Rebirth of e-Commerce in India
India is at the cusp of a digital revolution. Declining broadband subscription prices, aided by the launch of 3G services, have been driving this trend. This has led to an ever-increasing number of “netizens.” Furthermore, the likely launch of 4G services is expected to significantly augment the country’s internet user base.

Internet has become an integral part of this growing population segment for remaining connected with friends, accessing emails, buying movie tickets and ordering food. The changing lifestyles of the country’s urban population have also led many people relying on the internet for their shopping needs. The convenience of shopping from the comfort of one’s home and having a wide product assortment to choose from has brought about increased reliance on the online medium.

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Foreword

Milan Sheth
Partner and Technology Industry Leader
Ernst & Young Pvt. Ltd., India
The trend of online shopping is set to see greater heights in coming years, not just because of India’s rising internet population, but also due to changes in the supporting ecosystem. Players have made intensive efforts to upgrade areas such as logistics and the payment infrastructure. Furthermore, the Indian consumer’s perception of online shopping has undergone a drastic change, and only for the good. Given these developments, venture capital investors, who were restricting themselves to the sidelines, are now taking a keen interest in the country’s e-Commerce market.

In this report, we seek to provide an insight into India’s e-Commerce market. The report focuses on the various sub-segments of the e-Commerce market and highlights factors driving growth across these segments. We have also elaborated on challenges faced by stakeholders.

We are immensely grateful to industry leaders who participated in our survey and helped us present a comprehensive perspective of the market.
Table of contents

Methodology 06
Executive summary 07
Chapter 1 e-Commerce: view from the top 09
1.1 Services provided under the various modes of e-Commerce 10
1.2 The key stakeholders 11
1.3 How the market evolved in India 12
1.4 E-commerce market size in India 12

Chapter 2 e-Commerce ecosystem: enablers falling in place 17
2.1 First to second wave: fundamental enablers falling in place 19
2.2 Devices 20
2.3 Internet 22
2.4 Payment landscape undergoing change 29
2.5 Summary 35

Chapter 3 Online travel: lion’s share of the market 37
3.1 Market size and revenue sources 39
3.2 Ticketing — big brother of the online travel market due to its standardized nature 40
3.3 Growth in the online hotel reservations and hotel packages 42
3.4 International players adding to challenges facing domestic OTAs 45
3.5 Low technology adoption limiting growth of bus services in online travel segment 45
3.6 Summary 45

Chapter 4 Online retail/e-Tailing 47
4.1 Structure of online retail market 50
4.2 Emerging business models in India 51
4.3 Key decision points 52
4.4 Challenges in online retail market 61
4.5 Top categories driving online retail 62
4.6 Top reasons driving online retail 64
4.7 Summary 67

Chapter 5 Online classifieds 69
5.1 Market size and revenue sources 70
5.2 Transition from print media to the web 71
5.3 Online recruitment classifieds — largest category in online classifieds 72
5.4 Online matrimonial classifieds 73
5.5 Online real estate and auto classifieds a small portion of online classifieds 73
5.6 Challenges in online classifieds segment 75
5.7 Summary 75

Chapter 6 Investments in e-Commerce 77
6.1 Reduction in period between subsequent rounds of funding and increase in deal size 78
6.2 VCs investing across different e-Commerce verticals 79
6.3 Valuations — too good to be true? 79
6.4 VC players banking on growth of e-Commerce to make lucrative exits 80
6.5 Impact of retail FDI on e-Commerce players 80

Chapter 7 Challenges for e-Commerce sector 83
7.1 Cloud surrounding e-Commerce laws in India 84
7.2 Low entry barriers leading to reduced competitive advantages 84
7.3 Rapidly changing business models 84
7.4 Urban phenomenon 85
7.5 Shortage of manpower 85
7.6 Customer loyalty 85
Methodology

In 2012, Ernst & Young conducted a research study on the Indian e-Commerce sector, elucidating a detailed market perspective. The report focused on the key e-Commerce segments – travel, retail and classifieds – along with elaborating on the ecosystem, investment scenario and operational challenges.

As a part of the study, Ernst & Young conducted comprehensive interviews with the founders and senior executives of Indian e-commerce companies. These interviews provided a firsthand perspective on opportunities and challenges in store for various stakeholders. These findings have been combined with secondary research, analysis and insights provided by Ernst & Young.

List of participants

<table>
<thead>
<tr>
<th>Name</th>
<th>Designation</th>
<th>Company</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kunal Bahl</td>
<td>Chief Executive Officer</td>
<td>SnapDeal</td>
</tr>
<tr>
<td>Sundeep Malhotra</td>
<td>Chief Executive Officer</td>
<td>HomeShop18</td>
</tr>
<tr>
<td>Vikram Malhi</td>
<td>Country Head</td>
<td>Expedia (India)</td>
</tr>
<tr>
<td>Hitesh Oberoi</td>
<td>Chief Executive Officer</td>
<td>Info Edge</td>
</tr>
<tr>
<td>Madhup Agrawal</td>
<td>Head, New Initiatives</td>
<td>IndiaMART</td>
</tr>
<tr>
<td>Vivek Madhukar</td>
<td>Senior Vice-President</td>
<td>Times Business Solution</td>
</tr>
<tr>
<td>Vishal Mehta</td>
<td>Chief Executive Officer</td>
<td>Infibeam.com</td>
</tr>
<tr>
<td>Manu Agarwal</td>
<td>Chief Executive Officer</td>
<td>Naaptol.com</td>
</tr>
<tr>
<td>Sandeep Murthy</td>
<td>Chief Executive Officer</td>
<td>Cleartrip</td>
</tr>
</tbody>
</table>
Executive summary

The e-Commerce market in India has enjoyed phenomenal growth of almost 50% in the last five years. Although the trend of e-Commerce has been making rounds in India for 15 years, the appropriate ecosystem has now started to fall in place. The considerable rise in the number of internet users, growing acceptability of online payments, the proliferation of internet-enabled devices and favorable demographics are the key factors driving the growth story of e-Commerce in the country. The number of users making online transactions has been on a rapid growth trajectory, and it is expected to grow from 11 million in 2011 to 38 million in 2015.

Venture capitalists (VC) and private equity players have demonstrated their faith in the growth of e-Commerce in the country. This is amply substantiated by the significant increase in the total investments (US$305 million in 2011 against US$55 million in 2010).

Online travel has traditionally been the largest e-Commerce sub-sector (by revenue) in India. Nevertheless, online retail is catching up fast and is expected to match online travel revenues by 2015. To improve margins, online travel players are diversifying their offerings to include hotel reservations, along with the regular ticketing services. To make the most of this move, players will need to develop skill sets that are different from the ones required in the ticketing segment. They will have to manage challenges associated with a diverse supplier base, technological constraints, customer experience, authenticity of information and grievance re-dressal.

The online retail segment has evolved and grown significantly over the past few years. Cash-on-delivery has been one of the key growth drivers and is touted to have accounted for 50% to 80% of online retail sales. Players have adopted new business models including stock-and-sell, consignment and group buying; however, concerns surrounding inventory management, location of warehouses and in-house logistics capabilities are posing teething issues.

Classifieds, the earliest entrant in the e-Commerce space in India, is undergoing a shift in operational model from vertical to horizontal offering. Players now offer a gamut of services ranging from buying/selling cars to finding domestic help/babysitter.

To ensure that e-Commerce maintains the steam that it has gained in recent years, the government needs to focus on the regulatory front. Unlike many other countries, India still does not have dedicated e-Commerce laws. The Sales Tax laws need to be revised, as they are posing issues for online retailers while they decide warehouse location.

e-Commerce is set to continue on its growth path on the back of the stabilization of the ecosystem and interest demonstrated by VC players, combined with support from the Government of India (GoI).
Chapter 1

e-Commerce

View from the top

1.1 Services provided under the various modes of e-Commerce  
1.2 The key stakeholders  
1.3 How the market evolved in India  
1.4 E-commerce market size in India
1.1 Services provided under the various modes of e-Commerce

e-Commerce transactions can be segmented into three broad categories or modes, based on participants involved in the transaction.

**Modes of e-commerce transactions**

- **C2C**
  - Online classifieds
  - Online retail
- **B2C**
  - Online travel
  - Online retail/e-tailing
  - Online classifieds
  - Digital downloads
  - Financial services
- **B2B**
  - Online classifieds

<table>
<thead>
<tr>
<th>Online travel</th>
<th>Online retail/e-tailing</th>
<th>Online classifieds</th>
<th>Digital downloads</th>
<th>Financial services</th>
</tr>
</thead>
<tbody>
<tr>
<td>Customers buy tickets, book hotels and purchase tour packages online. The ticketing services can be for airlines, railways or buses</td>
<td>Online sale of products such as books, mobile handsets, mobile accessories, electronics and home and kitchen appliances among others</td>
<td>Portals connecting buyers and sellers by providing classifieds space where the sellers can advertise their product</td>
<td>Paid music, videos and games download</td>
<td>Online sale of insurance, loans and mutual funds</td>
</tr>
</tbody>
</table>

- **Business-to-Consumer (B2C):** The B2C market in India generates the bulk of revenues across the consumer-facing modes of e-Commerce. Furthermore, though online travel has typically held a major share of the B2C market, online retail is also growing rapidly and is expected to significantly increase its share.

- **Consumer-to-Consumer (C2C):** India's C2C market, though currently small, is set to grow with the entry of several players. These entrants are attracting VC investment. Their online portals are also garnering significant traffic. We expect the C2C segment to show rapid growth in coming years.

- **Business-to-Business (B2B):** The most common users of B2B online classifieds are micro, small and medium enterprises (MSMEs). These small businesses lack the requisite financial resources and, therefore, find it difficult to market their products and services to potential clients through traditional media such as newspapers, banners and television. Trade through online B2B portals increases the visibility of MSMEs in the marketplace and helps them overcome barriers of time, communication and geography.
1.2 Key stakeholders

Multiple stakeholders are engaged in the e-Commerce sector.

The supplier list is set to grow, with a number of businesses and individuals looking to join the e-Commerce bandwagon. The customer/buyer has become the focal point for e-Commerce players. In this background, enablers such as logistics players and call centers are widening and evolving their offerings to align them with the strategies of e-Commerce players. To gain an edge and differentiation power, all the key stakeholders are engaging in innovation to provide a rich experience to their customers.

These stakeholders coordinate among each other to facilitate the three main flows in an e-Commerce transaction:

- **Product flow**: movement of goods from suppliers to end consumers through e-Commerce and logistic players
- **Information flow**: Information transmission of orders from customers and subsequent information flow of order status through the value chain
- **Monetary flow**: payments from consumers to e-Commerce players and/or suppliers and vice-versa through financial intermediaries
1.3 How the market evolved in India

On the back of growing internet penetration and evolving consumer mindset, the e-Commerce space has touched new heights. The market was initially limited to print media-dominated classified services. It has now expanded to include new internet-focused business models, e.g., group buying and social commerce.

The evolution of e-Commerce in India can be broadly divided into two phases based on the emergence of various sub-segments. Furthermore, distinct developments define each of these phases.

E-Commerce evolution: the two waves

1st wave (1996-2000)
- Launch of internet in India via dialup in 6 cities
- Launch of online job portals
- Launch of online matrimonial portals
- Not to scale

- Muted activity in the industry due to the dotcom bubble in 2000

2nd wave (2006-present)
- Entry of a number of players in e-tailing segment
- Launch of first group buying website in India
- New trend of use of social networking sites (SNS) as a marketing tool begins or the advent of social commerce
- Launch of online travel agents (OTAs)
- Launch of online B2B portals
- Launch of online matrimonial portals

1.3.1. First wave: advent of online Naukri and Shaadi

The introduction of internet in India in 1995 marked the beginning of the first wave of e-Commerce in the country. Moreover, economic liberalization after the launch of reforms in 1991 attracted MNCs and brought about the growth of the IT industry. The implementation of liberalization policies led to the demise of the license regime, and high taxes and import restrictions, as well as facilitated the growth of SMEs. The IT industry and SMEs were the early adopters of internet. This led to the emergence of B2B, job searches and matrimonial portals.

B2B directory: India’s first online B2B directory was launched in 1996. The liberalization of the country’s international trade policies was the key factor that accelerated the growth of B2B online portals. It enabled buyers and sellers to easily connect with their global counterparts.
Online matrimonial: In 1996, the first online matrimonial portal was launched in India. A concept unique to India, online matrimonial portals transformed the perception about the matchmaking process from “marriages are made in heaven” to “marriages are made in cyber space.” Such portals have now evolved to cater to various segments of the population such as NRIs, H1B visa holders, widows or widowers, divorcees and other special groups.

Online recruitment: India’s online recruitment industry took shape in 1997. The growth of the services sector, following the launch of economic reforms in 1991, resulted in the creation of additional jobs. In this background, internet proved to be an efficient medium that allowed employers and job seekers to connect. Prior to job portals, weekly government magazines such as Employment News and newspaper notifications were the primary means for employers and job seekers to interact.

Online classifieds gained quick popularity among users, as they did away with concerns pertaining to physical delivery, logistics and taxation issues.

Although online businesses had begun to develop in the late 1990s, the supporting ecosystem had not been put in place. The first wave of e-Commerce in India was characterized by low internet penetration, a small online shopping user base, slow internet speed, low consumer acceptance of online shopping and inadequate logistics infrastructure. Thereafter, the IT downturn in 2000 led to the collapse of more than 1,000 e-Commerce businesses in India. Following this, there was muted activity in the space in India between 2000 and 2005.

1.3.2 Second wave: duplication of global business models and improvement in ecosystem

The entry of Low Cost Carriers (LCCs) in the Indian aviation sector in 2005 marked the beginning of the second wave of e-Commerce in India. Travel emerged as the largest segment. People began relying on internet to search for travel-related information and to book tickets. As a ripple effect, the success of the online travel segment made consumers comfortable with shopping through the medium, thus leading to the development of online retail.

Online travel: The decision of LCCs to sell their tickets online and through third parties enabled the development of Online Travel Agents (OTAs). Prior to the entry of LCCs in 2005-06, air travel was considered a luxury meant only for the rich and for corporate travel. LCCs changed the scenario by making air travel affordable for a large number of people. They developed their own websites and partnered with OTAs to distribute their tickets online and, thus, contain costs. The Indian Railways had already implemented the e-ticket booking initiative by the time LCCs commenced their online ticket booking schemes.

Online retail: The growth of online retail was partly driven by changing urban consumer lifestyle and the need for convenience of shopping at home. This segment developed in the second wave in 2007 with the launch of multiple online retail websites. New businesses were driven by entrepreneurs who looked to differentiate themselves by enhancing customer experience and establishing a strong market presence.

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2 “Matrimonial portals: tradition and technology are a perfect match for those looking online,” India Knowledge @Wharton website, www.knowledge.wharton.upenn.edu/india/article.cfm?articleid=4331, accessed 1 November 2011.
Group buying: Starting in 2010, the group buying and daily deals models became a sought-after space for entrepreneurs in India, emulating the global trend. Group-buying sites have seen a significant rise in the number of unique visitors and membership. This growth has attracted investments from VCs.

Social networking actively used by organizations to reach out to customers: In the second wave, social networking gained steam in the Indian online space. It has gone on to become an integral part of people’s lives. Initially used for staying connected with friends, social networking websites have now emerged as an anchor in any company’s digital strategy. Termed as social commerce, it is a key avenue for e-Commerce players to reach out to target customers. Companies have started establishing their presence in the social media space for branding activities, connecting with customers for feedback and advertising new product launches.

1.4 E-commerce market size in India

India’s consumer-facing e-Commerce market (B2C-C2C) grew at a whopping CAGR of 49.1% from 2007 to 2011 to reach a market size of US$9.9 billion. On the other hand, the B2B market is a small contributor to the overall domestic e-Commerce market, and it was estimated at US$50.37 million in 2011.5

Consumer-facing e-Commerce market size (US$ billion)

The country’s B2C e-Commerce sector can be split into two broad categories – travel and non-travel. Online travel is the largest domestic B2C e-Commerce segment, accounting for 81% revenues in 2011. The online non-travel market is further segmented into e-tailing, digital downloads, financial services and classifieds.

In the following chapters, we provide our perspective on how India’s e-Commerce market is shaping up and what it means for stakeholders. New opportunities are being generated out of the still-evolving ecosystem and e-Commerce market. We also analyze some deciding factors for stakeholders while formulating their market strategies.
Chapter 2

e-Commerce ecosystem

Enablers falling in place

2.1 First to second wave: fundamental enablers falling in place 19
2.2 Devices 20
2.3 Internet 22
2.4 Payment landscape undergoing change 29
2.5 Summary 35
<table>
<thead>
<tr>
<th>Pros</th>
</tr>
</thead>
<tbody>
<tr>
<td>► Annual disposable income per household to grow by two-and-a-half times by 2015</td>
</tr>
<tr>
<td>► Discretionary spending expected to form a major portion of expenditure in India</td>
</tr>
<tr>
<td>► Proliferation expected in the sales of PCs, tablets and smartphones</td>
</tr>
<tr>
<td>► More Indians increasing time spent online</td>
</tr>
<tr>
<td>► Probability of growth in internet user base, mirroring that of the voice user base</td>
</tr>
<tr>
<td>► Volume and average value of transactions higher for credit cards than debit cards</td>
</tr>
<tr>
<td>► Increase in the number of payment options</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Cons</th>
</tr>
</thead>
<tbody>
<tr>
<td>► Low average broadband speed and flat average internet speed cause for concern</td>
</tr>
<tr>
<td>► Online payment landscape marred by low penetration of credit and debit cards; high failure rate of online payment transactions</td>
</tr>
</tbody>
</table>
### 2.1 First to second wave: fundamental enablers falling in place

The supporting ecosystem for e-Commerce has evolved significantly from what it was a decade ago. Internet is the key to the development of e-Commerce and has become pervasive in daily life. People have come to rely heavily on internet for activities ranging from accessing email and searching for information to keeping in touch with friends.6

<table>
<thead>
<tr>
<th>Then</th>
<th>Now</th>
<th>Going ahead!</th>
</tr>
</thead>
<tbody>
<tr>
<td>Internet user base close to 5.5 million in 2000.</td>
<td>Internet user base 121 million at the end of 2011.</td>
<td>Internet user base to increase to 300 million by 2015.</td>
</tr>
<tr>
<td>Number of broadband subscribers as low as 51,000 in 2001.</td>
<td>The number of broadband subscribers 12.8 million, as of September 2011</td>
<td>Number of broadband subscribers to reach 100 million by 2014 and 150 million by 2020.</td>
</tr>
<tr>
<td>Number of credit and debit cards in India 4.2 million and 0.3 million respectively, in 1999.</td>
<td>Number of credit and debit cards in circulation in India was 18 million and 228 million, respectively as of July 2011.</td>
<td>Number of credit and debit cards to reach 73.7 million and 350.4 million, respectively in 2014.</td>
</tr>
<tr>
<td>No 3G spectrum auctions till 2010.</td>
<td>3G spectrum auctions in 2010.</td>
<td>3G subscribers to reach 118 million by 2014 and 303.4 million by 2020.</td>
</tr>
<tr>
<td>Average time spent online by an Indian consumer per month 12.9 hours in 2006.</td>
<td>Increased to 17.4 hours in 2011.</td>
<td>Forecast to increase to 21 hours in 2015.</td>
</tr>
<tr>
<td>Number of users transacting online 3 million in 2007.</td>
<td>Increased further to 11 million in 2011.</td>
<td>Expected to increase to 38 million by 2015.</td>
</tr>
</tbody>
</table>

Internet user base has been growing significantly, with an exponential increase in internet usage. This trend has been aided by the increasing PC and broadband penetration, coupled with the declining prices of PCs. Tablets and smartphones have given a new meaning to connectivity and user experience. The adoption of 3G, coupled with the declining prices of smartphones, is expected to further increase internet usage in the country.

Improvements on the payment front have brought about the increasing use of plastic money by Indian consumers. Payment gateways have now been made more secure through multiple levels of authentication via one-time passwords (OTPs) and transaction passwords. This has helped strengthen users’ confidence in carrying out online transactions. These enablers augur well for the development of e-Commerce in India.

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2.2 Devices

Increased spending power of Indian consumer ...

Annual disposable income per household is expected to increase at a CAGR of 5.1% from 2005 to 2025.\(^7\)

<table>
<thead>
<tr>
<th>Year</th>
<th>Income (US$)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>2,632</td>
</tr>
<tr>
<td>2015</td>
<td>3,823</td>
</tr>
<tr>
<td>2025</td>
<td>6,790</td>
</tr>
</tbody>
</table>

Source: ResearchonIndia

The last decade saw high GDP growth in India, leading to enhanced income levels. This helped position India among the fastest-growing consumer markets in the world. Discretionary spending is expected to rise from 52% in 2005 to 61% in 2015 and 70% in 2025.\(^8\)

Discretionary vs non-discretionary spend (%)

Source: Oppenheimer

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\(^7\) “Online Travel Industry - India (Part III),” ResearchonIndia, February 2012, p.6.

\(^8\) “MakeMyTrip limited,” Oppenheimer, 29 September 2011, via Thomson Research.
... and technological advances increasing the penetration of devices

Declining prices of PCs (on the back of technological advances) and increasing disposable income make it affordable for the majority of people to buy PCs, which are now available at a low a price of US$400–500. PC sales have been improving steadily in India over the years (stood at 89.3 million in 2011 and forecast to rise to 217.3 million by 2015).⁹

Number of PCs (million) with penetration (%)

<table>
<thead>
<tr>
<th>Year</th>
<th>Stock of PCs</th>
<th>Penetration (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006</td>
<td></td>
<td>2%</td>
</tr>
<tr>
<td>2011</td>
<td>89</td>
<td>7%</td>
</tr>
<tr>
<td>2012F</td>
<td>112</td>
<td>9%</td>
</tr>
<tr>
<td>2013F</td>
<td>140</td>
<td>11%</td>
</tr>
<tr>
<td>2014F</td>
<td>175</td>
<td>14%</td>
</tr>
<tr>
<td>2015F</td>
<td>217</td>
<td>17%</td>
</tr>
</tbody>
</table>

Source: Economic Intelligence unit website

In addition to the growth of PCs, smartphones have revolutionized the way people access internet and communicate. Consumers are swapping their feature phones for smartphones, which are much faster and provide a better user experience. Many variants of smartphones are priced at less than US$100 in the Indian market, making them affordable for a large number of people.¹⁰ The sale of smartphones is expected to grow rapidly in the near future.

Smartphone sales in India¹¹ (million)

<table>
<thead>
<tr>
<th>Year</th>
<th>Sale (million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011</td>
<td>9.5</td>
</tr>
<tr>
<td>2012F</td>
<td>20.0</td>
</tr>
<tr>
<td>2015F</td>
<td>81.5</td>
</tr>
</tbody>
</table>

Source: Trak, Gadgetizor
Note: Forecasted figure for 2015 is of smartphone shipments

Tablet PCs, or tablets, are becoming increasingly popular in the Indian market. Tablets come equipped with most of the features of a laptop or a notebook. The prices of tablets are declining, with the low-cost tablet introduced by the GoI costing as less as US$80, leading to its widespread adoption.

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The growing popularity of tablets can be gauged from the fact that more than 8,000 of these are sold every day. The tablet market is expected to clock sales of 1 million units by 2013 and a humongous 23.38 million by 2017.

2.3 Internet

Internet penetration in India among the lowest in the world...

Internet penetration in India was 11.4% as of June 2012, one of the lowest worldwide.\(^\text{12}\)

Internet penetration by country (June 2012)

<table>
<thead>
<tr>
<th>Country</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Germany</td>
<td>83</td>
</tr>
<tr>
<td>France</td>
<td>80</td>
</tr>
<tr>
<td>Japan</td>
<td>80</td>
</tr>
<tr>
<td>USA</td>
<td>78</td>
</tr>
<tr>
<td>Russia</td>
<td>49</td>
</tr>
<tr>
<td>Brazil</td>
<td>45</td>
</tr>
<tr>
<td>China</td>
<td>40</td>
</tr>
<tr>
<td>India</td>
<td>11</td>
</tr>
</tbody>
</table>

Source: Internet World Stats

... places it high on the Government’s agenda

The National Telecom Policy–2011 (NTP–2011) is a step toward increasing technology adoption in the country.

NTP–2011: objectives

<table>
<thead>
<tr>
<th>Year</th>
<th>Objective</th>
</tr>
</thead>
<tbody>
<tr>
<td>2014</td>
<td>• High speed and high quality broadband availability to all village panchayats through optical fibre</td>
</tr>
<tr>
<td>2017</td>
<td>• Target of 175 million broadband connections</td>
</tr>
<tr>
<td>2020</td>
<td>• Target of 600 million broadband connections</td>
</tr>
</tbody>
</table>

Source: TRAI

China’s growth story of internet penetration inspiring India...

The current internet user base and penetration levels in India are similar to those of China’s in 2005, when the country crossed the 100 million user mark. The Chinese netizen population has more than since quadrupled, driven by favorable policies, e.g., its 2006-2020 National Informatisation Development Strategy and its Eleventh and Twelfth Five-Year Plans.\(^\text{13}\)

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\(^{13}\) “China - Digital Economy and Forecasts,” BuddeComm., 13 June 2011, via ISI Emerging Markets;
India’s current internet user base, its penetration levels and the government’s initiatives through NTP-2011 seem to indicate that India would hopefully emulate China’s growth story in terms of internet user base.

… due to visible trends that indicate a similar spurt in the number of internet users in India

More Indians coming online...

India crossed the 100 million internet user figure in 2010 and reached 121 million users by end 2011, making it the third-largest country worldwide in terms of its internet population. The number of internet users in India is expected to triple to 300 million by 2015, growing at a CAGR of 25.5%.

The frequency of internet usage has increased in parallel to the growth in internet user base. The most visible shift has been multiple instances of net access in a week as compared to once-a-week or lesser access in 2007. The percentage of users accessing internet two or three times a week grew to 27% of total users in 2011 from 23% in 2007. This increase has come from segments using internet once a week or 2-3 times/month.

Source: I-cube, IIFL, IAMAI, Caris & Company, Ernst & Young estimates
Time spent by Indians on internet has been increasing over the years. The average time spent online per person per month rose from 12.9 hours in 2006 to 17.4 hours in 2011. It is forecast to increase to 21 hours by 2015.

Average time spent online per person per month (hours)

...aided by the increase in broadband connections...

Broadband users spend considerable time online. Broadband users are more likely to expend time on online activities, especially those requiring high bandwidth, e.g., video streaming.\(^\text{15}\)

Increasing proportion of broadband subscriptions...

While the number of narrowband connections in India has continued to be stagnant, broadband usage has been increasing. Broadband subscriptions rose by 66% between March 2010 and June 2012 to 14.6 million.\(^\text{16}\)

---


Broadband and narrowband connections in India (million)

Source: TRAI

...and shift in access point mix

There has been a progressive shift in access points used to log on to internet. Previously, cybercafés were the primary access point and accounted for 52% of internet usage in 2003. Over time, people have increasingly been accessing internet from home, with the segment's share growing by more than 60% between 2009 and 2011 to account for 37% of internet usage in the country.

Percentage of users accessing internet from home/office (internet access points)

Source: I-cube

The shift in internet access points works in the favor of e-Commerce players due to several reasons:

- **Convenience:** Consumers find it more convenient to access the internet and shop from the comfort of their homes. They have the option of considering alternatives before making a well-informed purchase.
- **Security:** Internet access from home enables users to overcome their concerns about data security, which posed a challenge at cybercafés.
- **Consumer analysis:** Online shopping helps e-Commerce players better analyze the shopping behavior of individual customers through the use of cookies and by tracking IP addresses.
Continuous reduction in the cost of internet access...

The tariffs of data plans and prices of data cards/USB dongles are on a decline, thus reducing the total cost of ownership (TCO) of an internet connection. As a case in point, the monthly charges of data plans for fixed line and wireless internet connections dropped by 50% each between 2009 and 2011.

<table>
<thead>
<tr>
<th>Mode</th>
<th>2009</th>
<th>2011</th>
<th>Speed/data</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Charges (INR)</td>
<td>Installation</td>
<td>Monthly</td>
</tr>
<tr>
<td>Fixed line</td>
<td>1,000</td>
<td>1,300</td>
<td>500</td>
</tr>
<tr>
<td>Wireless</td>
<td>2,500</td>
<td>1,250</td>
<td>1,800</td>
</tr>
</tbody>
</table>

Source: IIFL Institutional Equities

Data usage tariffs have declined dramatically over the years, thus facilitating a wider coverage.

...and internet user base spreading to non-metros...

Internet penetration is growing in towns with population of less than 0.5 million.

<table>
<thead>
<tr>
<th>Internet users across regions (2006)</th>
<th>Internet users across regions (2011)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Top 8 metros</td>
<td>29.0%</td>
</tr>
<tr>
<td>5-10 lakh towns</td>
<td>20.0%</td>
</tr>
<tr>
<td>Other metros</td>
<td>10.0%</td>
</tr>
<tr>
<td>Less than 5 lakh towns</td>
<td>41.0%</td>
</tr>
</tbody>
</table>

Source: I-cube

Between 2006 and 2011, internet usage in towns with population of less than 0.5 million increased by 27.5% to account for 37% of overall internet usage in the country. Internet usage in these areas surpasses that in metros and offers significant opportunities for e-Commerce players, given the inadequate penetration of organized retail in these regions.

...leading to internet user-base growth mirroring that of voice

There has been an inverse relationship between voice tariffs and the growth of the wireless subscriber base. Mobile subscriptions picked up in India when TCO (cost of device and voice tariffs) was reduced. Therefore, reduction in the price of data plans augurs well for internet adoption across the country.

Inverse relation between wireless subscriber base (million) and voice tariffs (INR)

Source: TRAI

However, flat average internet speeds in the country is a cause for concern\textsuperscript{19}

The average internet speed in India is one of the lowest in the world despite the growth of broadband subscriptions. The average internet speed was more than 900Kbps in 2007 and dipped to 844Kbps in 2Q11.

Internet speeds (Kbps)

Source: Trak website

The decline is attributed to the fact that Indians are increasingly logging on to internet on mobile devices that have fairly low speeds. Nevertheless, TRAI's recommendation of increasing the minimum broadband speed to 512Kbps from January 2011 and the increased adoption of 3G are expected to change this scenario.\textsuperscript{20}

India ranking low in average speed and peak average speed of broadband connections\textsuperscript{21}

India is one of the 29 countries with an average connection speed of 1 mbps or less. The peak average speed in South Korea and Hong Kong is 46.8 mbps and 46 mbps, respectively, as compared to India's peak average speed of a mere 5.8 mbps.

Consumers becoming mobile...

The mobile internet user base is growing, aided by the introduction of 3G data plans and declining smartphone prices. Several smartphone models are available at less than US$100 in the Indian market. Mobile internet users are expected to account for more than 60% of the user base in India, considering that their number is forecast to reach 200 million by 2015.

Telecom operators are incentivizing mobile internet usage by reducing tariffs and providing unlimited usage facilities. They are offering unlimited internet browsing plans at a lowly price of US$2 per month to their GSM customers. Within six months of the launch of 3G, the number of connections reached 10 million, closely matching the number of broadband subscribers.

...but user-experience underdeveloped

The growth of mobile internet is encouraging. However, all the components of this growth, e.g., the uptake of smartphones, mobile internet penetration and mobile internet speed, would need to be developed in tandem to support the growth of e-Commerce in the country.

User experience on e-Commerce websites also needs to be improved, since most of these sites are not optimized for use on mobile devices. Furthermore, not all e-Commerce sites have developed mobile apps. Given that an increasing number of people would access internet on their mobile devices, e-Commerce players need to step up and develop mobile websites and apps for major mobile platforms.

---

2.4 Payment landscape undergoing change

Number of cards per capita low...

The number of cards per capita in India is a mere 0.2 and is among the lowest in the world.

Number of cards per capita (August 2011)

![Graph showing number of cards per capita](image)

Source: Avendus

...and the success rate in online transactions a concern area for e-Commerce in India...

Transaction data on India’s most frequented e-Commerce website reveals that the success rate of credit or debit cards is still low at around 74%. Netbanking transactions have fared worse with a success rate of 68%.

Success rates of various modes of online payments in India

![Graph showing success rates](image)

Source: Pluggd website

The time taken to validate and authenticate a transaction has doubled after the implementation of “3D secure.” In view of the low quality of internet connections in India, this increase in time has led to a larger number of failed transactions.

---

...as global examples show that credit cards are the most preferred online mode of payment

Credits cards are the most popular payment instruments in the major e-Commerce markets worldwide. Therefore, improving the card ecosystem in India is a pivotal step to ensure higher uptake of credit or debit cards for making payments. This could help e-Commerce players reduce the cost of offline payment mechanisms.

Preference for credit or debit card for online payment (2010)

<table>
<thead>
<tr>
<th>Country</th>
<th>Preference for Credit Card (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Denmark</td>
<td>89%</td>
</tr>
<tr>
<td>Canada</td>
<td>81%</td>
</tr>
<tr>
<td>South Korea</td>
<td>75%</td>
</tr>
<tr>
<td>Japan</td>
<td>70%</td>
</tr>
<tr>
<td>UK</td>
<td>52%</td>
</tr>
<tr>
<td>Germany</td>
<td>43%</td>
</tr>
</tbody>
</table>

Source: CyberSource

RBI could look at playing a key role in monitoring the performance of payment providers

The failure of online payment transactions could be attributed to several reasons including network problems, the low credit limit of users or insufficient funds, communication errors between payment gateway server and bank server, erroneous entry of information by users and downtime at online payment gateways.

The performance of financial intermediaries cannot be solely judged based on the listed reasons. Alternatively, the RBI could consider mandating a certain quality of service metrics to ascertain the performance of payment service providers. Metrics could be based on performance criteria such as the proportion of failed transactions out of the total number of attempted transactions, and downtime and total refunds requested.

Credit cards declining and debit cards on the rise...

The decline in the number of active credit cards can be attributed to the fact that banks became stringent about issuing new credit cards after the financial downturn in 2008 and withdrew cards from defaulters.

The number of debit cards is on the rise due to the increasing access of people to banking services.

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The volume of credit card transactions has increased over the years despite the decrease in the number of credit cards. Debit card transactions have recorded a healthy uptake, in line with the growth in their number.

The value of transactions carried out on credit and debit cards has been increasing. However, the average transaction value of credit cards has been higher than that of debit cards and is continuing to grow, while average debit card transaction values have been flat.

The higher average credit card transaction value indicates that credit cards are still the preferred mode of payment for high-value transactions and are used by individuals with high spending power. The lower average debit card spend could be due to the fact that this medium is preferred for mobile recharge and bill payment.  

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Rebirth of e-Commerce in India

Value of transaction (billion) and average value per transaction (INR)

Source: RBI

Payment options increasing...

The payment landscape in India has evolved considerably. Cash cards have emerged in the market, in addition to credit and debit cards. Direct debit from accounts, electronic wallets and mobile payment are alternative options. The number of internet banking users increased to account for 7% of the total number of bank account holders in 2011 as compared with 1% in 2007.  

The number of payment gateways in India has also increased, and their charges have come down to 2.5%-3% of transaction value. Authentication requirements for online transactions have been made stringent with the addition of multiple layers including OTPs and two factor authentication. e-Commerce players have also come up with innovative delivery models such as Cash on Delivery (CoD) to overcome challenges associated with online transactions.

Mobile payment options are likely to witness increased uptake on the back of the growing mobile subscriber base in India. A leading telecom operator has launched a mobile payment system that allows users to deposit cash in mobile accounts and use it for various transactions through their feature phones without the need for a GPRS-enabled handset or smartphone.

... leading to more consumers buying online

Consumers’ attitude to e-Commerce has changed. This is apparent from the growth in the number of users transacting online from 3 million in 2007 to 11 million in 2011. The number is projected to rise to 38 million by 2015. A fast-paced urban lifestyle, dual-income families and parking space constraints at major malls have contributed to this shift in the perception of consumers.

Number of users transacting online (million)

Source: Avendus

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Payment options: success stories from around the world

Third-party online payment solution

China’s leading third-party online payment solution allows individuals and businesses to execute payments online in a secure manner. Its escrow service has made consumers confident about conducting online transactions without being concerned about product delivery and quality. This is because payment is only released to sellers when consumers confirm the delivery of orders.

Payment at convenience stores

Japanese e-Commerce players rely on convenience stores, for the payment and delivery of products. These stores also provide ATM, copier/fax, ticket reservation, digital camera print, bill payment and delivery services.

Users place their orders online and generate a unique payment number by selecting the convenience store option during checkout. They then visit the convenience stores, where they pay and receive the ordered products.

2.5 Summary

e-Commerce players are banking on the Indian internet growth story. The fact that an average online user is spending more time online gives these players the opportunity to draw more users to their websites through innovative marketing strategies such as those revolving around social media.

Furthermore, to fully utilize the opportunity, players need to leverage the growing number of mobile devices in the country. They should focus on developing mobile-compatible websites and applications. This would allow customers to log on to easy-to-access platforms and browse e-Commerce websites on their mobile devices.

e-Commerce players also need to focus on innovation to tackle challenges arising from low credit and debit card penetration. They could consider working with financial intermediaries to develop payment systems, such as escrow services, for resolving issues around security and product delivery. The RBI could step in and reduce the number of online transaction failures by defining service metric quality and monitoring it at regular intervals. This would enable it keep a close eye on the performance of financial intermediaries and plug gaps as soon as they occur.

Chapter 3

Online travel
Lion’s share of the market

3.1 Market size and revenue sources 39
3.2 Ticketing – big brother of the online travel market due to its standardized nature 40
3.3 Growth in the online hotel reservations and hotel packages 42
3.4 International players adding to challenges facing domestic OTAs 45
3.5 Low technology adoption limiting growth of bus services in online travel segment 45
3.6 Summary 45
Growth in India’s travel and tourism industry is the second fastest worldwide. India is poised to feature among the top five civil aviation markets in the world over the next decade. The entry of LCCs in the country made air travel affordable for a large number of people. Ticketing accounts for the largest share of the online travel market. Domestic air tickets are driving the online ticketing market. Opaque pricing is shifting the focus of airlines away from differentiation. OTAs are shifting their focus to hotel reservations and packages. Players need to acquire new competencies to succeed in hotel reservations, as they previously limited their scope to ticketing. India is witnessing the entry of international players and mushrooming domestic OTAs. An increasing number of challenges are marring the growth of existing players.

Indian travel industry among the fastest growing in the world

Growth in India’s travel and tourism industry is the second fastest worldwide. According to a Deutsche Bank report, the industry would grow at a CAGR of 10% to reach US$111 billion by 2020. The growth of the services sector (thereby leading to rising household income, an expanding middle class and more inbound and outbound tourism) is responsible for this rapid growth.

Decade of air travel

The civil aviation sector in India has witnessed favorable developments in the last decade. India is the ninth-largest civil aviation market in the world and is poised to feature among the top five global markets over the next decade. Airline passenger traffic rose rapidly from 59.3 million in FY05 to 162.3 million in FY12.

India’s air passenger traffic (million)

![India’s air passenger traffic graph](image)

Source: Airport Authority of India (AAI)

Growth in air passenger traffic in India can be attributed to the entry of LCCs in 2005, making air travel affordable for a large number of people. Furthermore, the modernization of airport infrastructure and

---

the permission granted to leading airlines to launch international operations have contributed favorably to the growth in air traffic.

Indians now travelling more...

Inbound and outbound travel for both business and leisure has increased. Spending on domestic and international travel by Indian travelers is forecast to touch US$1.4 billion and US$426 million, respectively, by 2013. This has prompted domestic full service carriers and LCCs to expand their networks by offering connectivity to near-shore destinations such as Hong Kong, Singapore, Malaysia, Thailand, Dubai and Nepal, thus aiding in the growth of online travel.

... which is expected to fuel the expansion of airlines’ fleet...

Airlines plan to upgrade their fleet due to the expected increase in spend on airline travel.

Air operators’ fleet expansion in India

![Air operators’ fleet expansion in India chart](chart)

Source: Oppenheimer

...and contribute to the growth of the hotel industry

The rise in inbound and outbound travel and the growth of tourism have increased demand for hotel rooms. At present, there is a demand-supply gap in the availability of hotel rooms, with the deficiency being on the supply side. Currently, 150,000 hotel rooms are available in India, and their number is forecast to grow at a CAGR of 9.5% between 2011 and 2015. This would help meet the surplus demand and spur the growth of online travel.

3.1 Market size and revenue sources

The online travel market grew rapidly at a CAGR of 51.8% from US$1.5 billion in 2007 to US$8 billion in 2011. OTA market penetration increased from 2.2% in 2005 to 28% in 2011.

Online travel market size (US$ billion)

![Online travel market size chart](chart)

Source: IAMAI

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Key services offered in the online travel industry:

In the online travel segment, global distribution systems (GDS), OTAs, airlines and hotels are engaged in providing information on tickets, hotel room inventory and tour packages. Revenue models depend on partnerships among these players.

Airlines either sell their tickets directly to customers or through GDS and OTAs. GDS offer air and railway tickets, car rental information and hotel rooms. This makes it compelling for OTAs to partner with them. OTAs also directly partner with airlines, hotels, railways and bus services.

Meta search engines partner with airlines and hotels to provide customers with a common portal that encompasses information from all OTAs and airline portals. This helps their customers obtain information on the best prices available on a single website.

Main sources of revenues for GDS, OTAs and meta search engine websites:
3.2 Ticketing – big brother of the online travel market due to its standardized nature

Travel ticketing is the largest segment of internet commerce in India both by volume and value. The segment currently represents nearly 90% of the overall online travel market in India (by value of transactions). In 2011, 59% of internet users searched for or bought travel products online.

Apart from the convenience offered by online purchasing, the limited need to touch and feel the product enabled this segment to grow faster than others in the industry. Price, schedule and choice of airline are the only parameters to be considered while buying a ticket online.

Railway tickets have been available online for close to 10 years now, though this mode of purchase has been witnessing rising volumes only over the last three to four years. Currently, the number of railway tickets sold online amount to nearly three times that of airline tickets.

Online purchase of air tickets the highest among the different online travel segments

OTAs derive the bulk of their revenues from the airline industry. Among the various modes of transport, more than 50% of air tickets and 40% of train tickets are bought online. This is not surprising, considering that a larger number of air travelers have internet access.

Airline tickets has benefited from the rapid growth of the overall airline industry in India, especially LCCs, which maintain focus on online booking.

Online travel penetration by segments (2011)

[Diagram showing online travel penetration by segments: 40% Train travel, 50% Air travel, 5% Hotels reservations and tour packages, 4% Bus travel]

Source: EY Estimates

Domestic air ticket segment driving online ticketing...

The Indian Railways website is the most visited travel site in India. However, since the average price of a railway ticket is less than that of an airline ticket, online booking of domestic air tickets has emerged as the largest segment of the online travel industry (with a 65% share in 2009). OTAs form a significant portion of this segment with a 34% market share.

36 “Indian Online Landscape 2011,” Juxt Consult featured research, August 2011, p. 8.
Break-up of domestic air ticket bookings (2011)

<table>
<thead>
<tr>
<th>Category</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Offline agencies</td>
<td>58%</td>
</tr>
<tr>
<td>OTA</td>
<td>34%</td>
</tr>
<tr>
<td>Air operators</td>
<td>8%</td>
</tr>
</tbody>
</table>

Source: Oppenheimer

...with international air ticketing accounting for a small share of the ticketing segment

International air ticket and bus ticket bookings contributed a minuscule 4% and 2% to the ticketing market in 2009, respectively. Despite the higher value of international tickets and air passenger traffic (40.8 million in FY12) accounting for one-third of domestic air traffic (120.5 million in FY12), most travelers seem to prefer offline agents to make bookings. As a result, the share of international air tickets is smaller than that of domestic air tickets.

Opaque pricing: initiation of commoditization of air ticketing?

A new model emerging in the online air ticket booking space is opaque pricing, with OTAs selling air tickets at a discount to existing prices. However, the names of the airlines are only revealed on completion of the booking process.

This pricing scheme benefits consumers, since they can buy tickets at low prices. This also provides an avenue for airlines to sell the maximum number of seats. However, while this scheme may benefit airlines in selling their vacant seats, it takes away their opportunity of differentiating services, since passengers are unaware of the names of the airlines.

3.3 Growth in online hotel reservations and hotel packages

Mushrooming OTAs posing questions to segment leaders

Low entry barriers in the online travel market have resulted in a number of small players entering this space. The market is now cluttered with a mix of large Indian OTAs, as well as several smaller players and international players.

Recent entrants are mainly competing on price to capture market share. This has put pressure on the margins of players across the segment.

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Low margins and declining airline commissions fueling shift to online hotel reservations

Commission rates in the air travel segment are low (around 7%). The margins of hotel reservations and tour packages are the highest among all the segments of online travel and are often as high as 25%.

Online travel: margins by segment

<table>
<thead>
<tr>
<th>Segment</th>
<th>Margins</th>
</tr>
</thead>
<tbody>
<tr>
<td>Air travel</td>
<td>7%</td>
</tr>
<tr>
<td>Train travel</td>
<td>5-10%</td>
</tr>
<tr>
<td>Bus travel</td>
<td>10%</td>
</tr>
<tr>
<td>Car rentals</td>
<td>10%</td>
</tr>
<tr>
<td>Hotels and tours packages</td>
<td>10-25%</td>
</tr>
</tbody>
</table>

Source: Avendus

Margins in the ticketing business for OTAs in India are expected to erode further, with airlines increasingly raising their voice against giving commissions to the former. The airline commission model has already been done away with in Japan.

Leading international airlines flying to India have already decided to adopt a zero-commission structure for travel agents. As of January 2012, 17 international airlines had stopped paying commission to travel agents. We foresee continued pressure on the margins of OTAs from domestic airlines as well.

In 2008, domestic airlines adopted international airlines' strategy of implementing a zero-commission structure. However, they had to revert to the model on being boycotted by OTAs.

The factors mentioned above are causing a shift in the revenue mix of OTAs, which are looking at hotel reservations to enhance their revenue stream. OTAs have expanded their operations beyond selling tickets online to offering complete travel and tourism solutions.

Shift in business model of OTAs required for them to expand their operations in the hotel reservation and tour package segment

Higher margins in the hotel reservation segment have lured many OTAs. However, players need to be aware and step up to the competencies required in the hotel reservation space in terms of supplier partnerships, management, operational requirements of workforce and information management. These requirements are different from those posed in the ticketing segment.


41 “Nothing but Net,” J.P. Morgan, 3 January 2011, via ThomsonOne.com

Issues in the online hotel industry:

- **Managing a diverse supplier base**
  Hotel reservations and tour packages entail higher customer engagement as compared to the simpler business of selling air tickets. While the airline ticketing segment may involve managing relationships with six players, the hotel segment requires a larger workforce to manage relationships with thousands of hotels. This requires the hiring of a substantial workforce to manage relationship with hotels, resolve disputes between customers and the hotels, and provide regular updates of inventory in hotels.

- **Overcoming technological constraints**
  The fragmented nature of the hotel industry in India and low technological investment made by hotels add to the challenges of maintaining a large workforce. This poses problems in providing accurate updates on inventory reserved for booking through OTAs. The recent growth of organized hotel chains in India offers a reprieve to OTAs from these challenges.

- **Customer experience**
  While the customer experience provided by airlines is standardized and lasts around two to three hours, engagements with hotel customers are of a longer duration and can stretch to days. OTAs need to ensure that they deliver on the promises made to customers.

- **Authenticity of information**
  OTAs need to ensure that hotels provide accurate information on services offered and tariffs charged. To address customers’ concerns about the validity of information provided by hotels, OTAs could consider performing regular audits of their hotel partners. User-generated content may also help alleviate such concerns.

- **Grievance redressal**
  OTAs should focus on providing call center services to customers seeking information and grievance redressal. Since customer experience is a prime focus area for all e-Commerce companies, OTAs need to invest in training customer care executives to ensure an enhanced experience for customers.

The success of OTAs in this segment is, therefore, dependent on how well the workforce is trained to perform these tasks efficiently.

Online presence of hotels resulting in higher visibility, as well as greater responsibility

The online presence of hotels ensures higher visibility and generates additional business even during off-season months. However, an online presence also entails the responsibility of servicing clients. Hotel services are different from those provided by airlines, since hotels need to deal with customers for a much longer period. Failure to deliver on promises or poor customer service may lead to negative publicity from customers. With online reviews gaining popularity in India, a bad word about a hotel may spread quickly and cause fatal damage.

Tour packages entering the mix

OTAs are also providing tour packages. They are bundling airline tickets, hotel reservations and tour packages to suit the needs of consumers who have moved from being low-price deal seekers to value-conscious users. OTAs need to ensure that they segment their target customers correctly and provide a value proposition that is commensurate with the latter’s expectations.
3.4 International players adding to challenges facing domestic OTAs

The growth of the Indian OTA market has attracted leading global OTAs to the country. Leading Indian OTAs have been successful in capturing market share because they understand the psyche of local customers and customize their solutions accordingly.

Although it may take some time for international players to understand the market and capture market share, they have more substantial financial resources and a wider global supplier network. International OTAs in India lead in servicing inbound traffic. Their supplier networks help them attract the best deals for their customers. This, coupled with their huge technological investments and the ability to provide relevant search results for their customers, makes them a force to be reckoned with.

3.5 Low technology adoption limiting the growth of bus services in online travel

There is low penetration of the online bus ticketing services segment in India. The online presence of bus operators would increase their visibility, since it would enable easier access to information for tourists.

Although there is significant scope for expansion, the low adoption of technology by bus operators and the fragmented nature of the bus industry hamper growth. Players need to, therefore, quickly invest in technology or risk losing out on a significant share of potential customers.

3.6 Summary

OTAs are increasingly feeling margin pressures in the ticketing business. They may use the ticketing segment to generate volumes and then cross-sell their hotel reservations and package services to customers acquired in this manner. Presence in the hotel reservations segment is expected to shore up margins, but OTAs need to develop specific capabilities to succeed in the hotel reservations segment.

In our opinion, the underpenetrated segments of online travel, including hotel reservations, tour packages and bus travel, would see growth in coming years. Suppliers in these segments, i.e., hotels and bus operators, would need to up their investment in adopting technology to increase visibility.

We believe that OTAs would increasingly focus on the hotel and tour package segments. Players that understand customer requirements and provide suitable products at the best value in terms of price and customer experience would undoubtedly gain an edge.

User-generated content is expected to play a significant part in consumers’ hotel selection decision. OTAs need to ensure an active role in the generation of online reviews and regular updating. Hotels need to be aware of the fact that though user-generated content (UGC) can be a primary source of marketing, it can also spread jarring negative publicity at the speed of light. Therefore, hotels must act on the promises made in their advertisements on OTAs or other media.
Rebirth of e-Commerce in India
Chapter 4

Online retail/e-Tailing

4.1 Structure of online retail market  
4.2 Emerging business models in India  
4.3 Key decision points  
4.4 Challenges in online retail market  
4.5 Top categories driving online retail  
4.6 Top reasons driving online retail  
4.7 Summary
Organized retail is growing at a faster pace than total retail.
Organized retail still forms a small portion of the total retail market.
Online retailers are moving to the inventory-holding model from the consignment model.
Online retailers are developing in-house logistics capabilities.
Logistics players need to gear up their operating models to tap the huge opportunity presented by online retail.
Complex tax structures are making decisions relating to warehouse locations difficult for online retailers.
Organized retail players are faced with the big question of entering the online retail market.
Online retail players need to focus on innovative business models to increase their margins.
The share of apparels is expected to increase in online retail.
Underpenetrated segments, such as online groceries, are expected to grow.
COD has emerged as a preferred payment choice for customers.

Online retail, in its various forms, has been drawing the maximum interest among all the segments of the internet commerce market. A recent report by comScore Inc. indicated that 60% of online users in India visited retail sites in November 2011.

The Indian retail industry was estimated at US$528 billion in 2012 (growing at 11% per annum). A significant portion (90.4%) of Indian retail is unorganized. Nevertheless, the share of organized retail is growing at 24% per annum. Currently, online retail constitutes 1% of the total organized retail market in India and is set to make a higher contribution to the growth of organized retail in the country.

Total retail market: market size of the organized and unorganized segments (US$ billion)

Source: BCG

According to IAMAI, online retail clocked sales of nearly US$572 million in 2011 and accounted for 6% of overall internet commerce revenues in India (grew at a CAGR of 25% since 2007). The market is expected to witness rapid growth in years to come.

While travel is the largest segment among all the internet commerce categories, internet retail would reportedly match the travel segment, by the value of goods sold, within three to four years and, thereafter, surpass it.

India – online travel and retail (%) breakup*

Source: Ernst & Young estimates, Avendus

*These shares have been calculated by considering the online travel and e-tailing market.

Been there for a long time, but never really made a mark

Internet retail is not a new phenomenon in India. It saw its share of popularity in the early 2000s, with several portals setting up shop during the period.

Some multi-media portals continued to have sections on e-tailing that largely focused on catering to the needs of NRIs looking for means to send gifts to India. Advertising revenue continued to be the largest source of income for these sites, with the average Indian consumer not showing much interest in making actual purchases.

Reasons for limited success were many...

Low internet penetration, an inadequate supply chain, the low propensity of Indians to buy online, among others, seem to be the plausible reasons for the low penetration of internet commerce in India.

While all of the above reasons have contributed to the dismal performance of the segment, another important reason was limited focus on the real value being delivered.
Most of the products sold online were inferior; there was limited assurance on the products that were eventually delivered, and customer service was a non-priority.

...but scenario is different this time

The new wave of e-Commerce in India is promising. This observation is not just based on the unprecedented number of people buying online or the range of products offered, but is also backed by the clear focus on customers.

Products available online are the ones that customers typically buy when they go out shopping. In fact, in some cases, the desired products are not available in shops but are being offered online.

Customer service is the buzzword, with portals increasingly thinking of newer ways to delight the average customer.

4.1 Structure of online retail market

The online retail sector broadly comprises two categories of players:

- **Vertical-focused players**
  - Deal in specific category of goods such as apparels, electronics and baby products

- **Multi-category players**
  - Deal in multiple categories of goods.

Break-up of online retail market (2011)

- 54% Vertical focused players
- 46% Multi-category players

Source: Avendus

Vertical-focused vs multi-category players

Initiation of most recent online portals with focus on single category

The choice of categories ranges across books, electronics, apparel, baby care products, perfumes and even prescription lens. Players that emerged as category leaders were those that were able to penetrate their target category deeply to offer a large range of products by spreading their operations beyond the top cities.
Players adding categories or getting acquired by multi-category players

Categories such as books and electronics saw early traction, with market leaders moving toward multi-category models. There has also been consolidation in the market, with larger players acquiring small single-category ones to enhance their portfolios.

Need to target a larger share of customers' wallets among key drivers of diversification

Online retailers incur high costs in their effort to acquire customers through aggressive marketing and by offering large discounts on products. Their underlying thought is to recover these investments over multiple purchases made by the same customer.

While this necessarily requires focus on delivering a superior customer experience to invite future business, a broader product category is a safer bet to invite customers wanting to buy from their preferred e-Tailers.

A higher volume of transactions could drive down cost per transaction (economies of scale), and it has a healthy impact on valuations also.

Vertical-focused businesses, however, are here to stay and grow

Vertical-focused businesses bring to the table a deep understanding of their target customer segments and product categories.

Maintaining category focus enables a portal to design the entire customer experience around the specific needs of its target segment. This can enable the portal to become a brand that is larger than the products sold and have strong bargaining power with its supplier group.

We believe that while vertical players may have to compromise on scale in the short term, profitable ventures (similar to those we see in the off-line world) are likely to emerge in this space in the longer term.

4.2 Emerging business models in India

4.2.1 e-Malls or e-Marketplaces

An electronic mall (e-Mall) or e-Marketplace provides a platform for merchants to set up virtual stores and sell their merchandise. Merchants frequently choose this option due to the advantages of reduced cost and the complexity of putting products up for sale on the web. They also benefit from leveraging websites (e-mail) traffic and user base, given the expectation that visiting other stores on the e-mail would lead to visits to their stores as well. Smaller merchants also look to leverage the brand name of the e-Marketplace, based on the premise that this would lead to increased trust and, therefore, readiness on customers' behalf to buy products online. Larger merchants sell their products through these virtual stores, in addition to their own sales channels.

Product pricing is not controlled by e-Commerce players and is decided by merchants. For the purpose of billing, merchants use the common payment gateway/method provided by the e-Commerce player hosting the platform.
Presence of the marketplace model in the C2C space

These marketplaces allow consumers to sell products directly to other consumers, either at a fixed price or through auctions. e-Commerce players allow monetary exchange through offering payment modes on their websites or proposing direct payment by buyers to sellers. Membership or subscription fees from sellers setting up virtual stores, and commission charges on transactions and advertising fees are various revenue sources for e-Commerce players.

4.2.2 Deals/Group buying

Deals and group buying are among the new business models that have quickly caught the attention of consumers, merchants and investors.

Deal sites provide daily discount offers in various categories including restaurants, apparel, lifestyle products and travel. Group buying sites work on the premise that collective buying leads to larger volumes for merchants, which, on their part, offer attractive prices to consumers. There is a subtle difference between deals and group buying. In group buying, a minimum number of buyers is required for a deal to go live, whereas deal sites do not have such requirements. Most online players in India offer deals; the group buying segment is smaller in comparison.

Deal sites provide another platform for merchants to advertise and sell their products and services. While small and new merchants may look at group buying as a marketing option, established brands perceive it or deal sites as another sale channel.

This business model is providing an avenue to offload distressed inventory

Revenue is lost if capacity is unused in the services sector. Perishable inventory in the services sector, such as restaurants, spas and beauty services, can be as high as 80%.\textsuperscript{46} Deal sites provide merchants a means for reducing distressed inventory in the services sector. Another motivation of discount selling is building customer loyalty. By taking a cut in their initial deal profits, merchants aspire for repeat visits and treat the loss as customer-acquisition cost.

The fact that customers prefer to buy deals that are in proximity of their localities has led group buying sites to provide hyper-local deals (deals in every major area of a city). Players are also upgrading technology to understand the buying behavior of customers (based on their previous purchases) and match the latter’s requirements.

Consumers are the key beneficiaries of this business model

Deal sites enable consumers to obtain products and services of their choice and in their locality at much lower prices than the original ones. Consumers are also drawn by the discounts offered and purchase products and services they would have not bought otherwise.

4.3 Key decision points

4.3.1 Inventory – to keep or not to keep

Two models have evolved within e-Stores with respect to inventory management.47

Stock-and-sell model
Assumes inventory risk and invests in warehouses and logistics

Consignment model
Ships products directly from the vendor to the customer with no investments in warehouses and logistics

e-Tailing in India was traditionally a low-entry barrier business, with most e-Tailers working on a consignment model based on the following principles:

- e-Tailers tied up with networks of merchants to source products.
- They then prepared web catalogs of products offered by their partner merchants.
- Once a customer order was received for any of the catalog items, a notification was sent to the merchant for its fulfillment.
- The merchant then supplied the goods to the customer, and financial settlement was made between the e-Tailer and the merchant for the products sold.

The model has several inherent advantages for an e-Tailer:

- Limited or no investment in inventory or warehousing
- Delivery of goods either managed by merchants or through third-party providers
- Payment received online and settlement with merchants executed later

(In this model, the e-Tailer is primarily responsible for managing the web catalog and the online experience of the customer.)

Despite the advantages of the consignment model, e-Tailers are moving toward an inventory-holding model, wherein players across the industry hold 40% to 80% of the SKUs they offer online as inventory.
The drivers of this initiative are quite apparent when one looks deeper to gauge the advantages of stocking products and selling them on an e-Commerce player’s portal.

- **Ability to honor customers’ commitments:** Meeting commitments on products and services consistently is the cornerstone of success of an e-Commerce business. The consignment model makes e-Tailers highly dependent on product merchants.
  - Minimal technology integration with merchants results in e-Tailers seldom having adequate visibility of the actual stock situation.
  - Additionally, meeting delivery commitments is always a challenge when merchants control the bulk of end-customer deliveries.
  - Managing in-house inventory enables e-Tailers to ensure that the right products (quantity and quality) are delivered within committed timelines.

- **Better bargains due to bulk buying:** e-Tailers focusing on specific categories have the option of making bulk purchases of fast-moving and popular products and, thereby, obtaining discount in the process. The additional percentage points in their gross margins can contribute significantly to the overall profitability of their portals.

- **Innovative pricing and product bundles:** Over time, we have seen vertical-focused e-Tailers gaining an adequate understanding of customers’ buying patterns, moving away from a cost-plus model and playing a larger role in the pricing and packaging of products. e-Tailers form innovative product bundles that are aligned with the unique needs of customers.

We see e-Tailers adopting a hybrid consignment- and inventory-holding model. Inventory-holding decisions would be based on factors such as the profiles of customers visiting a portal, unique category positioning, the delivery criticality of certain categories and historical sales numbers.

This decision would also be influenced by the degree of integration of technology of merchants, as well as the commercial arrangements of e-Tailers with product merchants for product ownership and return.

### 4.3.2 Logistics in e-Commerce: owned or partner led

Last-mile logistics constitute e-Tailers' key component of service fulfillment. This has been one of the key areas of focus for online retailers attempting to make the average Indian customer comfortable with buying products online.48

Till just about a year ago, almost all e-Tailers worked with third-party logistics providers to deliver goods to customers. Over the last year, several players have begun building their in-house capability to manage customers’ deliveries.

Inadequate capacity and high cost of logistics in India...

The number of express courier companies in India has grown significantly over the last decade, with more than 4,500 companies covering a large number of pin code areas across the country.49 The cost of logistics in India is, however, among the world’s highest due to the substandard quality of physical infrastructure.

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Another issue plaguing the logistics sector is the inadequate airline fleet size of express courier companies. This hinders same-day delivery of products ordered online.

Aircraft fleet size comparison of the leading express courier players

- **US:** 420
- **India:** 7

Source: Plane Spotters website

...substandard technology infrastructure in most logistics companies...

Logistics companies in India lag behind in terms of their technology infrastructure and limited investments in technology (GPS systems for fleet, bar codes/RFID tags on packages and hand-held devices for their field force). On the contrary, such a supporting ecosystem is a norm in developed countries such as the US. This grossly limits the ability of e-Tailers in India to monitor the delivery of shipments and provide accurate information in the event of delays.

...high charges levied by service providers for CoD shipments and returns management...

While CoD is emerging as the preferred mode of payment for a large section of customers making online purchases, it entails a host of challenges, especially when third-party logistics providers are used. These include:

- **Extra charges levied by logistics providers to collect cash from customers:** Service providers charge a combination of fixed charges for the collection of CoD, along with a percentage of the shipment value (1% to 2%), thereby increasing the cost of delivery.
- **Delays in remittance of cash collected by logistics providers:** Some logistics providers are known to remit collected cash after up to six weeks, which leads to working capital issues. In addition, the reconciliation of accounts with logistics providers adds another layer of administrative expense, which is expected to grow in complexity as operations grow.
- **Poor returns management and associated costs:** Most logistics providers are not adequately geared to manage returns from customers. Furthermore, players that offer this service charge an additional sum to handle returns. This adversely affects a retailer, which ends up paying twice for a product that was not accepted by a customer.

...makes self-controlled logistics a compelling case where there is scale

Several economic and operational advantages are in store for e-Tailers when they have self-controlled logistics.


Analysis suggest that in-house logistics become more cost effective when average daily shipments of common products such as apparel exceed around 100 deliveries a day in a city.

Key factors that decide the point of breakeven:

- Average value of goods
- Physical size of shipments
- Return rate witnessed by company
- Percentage of shipments delivered with CoD

Having in-house delivery capability is an advantage for organizations that have a high percentage of shipments on the CoD model or a high return rate. Not only do they save significant costs on account of returns, but they also benefit due to the shorter collection cycles of CoD shipments vis-à-vis delayed settlements made by service providers.

Other “soft” benefits of in-house logistics capability:

- Ability to tailor delivery schedules to meet specific customer requirements (urgent deliveries, specific time slots, etc.) leading to customer delight
- Opportunity to make an impression on customers through trained agents and, if possible, obtain first-hand feedback on services
- Cross sell (though this is uncommon in the country)
- Delivery team serving the purpose of OOH branding by e-Tailers

In-house management of logistics not for the faint hearted

Building in-house logistics capabilities is resource and capital intensive, and can be a significant drain on costs if not managed efficiently. It puts pressure on the already wafer-thin margins.

Scaling in-house logistics operations to meet growing demand is another challenge. This is one function where the size of manpower grows almost proportionately to the volume of shipments.

The management of a large workforce has always been an issue. It is a tradeoff that e-Tailers need to make between having greater control and working with a lean organization.

e-Tailers seem to be moving toward a self controlled rather than the owned logistics function. In this option, the bulk of manpower is contractual and leased from existing logistics providers, along with supervisory support. This team works dedicatedly for an e-Tailer and brings the required experience to run an efficient operation.

We foresee all e-Tailers adopting a hybrid model, with a mix of in-house and outsourced logistics functions (differing by cities) depending on the evolution of the organization.

Need for logistics players to act quickly; in-house logistics being favored

Online retail presents an attractive opportunity for logistics players, since the delivery of products to customers is an inherent part of this segment. However, players’ endeavor to enrich customer experience with quick delivery and the failure of logistics players to provide delivery services (based on the requirements of online retail players) have led to a number of online retail players developing in-house logistics capabilities.

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Product delivery in online retail is not just the delivery of products to the doorsteps of consumers, but also an important cog in customer experience. Therefore, logistics players need to gear up their operating models to suit the needs of their online retail customers and work on the following factors:

- Increase their adoption of technology
- Find investors to fund this technology adoption
- Focus on last-mile delivery
- Focus on time sensitivity by providing same-day delivery and specific day/time delivery options to customers
- Focus on returns management and COD services, which are key trends in the online retail market
- Training delivery personnel to handle additional responsibilities such as taking feedback from customers
- Making the customer experience paramount

4.3.3 Decisions on warehouses location

Tax reduction guiding decisions on the location of warehouses due to the non-uniform tax structure and multiple tax rates across states

The retail sector in India needs to comply with the regulations of a complex and multiple tax structure system. This poses various challenges for e-Commerce players.

Complex tax structure for the retail sector in India

Sellers collect Central Sales Tax (CST), which is levied by the Central Government when goods are shipped across states. When products are sold within a state in which a warehouse is located, state governments charge Value-added Tax (VAT).

Non-uniform VAT rates levied by state governments, CST charge on inter-state sales and the retention of VAT in case of inter-state stock transfers make it challenging to decide warehouse location. This challenge is compounded further by the fact that state governments can change VAT at their level. This implies that an economically sound decision taken at one point in time may seem unfeasible after the revision of VAT rates.

Currently, CST cannot be offset against any other tax in India. This means that it is a cost incurred by manufacturers and retailers. This results in double taxation, since an online retailer passes on costs to consumers.

In addition to these taxes, certain states or local municipalities levy entry taxes and octroi, respectively. These are collected at check posts, which are erected to monitor inter-state/
intra state movement of goods. This results in long queues and high transportation costs, as well as provides an opportunity for those controlling the check posts to have an extra source of income.

The issues mentioned above could force online retailers to open warehouses in various states, depending on tax rate and the location of consumer/manufacturer. The presence of a warehouse in the same state as the manufacturer is expected to enable online retailers to avoid paying CST and, thereby, avoid a cost component. VAT charged by the manufacturer could be used to pay off output VAT/CST liability of the retailer.

Implementation of GST expected to eliminate most tax issues ...

Online retailers are looking forward to the implementation of Goods and Services Tax (GST), since it would help iron out most of the tax issues.

CST and VAT will be subsumed in the GST; this would ensure:

- Uniform rate of GST on a product across all of the states
- GST to be creditable against IGST, which will be levied on inter-state transfer of goods

To explain how online retailers and consumers would benefit from the creditability aspect of GST, consider the following cases:

A manufacturer can sell goods to an online retailer, either in its own state or in another one, which can then sell these goods to end consumers located in the same state or otherwise. In the diagrams below, letters A, B and C denote states.
As stated previously, online retailers would benefit from the implementation of GST, since they would be able to offset the GST they would have paid to purchase goods against the GST they would charge from consumers. Furthermore, under the current indirect tax regime in India, online retailers, being trading entities, are not eligible to claim CENVAT credit of excise duty paid on inputs, capital goods (e.g., storage racks, pallets), and service tax paid on input services (such as warehouse rentals, transport, advertising) becomes a cost. However, such restrictions would not exist under the GST scenario, with fungibility of GST credits across goods and services.

The problem of double taxation would, thereby, be eliminated and is expected to result in the reduction of prices and prove beneficial to consumers as well.

... and shift the basis of warehouse location decisions from tax reduction to operational efficiency.\(^\text{54}\)

Making decisions pertaining to the location of warehouses (on the basis of tax considerations) implies the maintenance of small and inefficient warehouses. Small warehouses make technology usage, such as racking, automation and ERP implementation, extremely

<table>
<thead>
<tr>
<th>Branch</th>
<th>Comments</th>
<th>Current implications</th>
<th>Post-GST implications (likely)</th>
</tr>
</thead>
<tbody>
<tr>
<td>AAA</td>
<td>The manufacturer and the online retailer sell goods within the same state. VAT is collected by the manufacturer and the online retailer during the two transactions.</td>
<td>The online retailer can offset VAT collected by it from the consumer with the VAT it paid to the manufacturer.</td>
<td>The online retailer can offset the GST collected by it from the consumer with the GST it paid to the manufacturer.</td>
</tr>
<tr>
<td>AAC</td>
<td>The manufacturer sells goods to the online retailer in the same state in which it sells those goods to the end consumer located in another state. VAT is collected by the manufacturer from the online retailer, and the online retailer collects CST from the end consumer.</td>
<td>The online retailer can offset the CST it collected from the consumer with the VAT it paid to the manufacturer.</td>
<td>The online retailer can offset the IGST it collected from the consumer with the GST it paid to the manufacturer.</td>
</tr>
<tr>
<td>ABB</td>
<td>The manufacturer sells goods to the online retailer in a different state in which it sells those goods to the end consumer located in the same state as the online retailer. The manufacturer collects CST from the online retailer, while the online retailer collects VAT from the end consumer.</td>
<td>The online retailer cannot offset the VAT it collected with the CST it paid to the manufacturer.</td>
<td>The online retailer can offset the GST it collected with the IGST it paid to the manufacturer.</td>
</tr>
<tr>
<td>ABD</td>
<td>The manufacturer sells goods to the online retailer in a different state in which it sells those goods to the end consumer located in a state different from both the manufacturer and itself. The manufacturer collects CST from the online retailer and the online retailer collects CST from the end consumer.</td>
<td>The online retailer cannot offset the CST it collected with the CST it paid to the manufacturer.</td>
<td>The online retailer can offset the IGST it collected with the IGST it paid to the manufacturer.</td>
</tr>
</tbody>
</table>

expensive for owners and operators. Economies of scale affect warehouses positively only when they are larger than 30,000 sq ft. Total warehouse space requirements could be cut down by 20%-50% if tax reduction does not drive the warehouse location decision.

Tax reduction also means that retailers have to maintain a large number of warehouses, which results in inefficient distribution. The implications of a large number of warehouses are smaller loads on trucks and a larger number of trucks, leading to enhanced costs and deviation from efficient distribution models.

The implementation of GST would ensure that online retailers focus on cost efficiencies while deciding on the number and size of warehouses.

GoI can also consider incentivizing online retail by providing tax benefits...

Online retail in India is at a nascent stage and is still struggling with challenges arising from the ecosystem. The government could provide some respite in the form of tax benefits.

A number of factors could compel the government to provide tax holidays to such companies.

► Online startups may find it difficult to compete against established brick-and-mortar companies.
► Online retail is an energy-efficient form of selling, a factor that may influence the government to promote the sector.
► It enables a larger segment of the population to access a wide assortment of products.
► It helps in the growth of organized retail, which still forms a small proportion of the overall retail sector.

...by taking cues from the US Government, which provided tax benefits to e-Commerce players55

e-Commerce players in the US are exempt from paying sales tax on their sales to consumers located in states where they do not have a physical presence. This gives them a pricing advantage over brick-and-mortar retailers – a major impetus for companies and entrepreneurs looking to enter the e-Commerce space. For example, the price disadvantage for a local retailer ranges from 7% to 9.75%, depending on the location of the retailer and whether the sold product is a food or a non-food item in Tennessee, where 61.3% of state tax revenues came from the state's portion of Sales and Use Tax in the fiscal year ended June 2011. Some states have, however, reversed this tax exemption.

4.3.4 Big question surrounding the use of the online business model by organized retail players

Online retail is expected to grow at a rapid pace in India in coming years. While pure-play players are expected to benefit from the fruits of this growth, brick-and-mortar retail companies face the challenge of deciding on the right business model with respect to the implementation of an online sales channel. Staying off the online medium may imply losing sales to online retail players. They need to ponder on the following key aspects while deciding their strategy:

► How to enter the online space: through acquisitions, joint ventures or the organic route
► Partnerships with other online retail players

Presence in the offline and online space may present challenges related to:
- Pricing decisions on the same product sold via two channels
- Customer segmentation to ensure that customers are targeted through the preferred channel

4.4 Challenges in online retail market

4.4.1 Lack of touch-and-feel a mental barrier for online shopping
Most Indian consumers prefer to sample a product before making a purchase. This applies across categories such as clothing, shoes, perfumes and accessories. Lack of touch-and-feel in online shopping could lead to issues such as wrong product sizes (in shoes and clothing). This creates a mental barrier for consumers to shop online.56

4.4.2 Increased competition with the entry of global players
The growth potential of the online retail segment in India is attracting leading international players. The entry of international players would increase competition in the segment. The advanced technology capabilities of global players in areas such as customer analytics and recommendation engines would pose a challenge for local companies. International players have larger financial resources than their Indian counterparts. This enables them to bear losses and restrict supplies to their competitors by buying out supplies from vendors. This could drive out smaller domestic players from the market.

4.4.3 Low margins prompting e-Commerce players to look at new business models
The majority of e-Commerce companies are price players due to the stiff competition they face and the race to acquire the maximum number of customers. This results in very low margins or none at all.
e-Commerce players could look to adopt new business models to increase their margins. One such example includes private labels.57

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Retailers to increase their spend on private labels, since this is expected to draw the interest of consumers

According to a TechSci Research research study, Private Label & Indian Consumer Insight 2010, almost 85% of the consumers indicated willingness to purchase private labels promoted by retailers. Indian consumers, being value conscious, are expected to welcome private labels in the market.

High margins of private labels

Margins on private labels range between 10% and 15% in the case of FMCG products and touch as high as 40%-60% for apparel in India.

Private labels already in the e-Commerce market

Private labels have been adopted in e-Commerce markets worldwide. They have crept into the Indian e-Commerce market as well, with a few small players adopting the model to shore up margins.

4.5 Top categories driving online retail

Electronics is the largest category of products selling online in India, with a market share of 61%. Electronics include computers, peripherals, televisions, cameras and mobiles.

While electronics goods enjoy the maximum popularity in India, apparel and accessories seem to be the largest-selling categories in leading markets such as the US, the UK and Germany. This is because of the higher margins that this category generates for e-Commerce players. As is the case in leading e-Commerce markets, we can expect online retailers to shift to selling higher-margin products such as apparel.

The preference for apparel in online shopping is a global phenomenon. According to a survey conducted by Nielsen in March 2010, books and clothing/accessories/shoes emerged as the most preferred product categories to be bought online in the next six months. A total of 44% of the respondents claimed to buy books online in the next six months, while 36% preferred clothing/accessories/shoes. 58

Products/services intended to be purchased over the next six months (June 2010) - worldwide (%)

<table>
<thead>
<tr>
<th>Category</th>
<th>June 2010 Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Books</td>
<td>44.0%</td>
</tr>
<tr>
<td>Clothing/accessories/shoes</td>
<td>36.0%</td>
</tr>
<tr>
<td>Airline ticket/reservations</td>
<td>32.0%</td>
</tr>
<tr>
<td>Electronic equipment</td>
<td>27.0%</td>
</tr>
<tr>
<td>Tours/hotel reservations</td>
<td>26.0%</td>
</tr>
<tr>
<td>Cosmetics/nutrition supplies</td>
<td>22.0%</td>
</tr>
<tr>
<td>Event tickets</td>
<td>20.0%</td>
</tr>
<tr>
<td>Computer hardware</td>
<td>19.0%</td>
</tr>
<tr>
<td>Videos/DVDs/games</td>
<td>18.0%</td>
</tr>
<tr>
<td>Groceries</td>
<td>18.0%</td>
</tr>
<tr>
<td>Music</td>
<td>16.0%</td>
</tr>
<tr>
<td>Groceries</td>
<td>18.0%</td>
</tr>
</tbody>
</table>

Source: Nielsen

Underpenetrated segments in online retail...

Product categories sold in organized retail indicate a slightly different scenario from online retail. Certain segments that command a significant share of the organized retail market are underpenetrated in the online retail sector. Food services and beverages have a share of 20% of the organized retail market. However, these product categories are still at a nascent stage in the online retail world.

Organized retail categories in India in 2010 (%)

- Clothing: 36%
- Electronics: 14%
- Food and beverages: 12%
- Footwear: 9%
- Food services: 8%
- Leisure: 6%
- Furniture: 6%
- Accessories: 5%
- Pharmacy: 2%
- Health and personal care: 1%

Source: BCG

...such as online groceries to pick up speed in the near future

A number of online groceries are coming up in India. Considering that the working population in metros spends considerable time travelling and the number of nuclear families is rising, online groceries seems to offer a convenient channel.

Online groceries seem to be more popular in higher-density population countries. For instance, countries such as the UK (4%) and Japan (30%) have greater online grocery penetration than the US (2%), which is less densely populated. India, also being a densely populated country, may see growth in online groceries.\(^{59}\)

4.6 Top reasons driving online retail

4.6.1 CoD – a necessary evil

Indians prefer to transact in cash vis-à-vis all other payment instruments. Among emerging markets, the country leads when it comes to cash transactions. The proportion of value of bank notes and coins in circulation as a percentage of M1* in India is 60.1%, which is much higher than that in other emerging economies such as China and Brazil.\(^{60}\)


While the base of credit and debit cards is on the rise, Indians have been slow in using these payment instruments for shopping online.

e-Tailers understanding preference for cash payments and offering CoD

e-Tailers seem to have recognized the fact that only targeting credit or debit card owners for online purchases would greatly limit their target customer base. They have, therefore, added CoD to their portfolio of payment options. This has paid off handsomely, with CoD being one of the key factors influencing the rapid growth in online purchases.

CoD addressed some of the issues that customers had with transacting online:
- Privacy and security concerns while using cards for online payments
- Desire to see a product before paying for it
- Lack of trust in e-Tailers for high-value purchases

Industry estimates suggest that CoD accounts for nearly 50% to 80% of online transactions in India.61

CoD helping expand customer base

This mode of payment expands the customer base of e-Commerce companies beyond credit or debit card users and is useful for attracting consumers such as students, who do not have credit cards but spend a lot of time on the Internet, as compared to other age groups, and use the medium to shop for books and CDs, among other products.

Average time spent by age groups – March 2011 (hours per user per month)

Source: comScore media metrix

While CoD has driven volumes, it has also increased cost of operations

Although the COD option has helped Indians overcome their concerns about shopping online, e-Commerce players face operational challenges. The high service charges of courier companies reduce the margins of e-Tailers. Some courier companies charge a fixed amount in addition to 1%-2% of the transaction amount.\(^\text{62}\)

The implementation of COD adds another layer in the supply chain in the form of cash handling. This increases the settlement period of online retailers and courier companies to two to three weeks, which stretches the cash collection cycle of online retailers.\(^\text{63}\)

Online buyers opting for the COD option indicates their low commitment and increases the probability of returns. The return rates of merchandise in online shopping in COD transactions average at around 40%.

### 4.6.2 Discounts, convenience and value-added services key influencers of growth of online retail

The Indian consumer is price sensitive, and discounts are one of the major incentives for shopping online. e-Tailers offer products at reduced prices, since their operational and inventory costs are much less than those of offline retailers. This, coupled with the wider product assortment offered, is the major driver of online shopping.

Deregulation of fuel prices has led to a rise in fuel prices in India. Furthermore, heavy traffic is being witnessed in urban areas, and parking space constraints are cropping up at malls. All these reasons have led consumers to purchase their goods online.

e-Tailers in India are providing various value-added services such as free shipping, product returns, product and price comparison, user reviews and demonstration videos. All these factors have driven the change in preference from offline to online shopping.

As e-Commerce players increase their focus on customer experience by providing various value-added services, the Japanese and Chinese e-commerce markets provide some insights on how players can enhance customer experience.\(^\text{64}\)


Store and alternative site pickup

Focusing on enhancing customer experience, Japanese e-Commerce players, following suit of some of their European counterparts, have provided the option of delivery pick-ups at local convenience stores and other locations — 25% of products ordered via e-Commerce transactions are paid for and picked up at such stores.

Bundled deliveries

In 2010, a major e-Commerce player in Japan initiated a new distribution system that provided an option of bundled deliveries of daily sundry goods and household articles of varying shops on its website. The e-Commerce player handled order receipt and settlement operations on behalf of the shops. It used exclusive distribution centres for packing such orders. This delivery service was convenient for customers and helped broaden the use of e-Commerce for major purchases, including items of daily use.

User-generated content helping break credibility barriers

It has been observed that Chinese consumers are avid readers of online reviews before shopping online. According to a BCG report, more than 40% of Chinese shoppers read and post online reviews. This proportion is double that for the US. Chinese consumers trust online sources for information about products and services more than offline sources such as television advertisements.

Therefore, e-Commerce players need to provide shoppers with reviews on products sold. User-generated reviews go a long way in alleviating the concerns of shoppers and help convert website visits to purchases.

4.7 Summary

Online retail not only focuses on web capabilities but also on how well the peripheral aspects of online retail are taken care of. Online retail players pay as much attention to inventory management, logistics and warehouse management as they do to their online platforms. They need to invest time and money on all these, since customer experience is a function of how well they work in sync.

There is significant scope for online retail players to focus on new product delivery models and payment mechanisms, since customers are facing problems with the options available.

The online retail market presents an attractive opportunity for entrepreneurs, since it is growing rapidly and still forms only a miniscule portion of organized retail. Moreover, there are a number of underpenetrated segments such as online groceries in online retail. Players also have opportunities in sectors impacted by online retail, e.g., logistics, in which last-mile reach is a problem.

While organized retail players are attracted by opportunities presented by the online retail sector, they have critical questions pertaining to modes of entry, pricing decisions and customer segmentation.
Rebirth of e-Commerce in India
Chapter 5

Online classifieds

5.1 Market size and revenue sources 70
5.2 Transition from print media to the web 71
5.3 Online recruitment classifieds – largest category in online classifieds 72
5.4 Online matrimonial classifieds 73
5.5 Online real estate and auto classifieds a small portion of online classifieds 73
5.6 Challenges in online classifieds segment 75
5.7 Summary 75
5.1 Market size and revenue sources

The online classifieds market in India grew at a CAGR of 29% from 2008 to 2011.

Online classifieds market size (US$ million)

Source: ResearchonIndia

The primary target audience of the classifieds segment is restricted to urban areas due to the concentration of companies, real estate players and automobile players (willing to advertise online).65
The major sources of revenues for the online classifieds segment depend on the segment and are listed below.

- **Recruitment**
  - Charges for job listing and employer branding
  - Charges for resume database access
  - Charges for job seeker value-added services
  - Advertising fees

- **Matrimonial**
  - Subscription fees from customers
  - Advertising fees

- **Real Estate**
  - Subscription fees from developers, builders and brokers for property listings
  - Advertising fees

- **Automobiles**
  - Leads generated for new cars, auto insurance and auto finance
  - Subscription and brokerage charges
  - Charges for automotive listings
  - Advertising fees

- **B2B**
  - Subscription charges which include services like creating websites, micro-sites, catalogs and search engine optimization
  - Advertising fees

Subscription revenues in the online classified segment constitute the bulk of the revenues generated by these players, while revenues from value-added services (VAS) and non-contextual advertising form a minuscule portion. Companies in this space are also expected to increase their revenue share from VAS.

### 5.2 Transition from print media to the web...

The classifieds segment in India was the earliest to go online. It has been around for more than a decade. The segment is a replica of the offline model in terms of the categories it covers, but it is much more convenient for consumers. The classifieds segment was dominant in the print medium, but there has been a clear shift to the online medium in the space. Online classifieds surpassed offline ones in 2012.

**Classifieds market**

![Chart showing the transition from offline to online classifieds market in 2009 and 2012](chart)

Source: Netscribes
...led by easy search functionalities, a young internet population and low online advertisement costs

Databases and search functionality

Access to huge databases and advanced search functionalities, which make the process of searching for relevant information much easier than in the offline mode, are driving the success of the online classifieds segment.

Young internet population

Around 40% of internet users in India are aged 25-34 years and spend a significant time on internet. They are part of the country’s working population and the main consumers of recruitment and matrimonial classifieds. This makes online classifieds an attractive medium to target the young population.

Internet users by age (2011)

Source: comscore

Low online advertisement costs

The cost for online advertising is around US$1 per applicant. This is much lower than the advertising cost of US$12-13 per applicant in the offline mode.66

5.3 Online recruitment classifieds — largest category in online classifieds

The online recruitment or e-recruitment segment is the largest category in the online classifieds segment in India, with a market size of US$99.2 million and a 62.5% share of the online classifieds market in 2009.67

Expected growth of jobs in India bodes well for the segment

The number of jobs is expected to increase across sectors in India. According to the industry body, the Associated Chambers of Commerce & Industry (ASSOCHAM), 87.37 million jobs would be created by 2015. This holds promise for the growth of the online recruitment classifieds segment, since players have only scratched the surface of the job market and the full potential of the sector is yet to be realized.68

Online recruitment classifieds benefiting employers and offline recruitment agencies

The segment offers various benefits, including reduced advertisement costs, wider geographical reach and easy search options, to companies. Employers are increasing their budgets for online recruitment, realizing the convenience and efficacy of the mode.

Online recruitment classifieds are also proving beneficial for the growth of offline recruitment agencies, which are using online portals to build databases of candidates and jobs.

Increased focus on providing enhanced search options...

Online recruitment classified players are increasing their investment on search functionalities, since providing enhanced search options is high on their list of priorities. Furthermore, they are developing separate portals to cater to varying verticals such as financial services, technology and BPO to enable focused searches.

...and VAS

From providing databases of jobs and candidates, online classified players have moved to offering VAS such as short-listing profiles, screening resumes for recruiters and developing resumes for job seekers.

They are also offering new services, whereby job seekers can send salient details through their mobile phones. This doubles up as an initial screening process in sectors including BPO, where voice and idea articulation are the main criteria for judging candidates.  

5.4 Online matrimonial classifieds

The online matrimonial classified market grew from US$36.9 million in 2009 to nearly US$63 million in 2011, even during the financial downturn, as is evident from its 25% growth in 2008. It is the second-largest category in India's online classifieds segment. There are more than 100 matrimonial sites in the country, with small and niche players catering to multiple communities and segments. The market is, however, dominated by a few large players.

The "big fat" Indian wedding industry

Marriages are expensive in India, with the average spend in middle class weddings averaging INR0.5–1.5 million. This contributes to the growth of the already huge wedding industry, which was estimated at US$47.1 billion in 2011.

Online classified players augmenting traditional sources of revenue by widening their umbrella of services

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Matrimonial websites provide relationship counseling, horoscope matching, chat services, as well as 24/7 customer support. Premium members are provided dedicated relationship managers, who assist in their search for life partners.

The country’s marriage industry has led to demand for a new set of professionals including wedding planners, video makers, photographers, set designers and relationship counselors. Companies in the online matrimonial segment may look at providing such services through partnerships, so that their websites become a one-stop shop offering services from match making to wedding ceremonies. They may also look to provide wedding planning, catering and cards distribution services.

5.5 Online real estate and auto classifieds a small portion of online classifieds

The online real estate and auto classifieds segments had a market size of US$21.2 million, with a market share of 14% of the online classifieds sector, in 2009.73

The online real estate classifieds segment has seen slow growth due to real estate agents being largely computer illiterate. According to a leading online real estate classified player, 80% of its brokers do not have computers. However, larger real estate developers have an online presence and are using online classifieds to advertise new properties.

Real estate classifieds – growth dependent on ability to piggyback on that of real estate74

Demand for rented and owned properties is expected to rise significantly in India, since the country’s urban population is projected to increase to 590 million by 2030 from 340 million in 2008. Added to this is the projection that 70% of the new jobs created would be in urban areas. Demand for real estate is expected to grow at a CAGR of 19% between 2010 and 2014.

We believe that the growth of the real estate classifieds market is dependent on players’ ability to piggyback on this growth. Currently, these portals only serve as information directories. Considering the value of real estate transactions, the success achieved by these players depends on their ability to capture a significant share of this transaction value. To accomplish this, they need to provide users a rich experience, e.g., through virtual tours of properties and the ability to finalize deals on the online platform.

Auto classifieds – not yet off the block

The online auto classifieds segment is a recent entrant in the second wave of e-Commerce in India. Rising disposable incomes have increased the buying power of people. This has led to many more people aspiring to own cars and, consequently, to the emergence of online automobile classifieds players that connect car buyers and sellers.

Many first-time buyers opt for used cars before buying new ones. Therefore, ensuring genuine vehicle listing is critical. Segment leaders are likely to be those who provide quality assurance, e.g., leading offline used car dealers.

However, the majority of car buyers or sellers prefer to buy or sell cars through used-car dealers and personal contacts. The establishment of used-car dealerships by leading automobile brands has led buyers to rely on the offline rather than on the online medium. As a result, India’s online auto classifieds market is still at its nascent stage.

### 5.6 Challenges in online classifieds segment

- **Lack of vernacular content**
  - Majority of the online classifieds content in India is in English. But, 58% of the urban literate population in India in 2009 was non-English literate.
  - Absence of vernacular content in the online classifieds space is a barrier for that segment of the population.

- **Credibility of information**
  - In the online recruitment and matrimonial classifieds space, there have been plenty of instances of fake profiles and profiles with incorrect information.
  - This brings into question the credibility of information posted on these sites.

- **Preference of offline agents**
  - Due to the high value of transactions involved in the property and automobile market, majority of the real estate and car buyers take the services of an offline realtor or a car dealer.

### 5.7 Summary

The offline classifieds segment is leveraging the online platform. Leading newspaper dailies are launching their own online classifieds portals and are increasing competition for pure-play online classifieds companies, since offline players can leverage their brand image and reader base. They are also using their portals to feed their print ads business.

The growth of mobile web users in India has led to online classified players looking at capturing this segment of customers. Consequently, most players in the online classifieds space are developing mobile websites and apps that are compatible with various operating systems.

Online classifieds players focusing on specific areas are setting up sites that provide services targeted at specific cities and categories. These players have also customized their websites to provide content in local languages. Furthermore, though advertising revenues comprise the primary revenue source in this segment, some players have also adopted a lead generation-based model.

The horizontal classifieds space is growing with several players entering this market. Favorable demographic factors such as rising purchasing power and global exposure have shortened the consumer purchase cycle, and more used goods are coming into the market. Horizontal classifieds provide a suitable route to sell such goods relatively quickly. Response rates and the ability to generate genuine customer leads for ads posted are major determinants for the success of players. 75

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75 “Online and offline classifieds - India (part- 2),” ResearchonIndia, June 2011, via ISI Emerging Markets.
Rebirth of e-Commerce in India
Chapter 6

Investments in e-Commerce

6.1 Reduction in period between subsequent rounds of funding and increase in deal size 78
6.2 VCs investing across different e-Commerce verticals 79
6.3 Valuations – too good to be true? 79
6.4 VC players banking on growth of e-Commerce to make lucrative exits 80
6.5 Impact of retail FDI on e-Commerce players 80
The second wave of e-Commerce has witnessed the introduction of new business models and the rapid growth of players in the domain. Most e-Commerce players in this wave are startups that are on a steep growth curve. However, these players need additional capital to scale up and maintain the pace of this growth. The need for capital, coupled with the growth potential of the sector, has made it a favorite among VCs.76

India’s e-Commerce sector attracted US$305 million (in 37 deals) from January 2011 to November 2011 (454% more than US$55 million raised from 12 deals in 2010). Investments in the sector accounted for more than 20% of total VC investments in the country in 2011.77

The bulk of the funds raised by players was used to expand market presence, build logistics and supply chain capabilities, and enhance technology platforms.

**Value of VC investments in Indian e-Commerce sector (US$ million)**

Source: iamwire website

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### 6.1 Reduction in period between subsequent rounds of funding and increase in deal size

The main feature of funding received by e-Commerce players in 2011 was the reduction in time (by half) between two rounds of funding against 2010 levels. This is due to the need for funds to scale up rapidly. The average deal size of each round of funding received by e-Commerce players in 2011 was substantially more than that received in 2010. Deal sizes in the second and subsequent rounds more than doubled in 2011 compared with earlier years. These increased deal sizes have attracted private equity (PE) funds, which invest in mature companies. Another noteworthy feature is the increase in the fund size of VCs, which gives PE players the flexibility to make large investments in high-return deals outside their focus areas.78

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Average deal size (US$ million)*

<table>
<thead>
<tr>
<th>Year</th>
<th>1st round</th>
<th>2nd round</th>
<th>3rd round</th>
<th>4th round</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>10.6</td>
<td>6.2</td>
<td>4.8</td>
<td>8.2</td>
</tr>
<tr>
<td>2010</td>
<td>2.8</td>
<td>4.8</td>
<td>4.8</td>
<td>20.2</td>
</tr>
<tr>
<td>Jan-Nov 11</td>
<td>43.7</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Avendus
* Represents digital media companies which include e-commerce, information and classifieds portals, online advertising, services and payment platforms

6.2 VCs investing across e-Commerce verticals

Online retail, group buying and online travel segments were the top three segments to receive funding from VCs in India.

VCs were observed to be investing more in vertical focused niche e-commerce startups in India.

Early stage funding in the e-commerce sector in India has also picked up with a few companies providing seed-funding and series A funding.

6.3 Valuations – too good to be true?

The rapid growth of e-Commerce companies has attracted new players. Moreover, though many of the new companies do not have any significant differentiator in their businesses, they have been successful in attracting investments. However, most of these companies are not yet profitable and are only growing on volumes. This raises concerns relating to a valuation bubble.

Companies competing on price to gain customers

One of the reasons that justifies this concern is that companies are looking to acquire customers by selling below the cost price. They are mainly competing on price to overcome competition – at the expense of investors’ funds. The sales-to-market cap valuation ratio of leading e-Commerce players is around 1:100, which implies a mismatch between their sales, margins and valuations.

Creative accounting methods

The second reason relates to accounting methods adopted by e-Commerce companies. Some of these are amortizing discounts that they provide on sales as capital expenditure, based on the premise that this will benefit them in later years, instead of accounting for this in the year of sale. This leads to inflation of their balance sheets.81

6.4 VC players banking on growth of e-Commerce to make lucrative exits

Several VCs are investing in the e-Commerce space because they feel this is the right time to invest in the space and do not want to miss out on its current wave of popularity. They think it necessary to have an e-Commerce company in their portfolios, as this would allow them to sell their stakes at high prices.82

The sector would continue to receive funding from VC and PE players despite concerns relating to a valuation bubble. Early stage-focused PE players would invest a major part of their funds (40%) in internet-based companies by 2014-15.

6.5 Impact of retail FDI on e-Commerce players

In September 2012, the government made a landmark announcement allowing 51% FDI in multi-brand retail, subject to certain conditions. Initially, this announcement was applauded by e-Commerce players, since it was assumed that this would attract foreign investments in B2C e-Commerce. However, the initial euphoria was short-lived, since the Department of Industrial Policy and Promotion (DIPP), an arm of the Ministry of Commerce and Industry, later clarified that this mandate does not apply to B2C e-Commerce retail and is applicable only to retailers with brick-and-mortar operations. One of the reasons cited for this was the difficulty encountered in monitoring inter-state transactions in e-Commerce activities. Therefore, this relaxation does not benefit pure-play B2C e-Commerce players and may not also benefit retailers engaged in B2C e-Commerce operations.

<table>
<thead>
<tr>
<th>Segment</th>
<th>Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foreign sites operating outside India</td>
<td>No impact for cross-border shipment, but not allowed to set up operations in India</td>
</tr>
<tr>
<td>Foreign sites operating in India, but only listing products or services</td>
<td>No impact since these do not hold or own inventory</td>
</tr>
<tr>
<td>Indian e-Commerce sites</td>
<td>Will come under the FDI directive.</td>
</tr>
<tr>
<td>B2B portals</td>
<td>No impact on their 100% limit</td>
</tr>
</tbody>
</table>

Source: The Hindu

Players’ opinion about the government’s decision on not allowing FDI in B2C e-Commerce retail is mixed. Some players are indifferent and maintain that this new directive does not change anything for them; others have expressed their disappointment. However, consensus is that this may prevent foreign e-Commerce companies from entering India. They could have brought in the much-needed investments in the ecosystem, e.g., in logistics, payments, to drive market growth.

To access foreign capital, some players have set up a separate entity for activities where 100% FDI is allowed. This covers back-end operations such as logistics, inventory and technology, which enables 100% Indian-owned and controlled front-end entities to leverage on the capabilities of these back-end operations. With this new directive, future investments would be routed through the same path as earlier.

A positive aspect of the regulation is that it would buy more time for local e-Commerce players to consolidate and leverage their presence in India. Many of these have made significant investments and have offered steep discounts to generate recurring cash flows. Therefore, this mandate gives hope to domestic players to not worry about customers’ defection to global players.

While most players are pressing for FDI in e-Commerce, when the government will do so is a subject that is open to debate and conjecture. Overall, Indian players are expected to benefit from the current directive to consolidate and build their capabilities before facing competition from the eventual arrival of global players in India.


80 | Rebirth of e-Commerce in India
Chapter 7

Challenges for e-Commerce sector

7.1 Cloud surrounding e-Commerce laws in India 84
7.2 Low entry barriers leading to reduced competitive advantages 84
7.3 Rapidly changing business models 84
7.4 Urban phenomenon 85
7.5 Shortage of manpower 85
7.6 Customer loyalty 85
The phenomenal growth of the e-Commerce sector is accompanied by the challenges mentioned below.  

7.1 Cloud surrounding e-Commerce laws in India

e-Commerce is a rapidly growing market in India, and domestic as well as international players are looking to tap the opportunity in the sector. However, there are no specific e-Commerce laws in India. The sector is governed by the IT Act 2000, which regulates the legal obligations of sellers and buyers of goods and services in cyberspace.  

Apart from the IT Act 2000, e-Commerce laws in India need to comply with other statutory laws in force in the country, e.g., the Indian Contract Act and Foreign Investment Regulations. e-Commerce companies also need to comply with banking and financial laws, where applicable. For example, financial intermediaries are required to obtain licenses from the RBI to provide services. Adding to the complexity of such laws in the country is the fact that legal issues pertaining to the sector differ across categories of e-Commerce.

Laws regulating e-Commerce in India are still evolving and lack clarity. This poses a challenge for potential entrants and existing players. Furthermore, the lack of law firms or lawyers specializing in e-Commerce laws compounds the problem.

The onus is, therefore, on the government to formulate dedicated e-Commerce laws so that current issues in the sector’s legal environment can be addressed.

7.2 Low entry barriers leading to reduced competitive advantages

The rapid growth of the e-Commerce sector is attracting new players. The initial investment required to start an online venture is as low as a US$10,000–20,000. The sector is also attracting the interest of VCs and entrepreneurs to secure funds easily. This enables new companies to easily replicate the existing business models and, thereby, increases competition in the sector. Furthermore, some operational aspects such as free shipping of products and COD, which were differentiators earlier, have now become hygiene factors.
7.3 Rapidly changing business models

Business models have been changing rapidly in the e-Commerce sector. This could be due to heightened competition and the inability of players to sustain high costs. Some businesses, such as online DVD rentals, have gone into obsolescence; some companies in the online retail segment have shut shop due to their inability to sustain price wars with their competitors. Group-buying companies, which started off by providing deals at high discounts, have now begun selling products. Therefore, players in the e-Commerce space need to adapt to changing business models and innovate constantly to sustain their businesses.

7.4 Urban phenomenon

India’s e-Commerce market is mainly restricted to urban areas, with the bulk of the business being restricted to cities. Internet usage in rural areas is limited. This could be due to several reasons including low internet speed and internet user base (20 million out of a total of 121 million in 2011), though rural areas account for 70% of the country’s population. The inadequacy of vernacular content on e-Commerce websites is another reason for low penetration in rural areas.

7.5 Shortage of manpower

The e-Commerce sector is growing rapidly, but scarcity of trained manpower is threatening to slow down this growth. The lack of specialized courses on e-Commerce at college or university levels limits the talent pool available to e-Commerce players. Therefore, the senior management of e-Commerce companies needs to expend a considerable amount of time on hiring (the conversion rate is very low). The attrition rate at some e-Commerce companies is as high as 65% at the junior level and 20% at the mid-senior management level. Furthermore, due to the competitive nature of the industry, companies poach from their competitors. This drives up the cost of retention for companies, which sometimes offer employee stock options (ESOPs) and other incentives to retain their employees.

7.6 Customer loyalty

e-Commerce players offer huge discounts to lure people to shop online. However, since Indian consumer looks for the lowest price before making a purchase, the cost of customer acquisition is high for these companies. Moreover, since a large number of players offer the same products at the same prices, switching cost is non-existent. Consequently, a customer’s lifetime value is low. This poses a challenge for players in their effort to develop sound strategies to attract and generate repeat customers.

A major e-Commerce player in Japan has developed a loyalty program, which has helped it grow significantly. Under this program, buyers receive bonus points on purchases they make from different online shops on the player’s website. They can redeem these at any of the shops on the website. Many OTAs are also developing their loyalty programs in India and are offering discounts as well, e.g., to customers booking round trips, to increase customer loyalty.

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