by 2014. Bahl has now revised his outlook. He is looking to reach US$1 billion by 2015. "We didn't expect our growth trajectory to take off as much as it has, hence we have upped the ante and should get there comfortably," he notes.

Bahl is not alone among Indian online retailers (otherwise known as "e-tailers") in setting aggressive targets. Sudhir Sethi, founder-chairman and managing director of venture capital firm IDG Ventures India, points out that according to the Internet and Mobile Association of India (IAIMA), the Indian online retail market has grown from US$250 million in 2008 to US$300 million in 2009, US$400 million in 2010 and US$600 million in 2011. "This year [2012] it is expected to more than double to US$1.3 billion and by 2015 to US$6.7 billion," he adds. "If foreign direct investment (FDI) in multi-brand retail is permitted, then this US$6.7 billion could well become US$10 to US$12 billion."

Praveen Bhadada, director of market expansion at Bangalore-based management consulting firm Zinnov, expects online retail to outpace online travel in the coming years and account for more than 50% of total e-commerce in the country by 2015. It currently accounts for around 22%. "We expect e-commerce in India to be at around US$23 billion by 2016 from US$6.3 billion in 2011. Of this, US$11.8 billion will come from online retail," he says.

The Indian e-tail market is one of the fastest growing across the world. According to comScore, the U.S. online retail market (excluding travel) was worth US$162 billion in 2011, a 14% increase over the previous year. In the first quarter of 2012, the sector grew 17%. The Chinese market was US$124 billion in 2011, a 53.7% increase from 2010. China's e-commerce sector is expected to triple to over $360 billion by 2015. Industry observers point out that in China, online retail exploded when the country's Internet user based touch 120 million.

In India, there are multiple factors driving the explosive growth in e-commerce: India's base of unique Internet users has grown rapidly, reaching 120 million today and expected to expand to more than 350 million by 2015. India's mobile subscriber base is more than 900 million, of which 600 million are unique individuals. In the next few years, over 100 million mobile users will gain access to 3G and 4G connectivity and more than 200 million are expected to become active on social media, up from the current 51 million. Technology platforms are becoming cheaper and more robust. The ecosystem of logistics players and payment gateways is strengthening. E-commerce players themselves are introducing innovative features like cash-on-delivery to cater to the unique characteristics of the Indian consumers.

Investors have also played a key role by supporting the category. According to Venture Intelligence, a research service focused on private equity and mergers and acquisitions, while in 2010 there were six deals in the e-commerce space totaling US$43 million, in 2011 this jumped to 34 deals totaling US$282 million. In 2012, there have been around 24 deals so far totaling around US$275 million. The country's demographics are also encouraging. India has one of the world's youngest Internet populations: More than 75% are below 35 years of age. A report by Avendus Capital estimates that at present, there are around 10 million people transacting online in India. This is expected to increase to 39 million by 2015.

Gearing up for Growth

Many e-tail players are gearing up to grab a piece of this growing pie. Snapdeal, which started as an online group discounting site in 2010, transformed itself into a marketplace a few months ago. It now offers more than 3,000 brands, which are shipped to over 4,000 towns and cities in India. "We never saw ourselves [merely] as a discount site," Bahl says. "We started as a marketplace for local merchants to acquire customers and over a period of time, expanded the marketplace to include brands and merchants selling products as well."

Flipkart.com, the county's leading online retailing site started with selling books in 2007. The site now offers a wide range of products, including mobile phones, computers, movies, music, baby products and stationary. The company has its own warehouses in seven cities, has partnered with 2,000 suppliers across the country, has a customer base of four million and ships out more than 50,000 items a day. According to co-founder Sachin Bansal, Flipkart has grown tenfold in the past year. "For the year ended March 2012, we crossed revenues of US$100 million," Bansal notes. "By March 2013, we expect to reach revenues of US$500 million."

At Bangalore-based Myntra.com, revenues have been doubling every four to five months over the past year-and-a-half. Myntra started life as an online personalized gift-giving portal in 2007. In mid-2010, the site shifted gears and became an online fashion and lifestyle retailer. Co-founder Mukesh Bansal expects to reach revenues of Rs. 500 crore (around US$90 million) for the financial year 2012-2013. "We are targeting Rs. 1,200 crore (US$220 million) for the next year," he says.

The e-tail space in India is estimated to have hundreds of players currently. While some like Flipkart and Snapdeal are horizontals, others like Zivame (lingerie), BigBasket (groceries and food items) and FirstCry (baby products) are operating in verticals. All of these players are arming themselves to compete not just against each other, but are also preparing to face the inevitable competition from the global e-commerce sites if the Indian government loosens restrictions on FDI in the space. The companies are making investments in various aspects, including logistics, technology, people and product portfolio, and striving to offer a rich customer experience.

At present, India permits 100% FDI in cash and carry and wholesale trading (which is business-to-business) and also in single-brand stores (like Ikea and Apple). In November, the Union Cabinet cleared 51% FDI in multi-brand retail, but this has been put on hold due to opposition from various political quarters. However, it is widely expected that sooner or later, the government will push through the measure. (E-commerce companies in India are governed by the same FDI regulations as brick-and-mortar retail firms.) Once FDI is opened up, global players are expected to rush into not just the physical retail space in the country, but also in the fast-growing e-tailing sector.

"FDI in multi-brand retail will certainly give a boost to online retail," notes IDG's Sethi.S. Ramesh Kumar, professor of marketing at the Indian Institute of Management in Bangalore adds that "global online retailers who build an effective supply chain and collaborate with well-known brands are likely to have an impact on the Indian scenario."

Global Players, Indian Moves

Some have already started making their moves despite the restrictions. For instance, earlier this year, Amazon, the world's largest online retailer, entered the India market through Junglee.com, a comparison site it bought more than a decade ago. According to its website, Junglee is "an online shopping service by Amazon" and directs customers to both online and offline vendors. Amazon has also launched its seller services program in India, under which retailers can advertise and list their products on Junglee.com. In addition, Amazon has secured government approvals to set up large warehouses across the country for stocking third-party merchandise and to also set up a logistics arm to ship products. Industry observers point out that these are clear indications that Amazon is gearing up for a full-fledged entry once FDI in multi-brand retail is permitted.

Meanwhile, eBay, which entered India in a small way in 2004 with the acquisition of Baazee.com, is busy signing up with new merchants. At present, the company is estimated to have over three million registered users and over 25,000 sellers in the country. eBay does not stock the products, but provides a platform for third-party merchants to sell to registered users. The firm recently also launched its own shipping service, PowerShip, which enables sellers to deliver their products to the buyers. In an interview with Reuters earlier this year, eBay India country manager B. Muralikrishnan noted that "most of the new business models are just waiting to implode. We have chosen the cautious route, unlike a lot of Indian businesses who are blindly investing money without having an eye on sustainability or profitability."

Another foreign firm that has entered India is LuxeYard from the U.S. Known for flash sales -- heavy discounts on items that are available for limited periods -- LuxeYard has partnered with serial entrepreneur Sashi Chimala, who will launch a local venture that LuxeYard plans to buy after two years. According to Steve Beauregard, chief operating officer of LuxeYard, this reverse-acquisition model "eliminates the risk and uncertainty of expansion into a new market." Speaking to business daily *Economic Times*, Beauregard pointed out: "By partnering with Sashi's team, we get to eliminate the learning curve and enter the market immediately."

Changing the Landscape

What will the coming of the global e-tailers mean for the sector in India? Bansal of Myntra believes it will be a positive move. "We are still in the category-building phase, so the entry of players who have in-depth knowledge will be good for the industry. It will force the existing players to ramp up their game." Bahl of Snapdeal adds: "If the large global players set up operations here and make significant investments, it will validate the model and create awareness and credibility of online retailing among Indian consumers." Bahl points out that in India, only 0.2% of retail is online; in the U.S. this figure is at around 10%, while in China it is around 5%. "So it's not a question of market shares as yet. The market has tremendous headroom for growth," Bahl says.

According to Sethi, global players have systems and processes that have been tried and tested over the past 20 years and on a much larger scale. "They will also have the advantage of their international relationships and offer a better range of products at better prices," he adds.

The entry of the global powerhouses is likely to have another impact: a shake-out in the industry. "The capital requirements of the Indian players will increase in order to compete with the deep pockets of the global firms," notes Akhilesh Tuteja, a partner at KPMG India. "And with money invariably moving toward the more successful players, the smaller ones may find it hard to raise the next round of funding. They will have to either shut down or sell out. Only players with deep pockets and scalable businesses will survive."

The big question, though, is that with the government dragging its feet on permitting FDI in multi-brand retail, have the global e-tail players missed the bus in India? Have the Indian firms gained a formidable lead? Kedar Gavane, director at comScore and head of India operations, does not think so. "It is early days yet for the industry," he says. Gavane points out that even though Amazon.com does not have a full presence here, it is the most visited site from India. "If they were to enter India [with complete operations] it will not take them long to grow the numbers."

Pragya Singh, associate director of retail & consumer products at research and consultancy firm Technopak Advisors, adds: "While Indian players have got some head start, most of them are new to online retailing and still learning the rules of the game and fine-tuning their business models as consumers, as well as their businesses, evolve. Global e-tailers, on the other hand, come with deep understanding of e-tailing processes and systems, as well as deep pockets."

According to Myntra's Bansal, if the global players can come within the next 12 to 18 months, they wouldn't miss much. But this is not to say that they will have a smooth sailing. Industry observers point out that despite their experience and expertise, global players could find it tough to deal with the unique nature of the India market.

Challenges Ahead

Take the payment mechanism, for instance. In mature, developed markets, online payment is the norm. In India, on the other hand, more than 80% of payments are made as cash-on-delivery, in line with the traditional Indian consumer behavior of paying for goods only after receiving them. But the cash-on-delivery model has its own issues: cash gets blocked, inventories are high and returns have to be managed. This model is contrary to the typical e-commerce model, and global players will find it challenging. Flipkart's Bansal suggests that this model is here to stay. Pointing out that even in offline retail, over 90% of transactions are by cash, he says: "It is important for online players in India to embrace cash. This may be contrary to how it happens in the U.S., but we don't have to follow the same measures here."

Then there is the problem of delivery. Global players typically use third-party logistics. But in India, this sector is not adequately developed. Take last mile delivery -- of the over 100,000 pin-codes in the country, only 10,000 are connected by courier services. What makes this even more significant is that, at present, around 60% of online sales are from tier two to tier 10 cities. In order to circumvent this hurdle, some Indian players like Flipkart have invested heavily in their own logistics operations.

There are other differences, too. Global players tend to deal with a few large suppliers. In India, e-tail firms have relationships with thousands of suppliers of all sizes. And unlike in the West, where ticket sizes are fairly large, India is a market of a large number of people looking to make numerous small-value transactions. "Global players will need to tweak their business models to suit the Indian environment," says Bhadada.

There are challenges even for the Indian players in the current environment. In addition to inadequate logistics infrastructure, there are also regulatory and taxation hurdles with respect to movement of goods from one state to another. Local language content has been slow to take off. Mobile payment is in a nascent stage. Customer acquisitions costs are high. All players are currently in the investment mode and very few have turned profitable. Some venture-funded players -- like Taggle.com, which started operations in June 2010 -- shut down last year. Investors are in a wait-and-watch mode.

According to Singh, it is not surprising that most e-tailers in India have yet to make money in their ventures. "The frenzy to attain the critical mass of customers where they can start to make money is leading to customer acquisition by heavy discounting and mass media advertising." Adds Tuteja: "There is lack of innovation and lack of service levels. Online retail firms are differentiating only on price and that is very expensive and unsustainable. Quality and customer experience comes with learning and failing a few times. Each player has to create their own magic formula and that takes time."

IIMB's Kumar points out that online retailers should not just create an online experience: They should create a total buying experience that has been missing in the Indian context. "How many consumers are advised appropriately at a sales outlet when they go to buy a washing machine for their needs?" he asks. "Online customized assistance backed up by offline service and association with good brand names may even open up markets for durable categories that have been conventionally associated with the 'touch and feel' buying cycle."

"The Indian online retail industry is at an inflexion point," adds Zinnov's Bhadada. "The companies that are able to ride this wave -- whether Indian or global -- will take the lead."