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Online Retail in India
Clicking Towards Growth

November 2014

Background

The previous Indian Government's move in September 2012 to allow Foreign Direct Investment (FDI) in Multi-Brand Retail (MBRT) was seen as a major reform and was expected to attract global players along with significant investment at the backend. It is fair to say that there has been a significant gap between realized and expected benefits.

When MBRT was allowed in 2012, Deloitte in India had shared its views in a paper published in January 2013 – 'Opening More Doors'. That paper had identified the potential hurdles in realizing the envisaged benefits, which included restrictions like minimum local sourcing from SMEs, designated levels of investments at the backend, approvals required from state governments and presence in million plus cities. While the previous government has since looked to ease some of the restrictions, the situation has not changed. These, coupled with the overall economic and political climate that has prevailed since, had played a key role in the muted impact of this 'big-bang' reform.

Deloitte believes that the online retail could have significant direct and indirect upsides to the consumption landscape in India. The B2C e-commerce market in India has exhibited rapid growth and has attracted large investments from the PE/VC community. With positive fillips from the demand and supply side, this market is likely to reach $60Bn by 2017.

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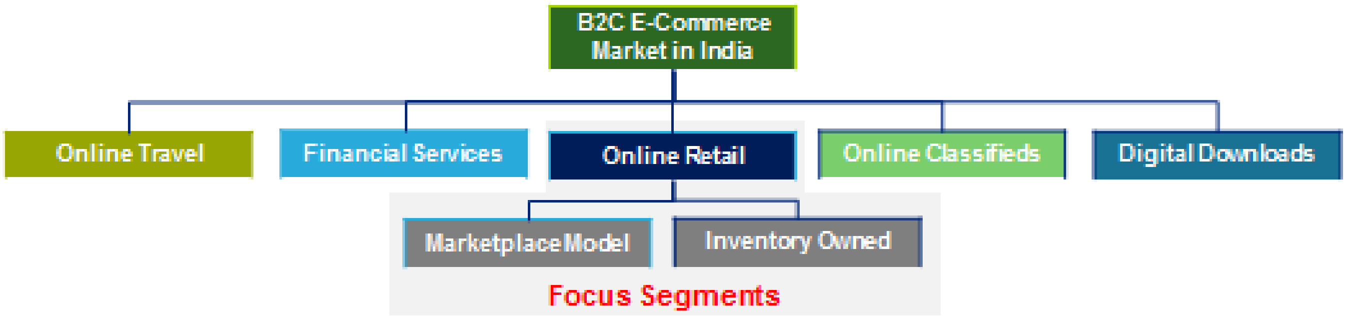
Background

From the policy perspective, it is essentially the inventory-owned model that is now looking for government approval. The market place model has seen significant amount of FDI, either through the PE/VC route or with the entry of global players like Amazon. Thus, it would be interesting to note whether any policy announcement covers the marketplace model specifically, thus causing flutter amongst existing players.

There was talk in early 2014 of FDI norms getting relaxed in B2C e-commerce. But that momentum does not seem to continue with the change in regime, especially with its negative view with regard to MBRT. It remains to be seen as to how the current establishment views the online retail market opportunity which could be a potential market discontinuity in the India consumption story.

Fig 1: B2C E-Commerce Segments



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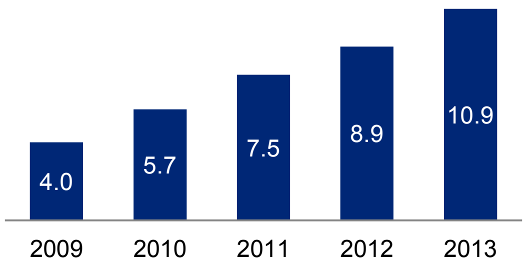
Online Retailing in India: Opportunity of the Future

The Indian B2C/C2C e-commerce sector has grown rapidly in the last 5 years to reach USD11Bn in 2013 (Fig 2). This segment is expected to grow to USD 60Bn by 2017, making India the fastest growing e-commerce market in the APAC region. The major factors driving this growth are decreasing cost of devices (PC & mobile), increasing internet penetration, more payment options backed and lastly changing consumer preferences.

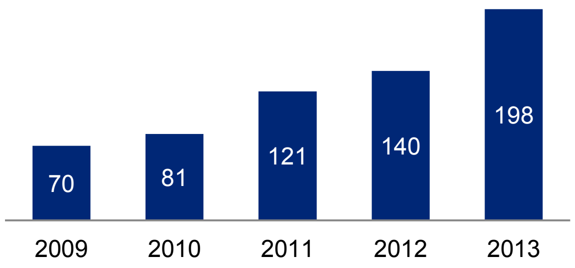
India has the third largest internet user base in the world behind China and US and is expected to overtake the US in the next 2-3 years. While it took a decade for the number of internet users in India to move from 10 million to 100 million, the subsequent leap to 200 million happened in a mere three years (Fig 3). This accelerated pace of growth is expected to continue and to be bolstered by the number of users accessing the internet from their mobile devices, estimated at 110 million users as of October 2013 and growing rapidly. This rapid spread of mobile internet, especially of smart phones could unlock a significant market beyond the Tier 1 cities for the online retail segment.

Fig 2: B2C/C2C E-Commerce Sales in India (USD Bn)



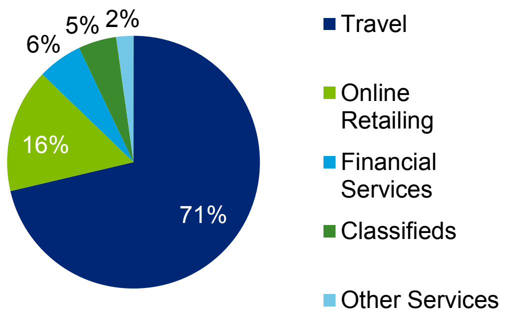
Source: eMarketer, Deloitte analysis

Fig 3: Internet Users in India (Mn)



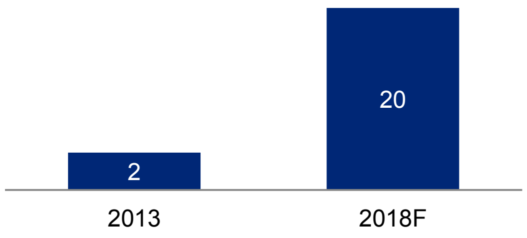
Source: IAMAI, TRAI, Deloitte analysis

Fig 4: Key Segments 2013



Source: eMarketer, Deloitte analysis

Fig 5: Online Retail Market in India (USD Bn)



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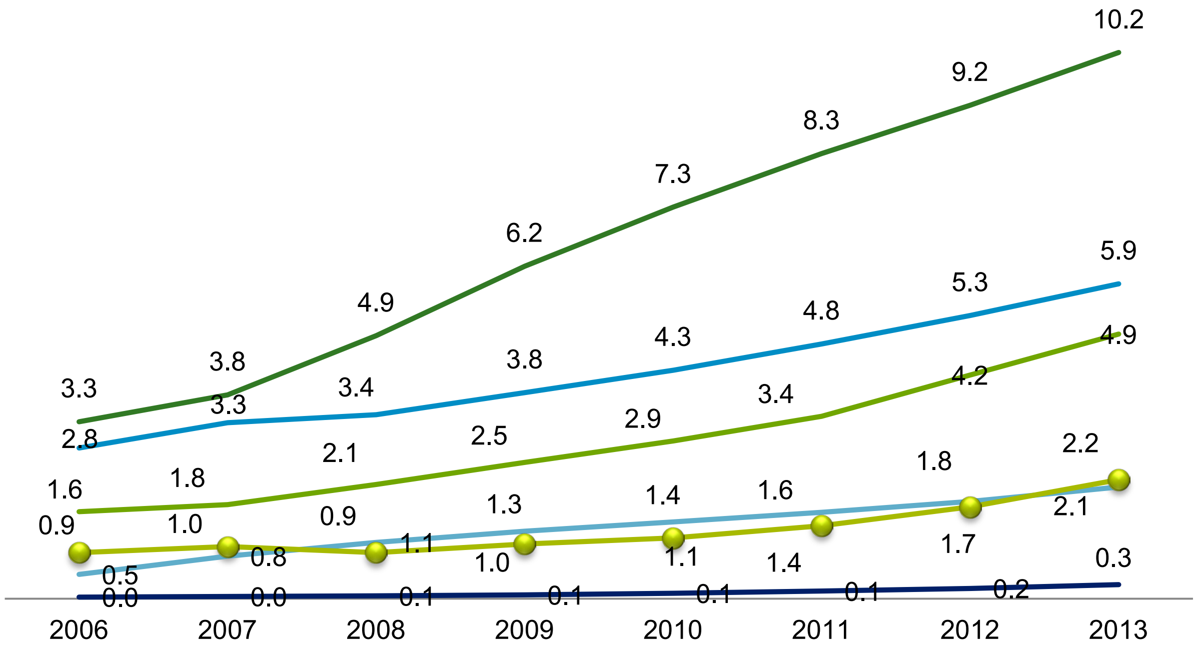
Online Retailing in India: Opportunity of the Future

Currently travel has more than a 70 percent share of the B2C e-commerce market (Fig 4), which is likely to come down with online retail gaining prominence (Fig 5). Industry experts believe that this ‘second-coming’ of the online retail sector in India is here to stay. This confidence comes from the much better eco-system that prevails in terms of consumer acceptance and the infrastructure to deliver. And there is the successful example of the air and train travel segment where online booking has permeated across socio-economic strata. Experts also point out that with the huge mobile subscriber base and fast increasing base of mobile internet users, the Indian online retail market could potentially take a non-linear growth in the years to come (Fig 6).

This sentiment is shared by PE/VC community which has backed the India online retail market, by investing nearly USD2Bn in various online businesses by first half of 2014. In the recent past, significant additional investments have been shared publicly, the USD1Bn funding raised by Flipkart, Amazon’s planned USD2Bn investment and the proposed USD650Mn funding to be raised by Snapdeal.

Fig 6: Share of Online Channel in Overall Retail (%)



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Continuing Challenges for the Indian Online Retailer

It is interesting to note that the access to capital has also led to Indian online retailers looking to buy market share. This has been especially true for the large players like Flipkart, Amazon, Myntra, Jabong and Snapdeal. Players have indulged in aggressive pricing backed by massive advertising spends. Everyone is wanting to be the 'last-man standing' in this bloodbath. The PE players continue to back their chosen players in this sustenance game with repeated capital infusions.

Another peculiar challenge in the Indian online retail market is the majority share of Cash-on-Delivery (CoD) amongst payment options. While CoD has definitely enabled the explosive growth of online retail, it has also presented multiple challenges like additional cost, longer revenue realization cycle, increased supply chain complexity, and fraud risk. Current market structure and consumer purchase patterns indicate that CoD is not likely to go away in a hurry. However, its share is likely to reduce gradually, with increasing penetration of credit/debit cards coupled with its online usage and greater consumer confidence in such transactions.

The Indian online retail market has had a dream run in recent years when it comes to transaction value, however significant challenges still remain. These challenges are expected to drive consolidation in the market. We strongly believe that Flipkart's acquisition of Myntra is potentially the start of this consolidation phase. There will be many more; the question is when and to what extent.

While developing this PoV, we met many industry experts who suggested that Indian online players should study global learnings in their attempt to create a sustainable business model. This is based on the premise that market characteristics of online retail are more similar across geographies as compared to brick and mortar retail. Thus, looking at how online retail has shaped up globally and studying relevant success factors could provide significant insights.

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Increasing Share of Online in the Global Market

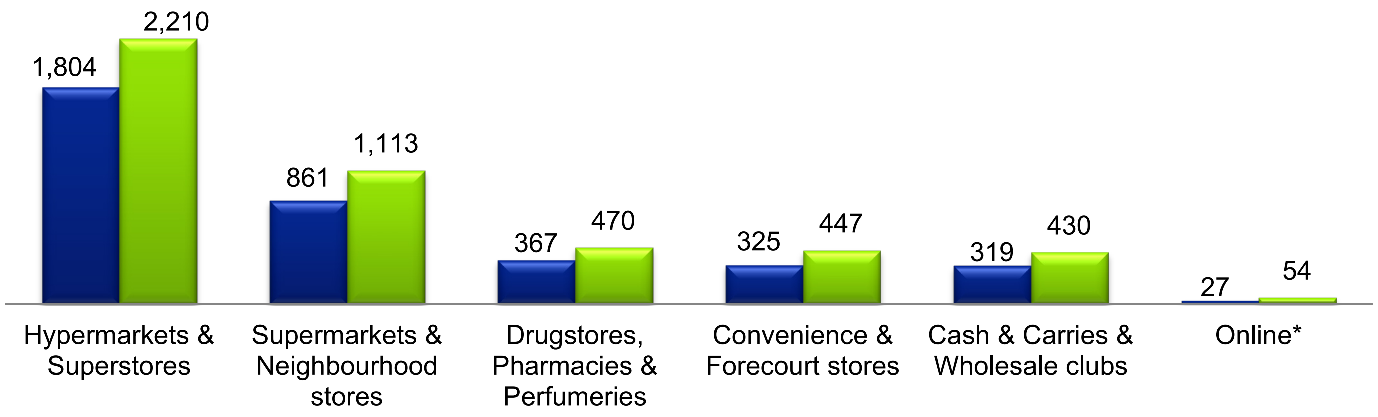
Online retail is the fastest growing channel globally, as confirmed by the Planet Retail's retail panel data (Fig 7). The online channel is expected to grow at a much faster rate vis-a-vis more established channels. The channel is expected to account for 10.1% of overall retail sales in 2018, up from 6.5% in 2013, and 3.5% in 2008.

Developed markets like the US already observe 7.7% retail sales via the online channel and expect it to reach 10% by 2017.

In China, online retail accounts for 5% of the total retail sales and in absolute terms, it is expected to have overtaken US online retail very shortly. On a broader note, e-tailing is estimated to have added 2% to China's private consumption in 2011 and expected to add 4-7% by 2020. These are significant metrics when it comes to stimulating demand from such a huge base.

Research indicates that global e-retailers have not been able to make much headway in developing markets like China, Brazil, and Russia. In these geographies, domestic players have emerged as market leaders by leveraging their superior understanding of consumer needs.

Fig 7: Global Retail Channels Growth (USD Bn)



Source: Planet Retail, Deloitte analysis

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Category-Level Learnings in the Global Market

The sizeable categories sold online are Consumer Electronics and Apparel, accounting for roughly 40% and 45% in the US and China, respectively. And as expected, for the books category, 45% of retail sales in the US come from the online channel.

It is interesting to note that globally, the share of the online channel in food & grocery (F&G) retail is negligible. However there are certain hybrid concepts like the 'Drive Format' which is a form of 'Click & Collect' gaining ground in markets like France. This format was nearly a Euro 4Bn market in France in 2013 having grown at 75% YoY. This concept looks to target young shoppers who are looking for convenience because of hectic lifestyles (Box 1: Drive Format).

Another interesting trend is the performance of niche online retailers in the developed markets. These players have the tendency to bypass the large online retailers. Wayfair is a great example from the US market, with revenues nearing $1Bn and profitability achieved in a little over 10 years. Wayfair started out by offering niche home products on 200 absurdly named narrow sites such as everygrandfatherclock.com and allswivelbarstools.com. They have recently merged under the brand Mayfair and are eyeing the $500Bn home goods market in the US.

Box 1: Drive Format

Drive is a form of click and collect:

- Where a retailer prepares customer orders placed online;
- With or without order fee;
- Where shoppers collect their order at a pick-up point with a dedicated car parking area at a time of their choosing;
- Shoppers have to identify themselves at the terminal;
- Where orders can be pre-paid online or paid for at the collection point

Source: Planet Retail, Deloitte analysis

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Omni channel Retailing
The Way Ahead

Brick and mortar retailers are increasingly realizing that the physical store is just one part of the overall consumer experience. Access to the internet and mobile devices has enabled consumers to research and shop anytime, anywhere. This has resulted in a critical need for retailers to take a holistic view of the various channels.

This new concept of retailing which integrates and aligns all channels of consumer engagement (stores, e-commerce, mobile apps, and social media) is called **Omnichannel retailing**. This talks of a flexible and seamless shopping experience to consumers, irrespective of which of the channels is being used to engage with the brand.

The table on the right lists out the Top 20 online retailers globally (Fig 8). Interestingly 14 of them are brick and mortar retailers. And each of them has shared their intent to invest in the online channel.

Fig 8: Top 20 Global Online Retailers

Retailer	Online Sales (USD Bn)	Online Share of Total Sales (%)
Amazon	85	100%
Apple	18	43%
360buy	17.8	100%
Walmart	9.2	2%
Otto Group	8.8	47%
Dell	7	100%
Tesco	5	4%
Casino	4.5	35%
Sears	3.8	9%
Netflix	4.5	100%
Rakuten	3.6	100%
Newegg	3.2	100%
Suning	3.1	21%
QVC	2.9	40%
Lojas Americanas	2.8	42%
Staples	2.7	10%
CostCo	2.6	2%
Best Buy	2.5	5%
Dixons Retail	2.4	15%
Next	2.7	33%

Source: Planet Retail, Deloitte analysis

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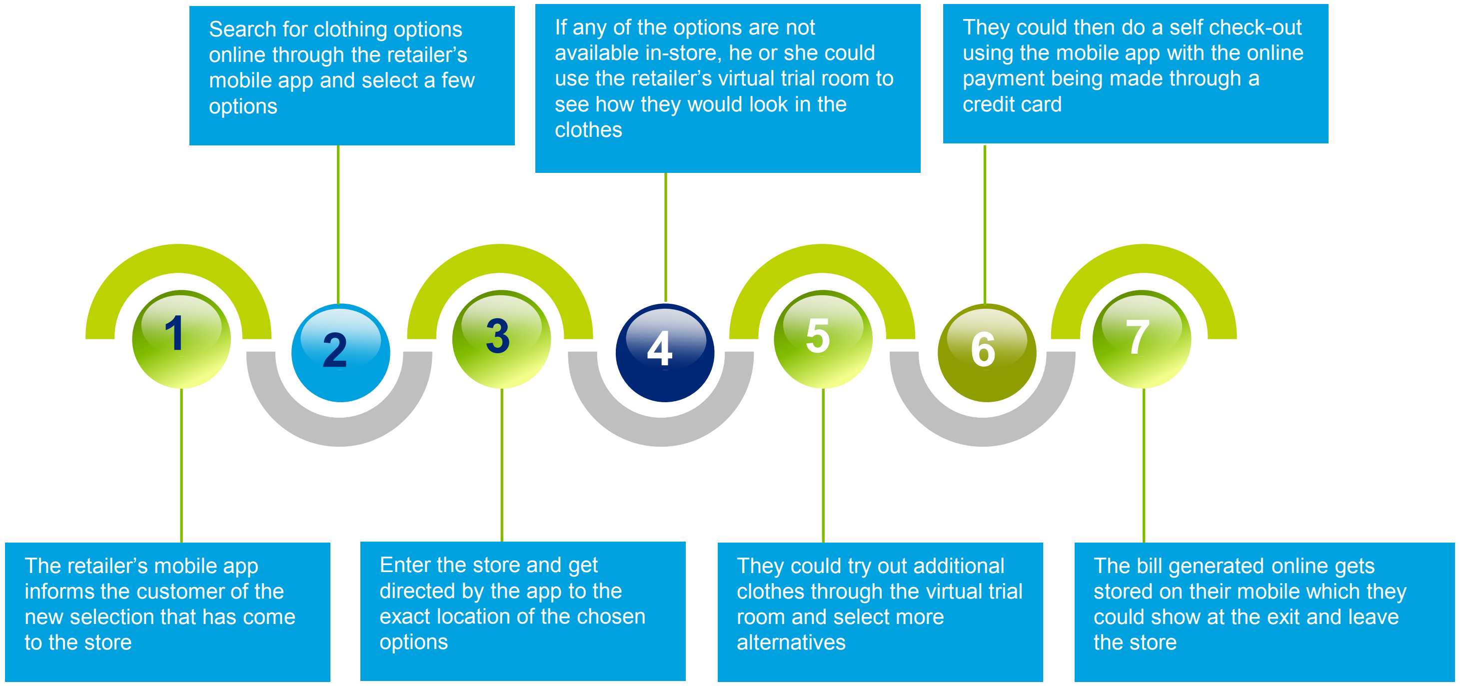
Omni channel Retailing

The Way Ahead

In India, large brick and mortar retailers like Shoppers Stop, Croma and Future Group have invested in building their online capabilities, albeit that the business share currently is extremely small, at <5%. However there is unanimity on the importance of this channel. With their stores already existing as brand mascots, it will be critical for these players to align all their channels and not grow them separately. This could act as a significant differentiator in an increasingly cluttered market.

For example, given below is a figure that describes how aligning various points-of-engagement could provide a much superior experience to an apparel consumer.



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Consumer

The Biggest Benefactor of Online Retailing

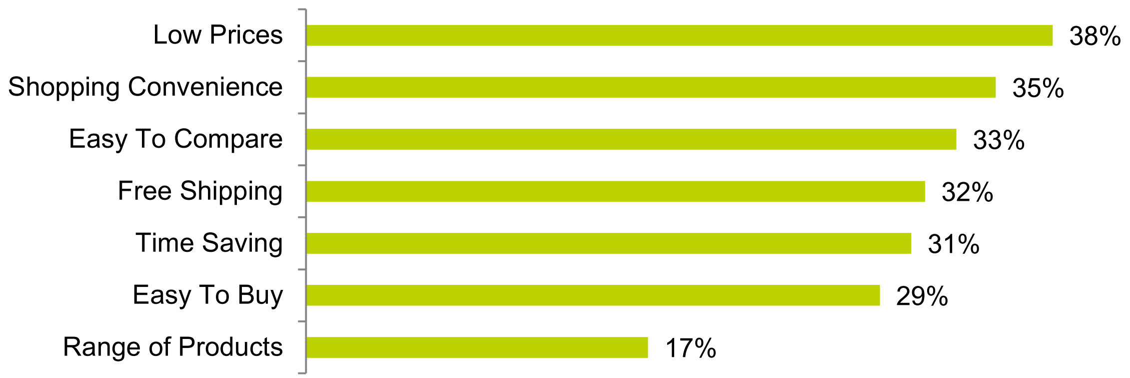
The consumer is the biggest beneficiary of online retailing in all its variations. Research indicates that the wide choice of products at lower prices coupled with convenience emerge as top reasons for consumers to shop online (Fig 9).

Deloitte recently conducted a survey in the European market which revealed certain interesting facts on the importance of Omni channel:-

- Up to 37% of transactions made online are likely to be additional to in-store purchases
- Up to 25% of recent online purchases were goods which could not have been purchased locally
- Up to 63% of shoppers used multiple channels when making orders above 100 Pounds

In China also, surveys have revealed that slightly less than half of every Yuan spent online is new consumption generated from the online channel – this proportion is expected to be even higher in lower tier cities. The new channel is thus, driving the overall industry's size higher and propelling consumption in the country – a trend that would hopefully be replicated in India.

Fig 9- Why People Buy Online?



Source: Invesp

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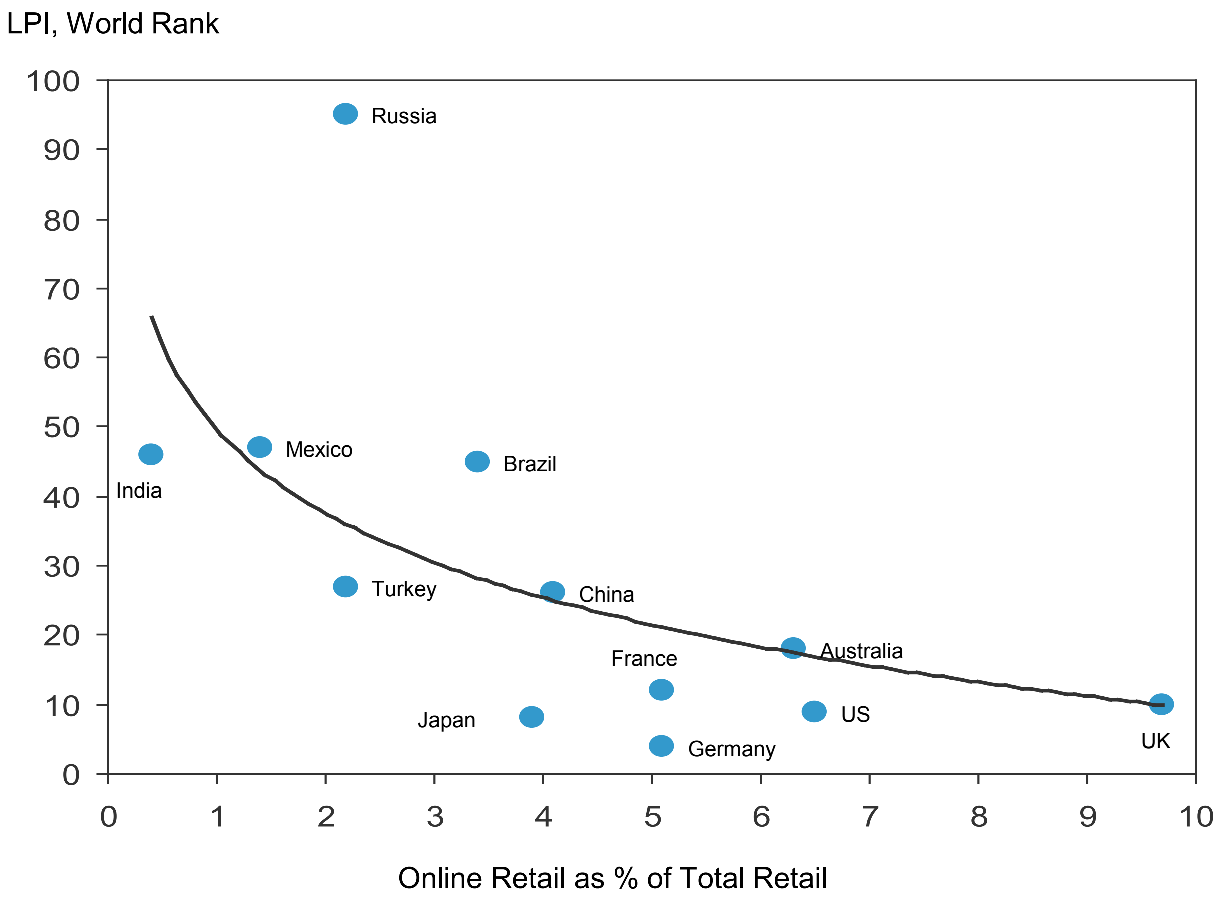
Benefits in Manufacturing and Logistics

The growth of e-commerce is likely to provide a fillip to the manufacturing sector by driving overall demand for goods. This channel is especially critical for the SME sector which gets extended market reach.

E-commerce also gives rise to a new class of logistics and distribution owing to business requirements. Typically, this includes mega fulfilment centers, parcel sorting and delivery centers, local depots for rapid order fulfilment and return order processing. Globally e-commerce growth has improved retail logistics – studies indicate that countries with a high proliferation of online retail rank high on World Bank's 'Logistics Performance Index' (LPI). These include countries like the United States, United Kingdom, Australia and Germany (Fig 10).

Fig 10: Logistics Performance Index (LPI) v/s Online Retail Penetration



Source: JLL Online Retail Logistics Report

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Potential Discontinuity in the Indian Online Retail Market

Online retail in India could potentially be a disruptive model for the Indian market. It helps players avoid two of the most oft repeated challenges in Indian retail – high rental costs and lack of skilled store level manpower.

If provided with the right regulatory enablers and economic conditions playing out favorably, the online market opportunity could be substantially higher. To estimate this incremental value, the typical lag between India and China on various macro-economic, adoption, and consumption indicators was observed (Fig 11). This analysis revealed a broad range of 2 to 20 years, with 6-7 years being the most common. It was interesting to note that organized retail share showed the highest gap, and this is one area which has seen significant policy restrictions in India.

Thus, it is fair to assume that with the 'right' enabling framework, online retail in India can be a disruptive market opportunity. Taking a conservative 10-year gap from the above logic, we could potentially add more than $12Bn to the originally projected market size for the Indian online retail market in India (Fig 12).

Fig 11: China vs India Across Key Indicators

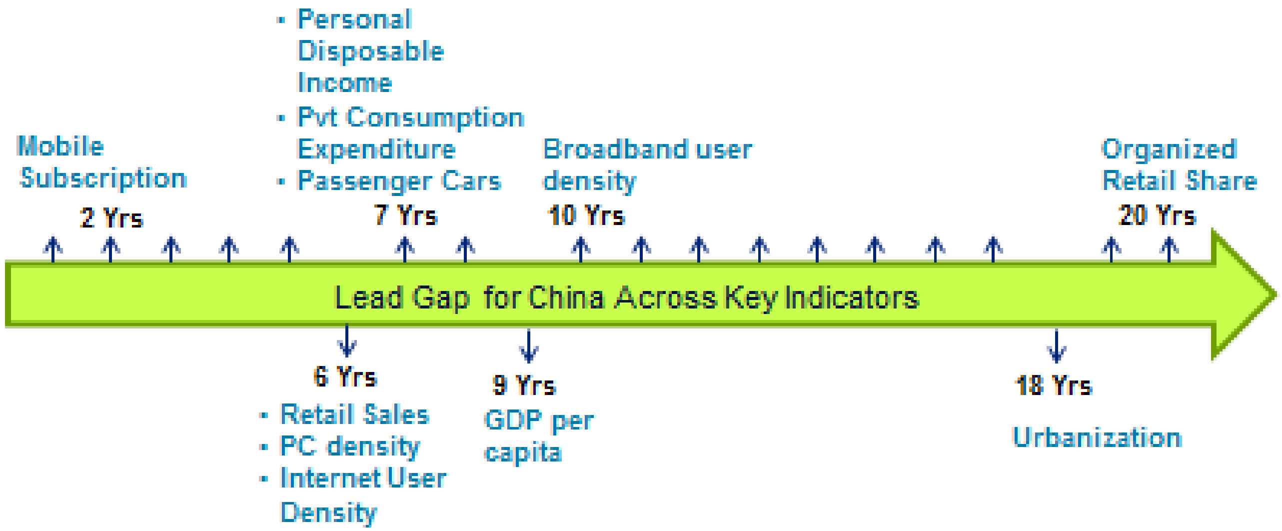
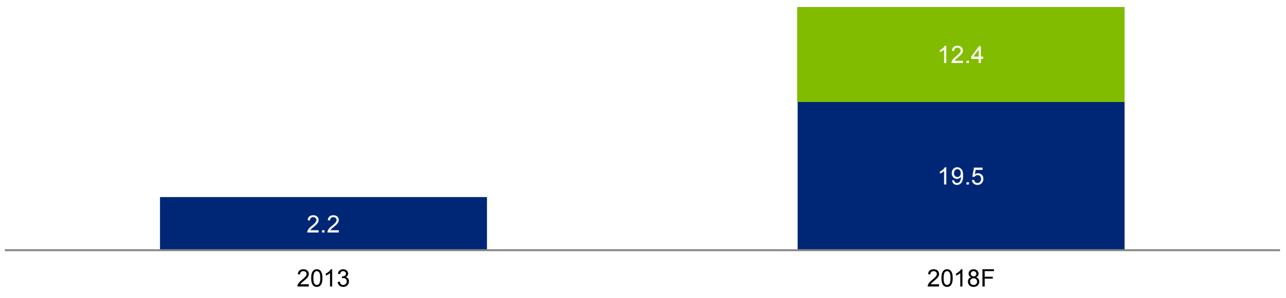


Fig 12: Accelerated Growth of Online Retail Market in India (USD Bn)



Our Point of View on the Proposed Policy considerations

E-commerce is a global mega trend and is rapidly gaining ground in India. It is crucial for a large consumer market like India to put in place a framework that could help leverage this market opportunity. The role of foreign capital in growing this segment is likely to be critical. Thus, allowing FDI in this sector would act as a great enabler in accelerating the growth of online retail and drive consumer demand as a whole.

And if an important objective is to drive demand, there should be no restrictions on the products or services that can be offered via e-commerce. Similarly, there should not be any geographic constraints. The point on geographic constraints might be slightly irrelevant considering that internet penetration and online retail primarily is a top-down phenomenon in the city hierarchy. There has been positive movement with the recent budget by the new government allowing manufacturers to engage in e-commerce.

The fundamental objective of opening up any FDI is to attract foreign investments into India. Thus there should not be any restrictions on foreign shareholding. This will ensure sustained interest in growing the Indian business and would enable them to make investments in line with their business models. However, to ensure that only serious players enter this market, the government could explore a minimum quantum of investment in select categories.

While there are reservations expressed on the impact of e-commerce on local kirana stores and small players, we expect such negative impact to be minimal. Preliminary analysis suggests that the Indian retail market accords opportunities for multiple retail channels – traditional, organized, and online. All these three channels are expected to register growth in coming years. This indicates that the total retail market in India is large enough to accommodate multiple channels. Moreover, the organized retail segment will more likely feel the impact of the growth in online retail. The cause for worry for traditional retail is much lower.

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