BUSINESS AS USUAL: E-Commerce in India

INDIAN INSTITUTE OF FOREIGN TRADE

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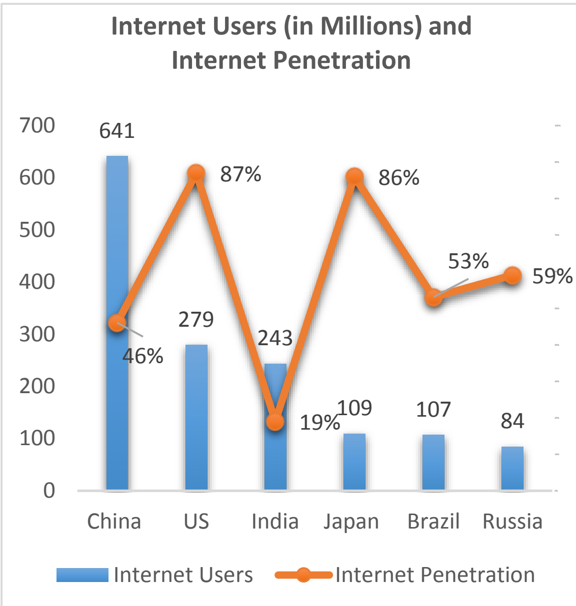
ABSTRACT

E-Commerce in India, in the recent years, has shown a growth which is unparalleled in Indian Corporate history. Growing to a billion dollar company within a short span of five years was completely unheard of in the Indian context. However, the fast growth and the strategies used to achieve this growth have led to some major issues. In this paper, we discuss the concern related to mounting pressure on profitability due to sustained discounting strategies. Next, we try to determine the root cause behind the concerns. Finally, we present some of the possible strategies to overcome these concerns.

INDUSTRY ON THE RISE

Over the last two decades, the emergence of the Internet and mobile penetration in India has created a paradigm shift in the way business is conducted. A direct offshoot of this technological revolution has been the emergence of E-commerce. It uses the Internet and the mobile phone revolution to fundamentally alter the way businesses reach their customers. E-commerce ventures deal with buying and selling of goods/services and/or the transmitting of funds or data, over an electronic platform. E-commerce processes are conducted using applications, such as email, online catalogues and shopping carts, electronic data interchange (EDI), web services and e-newsletters to subscribers [1]. Two of the most popular formats of E-commerce have been e-travel and e-tail. The latter specifically refers to selling goods on the internet to retail consumers (B2C category). According to Forrester Research [2], an independent technology and market research firm, only 16% of India's total population was online in 2013 and of the online users only 14% or 28 million were online buyers. India, therefore, is still in a nascent or immature stage of evolution of online retail spending. China was in ascending stage at 50%, whereas Japan (69%), Australia (57%) and South Korea (70%) were in mature stage. This perhaps best demonstrates the potential of e-commerce, particularly, e-tail in India. Over the last few years, the sector has grown by almost 35% CAGR from 3.8 billion USD in 2009 to an estimated 12.6 billion USD in 2013 [3], a growth story unheard of in the India context. If this robust growth continues over the next few years, the size of the e-retail industry is poised to become 10 to 20 billion USD by 2017-2020. This growth is expected to be led by increased consumer purchases in durables and electronics, apparels and accessories, besides traditional products books and audio-visuals.



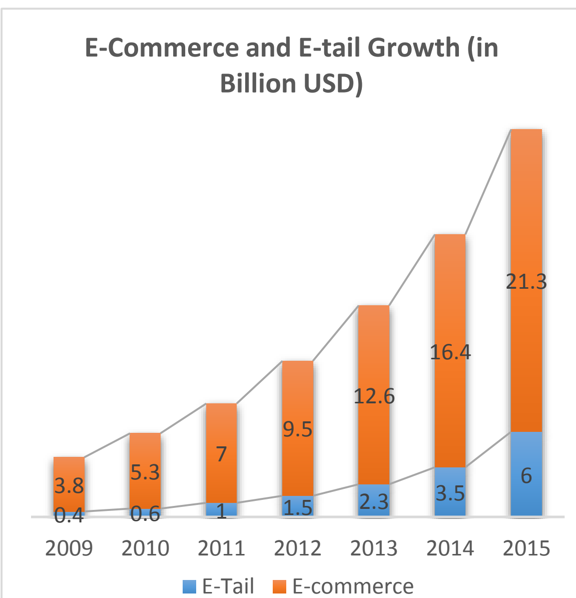


Figure 2: E-commerce and E-tail growth rate in India

ONLINE BUSINES MODELS

A large number of companies in the E-commerce space have adopted different innovative ideas and operating models including partnering with online market places or setting up their own online stores. Some key operating models include the following

- Marketplace Model
- Self-Owned Inventory Model
- Private label
- White label

The most prevalent of these in India is the Marketplace Model. This is being followed by the three major players of India E-commerce: Flipkart, Amazon and Snapdeal. In this model, the sellers often partner with leading marketplaces to set up a dedicated online store on a common aggregator website. The sellers play a key role of managing inventory and driving sales. They leverage on high traffic on the marketplaces' website and access their distribution network. However, due to the cutthroat competition existing among platforms, the sellers have to bear the brunt of competitive pricing. Also, the customer experience needs to be of the highest standards, to comply with the norms set by the e-commerce platforms. This adds to the pressure on the sellers to perform.

One of the key tenets of the marketplace based model has been the discount based strategy to increase sales. E-commerce websites generally use heavy discounts and cash backs to promote sales and customer loyalty. This has been quite evident in the recent Big Billion Day" sale by Flipkart and "The Great Indian Summer" sale by Amazon.in and 60-70% cashback offers that are a testament to the extent to which major players in the industry are willing to go for discuss the various issues that arise due to the discount based model and how can major E-commerce companies use different strategies to mitigate these concerns

DISCOUNT BASED STRATEGY

In the E-commerce space, pricing has emerged as the biggest differentiator driving consumers to shop online. It would not be wrong to argue that the very foundation of the industry is its discount based strategy. As a result of this, the customers are used to discounts throughout the year. This is to such an extent that the entire buying decision process is now based on the quantum of discounts given by the E-commerce platforms. Customers now browse through the various platforms (both online and offline) and then buy from the platform which gives the highest discount, or effectively the lowest price. As a result, the major e-commerce platforms are at perpetual price wars, trying to lure in customers with as high a discount as possible. For some products, the quantum of discounts can be as high as 75-80% of the marked price. While this strategy has been successful in driving sales (Flipkart expected to cross USD 8 Billion and Amazon expected to cross USD 1 Billion in GMV March 2016) [4], there is a continuous loss of profitability and dependence on equity infusion from promoters and venture capitalists to fund the discounts.

Product/ Discount offered on selected brands	**Flipkart**	**Amazon**	**Snapdeal**
Mobile Accessories	Upto 80% off	Upto 70%	Upto 80% off
Belts and Wallets	Upto 80% off	Upto 50% off	Upto 80% off
Printers	Upto 35% off	Upto 40% off	Upto 50% off
Books and Media	Upto 40% off	Upto 60% off	Upto 30% off
Sunglasses	Minimum 50% off	Upto 80% off	Upto 80% off

Table 1: Quantum of discounts for key product categories (1 August 2015)

CONSOLIDATED LOSSES

The three major B2C E-commerce company are yet to post a profit despite their high GMV. According to a UBS report [5], Flipkart, Amazon India and Snapdeal reported a combined revenue of $85 million and a loss of $163 million in FY14. At the risk of over simplification, this means these companies spent nearly $3 to earn revenue of $1[6]. The consolidated losses as a result of the discount based strategy stands at Rs. 1000 Crore. The root cause for these losses seem to be the high percentage of discounts which seem to eat up the profit margins. While it can be argued that, being on the early stage of the product life cycle, the immediate concern is revenue growth and not profitability. However as Pinaki Ranjan Mishra, national leader retail practice at EY, says "You can't run a business unprofitably for long. You have to earn profit to be sustainable." [7].

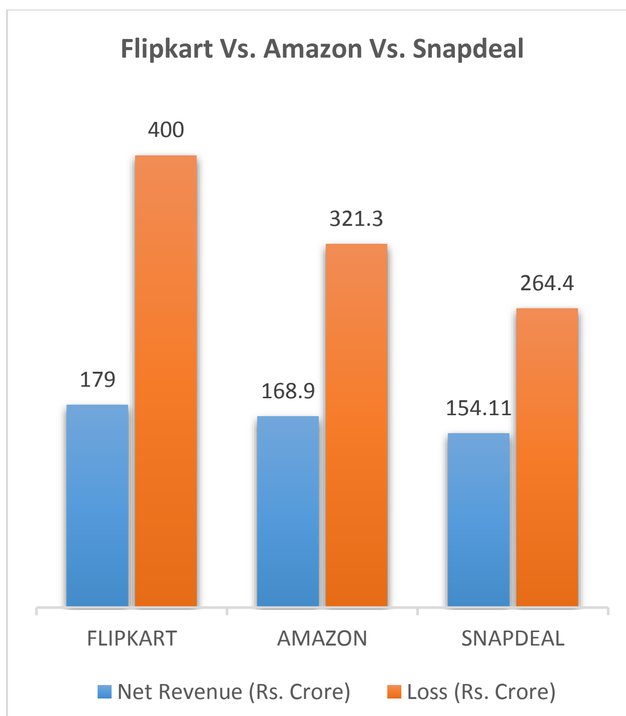


Figure 3: Comparison of net revenue and losses [6]

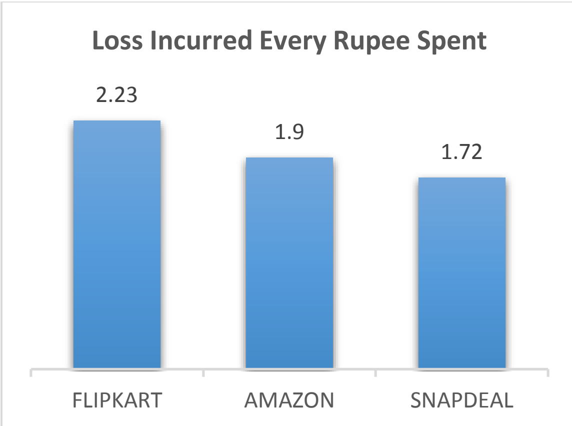


Figure 4: Loss incurred per unit investment [6]

OVERVALUATION

Since the losses incurred are balanced by the equity infused by the private investors, there is a fear amongst analysts that the E-commerce space is a bubble waiting to burst. For instance, Flipkart here, raised 1.91 billion USD in 2014 which took it to a valuation of roughly 16 billion USD. Flipkart today is amongst the highest valued privately held companies. However on comparing with Alibaba, which is profitable (reasons to be discussed in next section), the valuation to GMV multiple is somewhere 0.65-0.7 [7]. A similar story can be seen with other E-commerce majors. Given the current burn rate of the E-Commerce major companies, they might face difficulty in raising money and they will be forced to raise capital at lower valuations or at par with current valuations.

Another concern is that some analysts feel that E-commerce industry is going on the same path that led to the dot com bubble burst of the early 2000's. Whether this holds true is something that only time can tell [8].

TAX ISSUES

Indirect fallout of the discount based model also has problems pertaining to sales tax. For instance, if a product priced Rs.100 is sold for Rs.70 by a seller on an E-Commerce platform, the online retailer will collect Rs.70 from the customer, keep a cut for itself, and give the remaining proceeds to the seller. Then, the E-Commerce platform will also give the seller an additional amount to account for the discount offered by the seller. This amount could be Rs.30 or lower. [9] This method potentially poses a problem for state tax authorities. Tax is typically charged on the product when there's a transfer of ownership. In the case of e-commerce, sales tax is collected on the cost of the product and then on the price at which it is sold to the final customer. If a product is sold on a site below the cost price—as it happens in some cases—then the tax collected from the customer is much lower than what was paid originally. In this case, the seller would potentially be eligible to get a tax refund from the concerned state tax department. The Karnataka commercial tax department in second half of 2014 has stopped Amazon India [10] from selling electronics and several other products from its warehouse in the state by cancelling the licenses of third-party merchants that work with the local unit of the world's largest online retailer. These unfavorable government regulations can be detrimental for the entire sector.

THE WAY AHEAD

While it can be argued that the root cause of some of the major industry problems is the discount based strategy, given the consumer behavior of Indians and the hesitation of the Indian consumer towards internet based commerce, it is unrealistic to say that discounts will completely disappear. Quoting Mr. Vidmay Naini, Business Head of Ebay, "It is in the DNA of Indians to bargain, from that point of view discounts are going to stay and are not going away anytime soon." [11]. Continuing on this thought, this paper proposes some of the strategies that can be used to mitigate the effects of discount to some degree.

EXCLUSIVITY

Recently, a trend of exclusive launches on a single platform has emerged. In the last couple of years, major brands like Xiaomi, Motorola, One Plus 2 etc. were launched exclusively on a single platform only. The advantage of this approach is that since there are no competing platforms, there is no requirement of using heavy discounts to entice customers. This is evident that most of the exclusive launches do not have more than 20% discounts. Moreover, exclusivity is the closest alternative to induce brand loyalty in the e-tail industry. As of now, most of the exclusive deals are mostly for mobile devices, books and high end apparels. A future strategy could be to broaden the scope of exclusive deals to daily household requirements like introducing FMCG brands. Recently, a lot of E-Commerce startups (like Groffers) have been targeting this particular segment. Having more exclusive brands which are used on a daily basis will not only help to reduce the financial burdens of the discount but also help to increase market share.

Amazon	Flipkart	Snapdeal
OnePlus2	MotoE , G, X	Xolo
InFocus M810	Half Girlfriend	Micromax Canvas Spark
Yureka Plus	Diesel	HTC

Table 2: Major exclusive deals

B2B E-COMMERCE

A surprising paradox of the E-Commerce industry is that while B2C platforms are not/less profitable, B2B platforms have been successful in creating profits. The best example of this is Alibaba that posted a profit of 467 million USD, or 18 cents a share and has one of the lowest valuations to GMV ratios [12]. One of the basic reasons for this profitability in the B2B sector is the lack of heavy discounts. Since B2B customers have more emphasis on quality of product rather than price of the product, the need to entice customers with discounts evaporates. Also given the value driven nature of B2B business, there is a huge potential for E-Commerce industry. According to a report in Forbes, B2B E-commerce is expected to reach up to 6.7 trillion USD by 2020 [13]. As of now the Chinese are the dominant forces, but there is a big market share which can be taken up by the Indian E-commerce majors. Having said that, there are some inherent complexities to this strategy. Volumes are much higher, but also of a much wider range, necessitating a flexible shipping and logistics solution. Tax and regulatory concerns impact sales highly, and providers typically employ large staffs whose only responsibility is delivering products and services within these restrictions. Marketing is more complex, as clients need to understand how products work and interact with other systems they already have or are considering for purchase. These are some of the key challenges that an E-commerce platform needs to overcome to successfully foray into the B2B E-Commerce world.

CONCLUDING THOUGHTS

The E-Commerce industry, in the last five years or so, has revolutionized the concept of shopping in India. As the internet penetration and infrastructure improves, this industry stands to flourish. Having said that, there are some key issues that need to be resolved. While some have been discussed in this paper, there are other issues like penetration of market share, gaining and upholding customer trust etc. However the biggest challenge remains whether the industry can adapt itself to an ever changing business environment. Nevertheless, the one thing that remains constant is customer satisfaction and convenience. If a company can deliver this on a consistent basis - no need for discounts in the long run.

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