E-Commerce Companies in India- Its Growth and Governance

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Abstract

With $681 billion in online retail sales in 2016, China captured the top slot in e-commerce, United States of America secured the second position, and India became one of the fastest growing country in the space of e-commerce. It is a well accepted truth that we are living and breathing in a world where communications through internet, mobile phones etc are more frequent than face to face communication. Days are almost over when consumers have to walk to the doors of the retail shop and do shopping. Today one can select a commodity of any nature at a price acquiescing to him and place an order through online platforms. The foray of online companies into retail space have completely changed the lifestyle and ushered in a new approach towards buying of products. But despite such positive developments there are numerous critical issues that needs to be looks into, especially the sustainability of online or e-commerce companies and governance issues. Since corporate governance is a crucial component for ensuring protection of interests of stakeholders, in view of this, it is imperative to explore the issues that have a bearing with either all or some of the stakeholders. Recent events pertaining to corporate restructuring will be referred in this article to comprehend the magnitude of corporate governance prevailing in e-commerce companies.

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Introduction

We are living in an eon where geographical boundaries are shrinking, there is ease of doing business, markets have become a global village, companies are acting on the concept of being'Glocal', i.e. '*Think Globally and Act Locally*', myriad trade related transactions are occurring at nano seconds and all these due to onset of advanced technologies. Harnessing the merits of latest technologies, e-commerce companies have captured a sizeable chunk of the market. According to a study by Forrester Research, nearly a fifth total retail sales will take place online by 2021 in Asia Pacific, with 78 percent of it driven by mobile, up from 63 percent in 2016. The study further revealed that online retail via mobile will rise at a CAGR of 15.6 percent, to touch $1 trillion in 2020, up from $539 billion in 2016 (Please refer exhibit 1). Now a pertinent question arise as to why the focal point is Asia Pacific? According to Forrester, Asia Pacific continues to be the biggest region for online retail sales. China accounts for approximately 80 percent of online retail sales in Asia Pacific, and according to Forrester it is expected to touch $ 1 trillion in online retail sales in 2020. Further,Western e-Commerce brands have also shown proclivity in India's growing maturing commercial scene. Canadian e-Commerce start-up Shopify announced the release of Shopify.in in 2013 to much fanfare and publicity. Shopify was quick to capitalize on the soaring e-Commerce entrepreneur and SME market.

But despite the growing prominence the e-commerce companies, especially, early stage start-ups in India are witnessing the following challenges- Customer acquisition; Raising funds; Shift to cashless payments; Logistics and Supply chain and Constant reinvention. Taking the case of Snapdeal, a renowned e-Commerce company faced the slew of challenges that involved cautious sellers, brand taking a hit and high attrition among top executives.

Growth of e-Commerce companies in India

Despite witnessing varied challenges which involves shutdown of even few e-tailing firms, the size of the domestic e-commerce market, which stood at $28 billion in 2015-2016, is estimated to witness a 17.8% growth in 2017-18, thus touching the $33 billion mark, according to NASSCOM. With valuations in the industry falling, it has seen a sharp surge in funding activity. According to report by Jefferies, during January to March quarter of FY17, private internet companies procured $2 billion, the second highest after Q3 of FY17. In FY16, these companies had raised only $2.7 billion. The report noted that e-tailing once again accounted for above 60% of the fund raised during the quarter as Flipkart, Paytm Mall and Delhivery did $100 million plus rounds. However, both Flipkart and Ola procured money at valuations lower than previous rounds which is likely to have assisted them raise large rounds. In the outcome of demonetization, four fintech companies also raised $100 million during the quarter. The companies include Freecharge, Ccavenues, Truebalance and Creditmantri. Money raised by internet companies fell to a three year low in December quarter (2016), with less than $300 million pouring in. The fact was that funds were hard to come by 2016 and the $2.7 billion that was invested was 50% below than the amount invested in 2015.

However, the silver lining is that e-Commerce has made it quite convenient for top American brands to reach Indian customers, and has emerged as one of the rapidly growing trade channels available for the cross border trade of goods and services. There is a rising predilection for international brands and superior quality foreign products amongst digitally connected Indian shoppers due to soaring income levels and enhanced awareness. Numerous categories include lifestyle products, consumer electronics, clothing, footwear, jewellery and accessories, health and beauty, household goods, art and collectibles, event tickets and online music are doing good for online sales. Technology enabled innovations like digital payments, hyper-local logistics, analytics driven customer engagement and digital advertisements have assisted the e-Commerce industry in India to grow at an astounding pace.

Government initiatives like, Digital India, Skill India, Start up India and Make in India are also contributing immensely to the growth of the e-Commerce industry. Despite the demonetization move online sellers of food and grocery reported enhanced sales and the fillip to the digital payment mechanism may strengthen the sector in the long period.
At this juncture, it is pertinent to take a view of regulator landscape for e-Commerce Foreign Direct Investment (FDI):

a) B2B: 100% FDI is allowed in companies engaged in B2B eCommerce, e.g. Walmart, Alibaba can operate cash and carry business.

b) B2C Marketplace: 100% FDI is allowed in online retail of multi brand goods and services B2C under the marketplace model, e.g. Amazon, Flipkart, Snapdeal. Any eCommerce entity providing a marketplace cannot exercise ownership over the inventory and is not permitted to sell more than 25% of total sales through its marketplace from one vendor to their group companies. There are also conditions restricting to offer discounts by marketplace.

c) B2C Inventory-Based: FDI is not allowed in inventory-based model of eCommerce.

d) Single Brand: A single brand retail trading entity operating through brick and mortar stores is permitted to undertake retail trading through eCommerce subject to local sourcing requirements. Food retail: 100% FDI is allowed for trading (including eCommerce) food products manufactured or procured in India.

e) Multi Brand: No FDI is allowed in companies which engage in multi brand retail trading by means of e-Commerce.

f) Other Government Actions: National Institute for Transforming India (NITI Aayog) has set up a high level committee to look into issues related to eCommerce including FDI. Food safety and Standards Authority of India (FSSAI) has also issued draft norms for licensing online food operators. Consumer Affairs Ministry is also planning to regulate eCommerce through the proposed new consumer protection law.

In the past, online retail was considered to be a failed dream. Until it started showing a CAGR of 50-55% to clock US$ 4 .5 billion in 2014, nobody believed it could become a reality in India. Since then, it has never looked back and has been growing exponentially.

The e-commerce industry is pegged to multiply 15 times the current size of US$ 20 Bn to reach US$ 300 Bn by 2030 as per IBEF.

Corporate Governance in e-Commerce Companies

Corporate governance is pervasive and a crucial component for ensuring the journey of a corporate towards excellence. Merely setting up of a business is not enough, what is more important is to make sure that it takes care of its stakeholders interest and attain sustainability. In this regard, it is imperative to discuss certain noteworthy events that have taken place in various e-Commerce companies, which have resulted into frowning of various experts and stakeholders who have been associated with such developments.

There are numerous instances of e-Commerce companies entering into trouble water, thereby, raising a question on their sustainability. When the stock price of China's online retail mammoth Alibaba Group nosedived due to sluggish growth and question marks over the company's accounting policies and business model, investors feared a ripple effect on valuations of e-commerce companies in India. The funding boom in India which was partially driven by the success of Alibaba's initial public offering (IPO), which was the largest ever share sale and valued the company at more than $230 billion created the hope of India being the next online retail market after China. Interested investors pumped more than $8 billion in Indian start-ups. Tech investors in the US, Europe and Asia, who either missed out on Alibaba's IPO or were enriched by it, queued up to invest in India's e-commerce segment. But after Alibaba's abysmal performance, venture capital firms and other investors became highly cautious on late-stage deals in India, conducting stringent due diligence and demanding higher transparency and disclosure from current and potential portfolio companies. Since Alibaba espoused the initial public offering route, the company's market value dipped to less than $160 billion from a peak of more than $250 billion.

Private equity and venture capital largely select to ignore India's e-commerce in the March 2017 quarter even as the total tally reached $4.2 billion, basically driven by Canadian pension funds deals. According to the report of EY, March 2017 reported deals worth $2.6 billion across 60 deals, registering a robust hike of 52 percent in value and 31 percent in volume over March, 2016. The E-commerce sector's struggle got aggravated when it witnessed merely 11 deals worth $85 million in the January-March period of 2017, while in the corresponding period of previous year there were 29 such transactions worth $764 million.
E-commerce didn't witnessed any equity investment in March 2017. There was only one $4 million debt raised by Bigbasket. It appears that e-commerce sector is undergoing a lot of churn and most businesses are in the recalibration mode, resulting into low deal activity.

As a part of ensuring best corporate governance practices, it is highly important that e-commerce companies addresses the following issues but not limited to for their smooth operations-

1) Cyber law compliance.
2) FEMA contraventions and regularization.
3) Legal exposure in agreements / arrangements.
4) Tax technology.
5) Brand risk.

6) Website uptime.
7) Employee-vendor nexus.
8) Bribery and corruption.
9) Sub-optimal warehouse tax planning.
10) Uncertainty around GST.
11) Keeping organization design in pace with rapidly evolving business strategy.
12) Evolving roles, responsibilities and KRAs.
13) Performance management and benchmarking.
14) Absence of synergy between business, technology and operations functions of the enterprise.
15) Transforming IT as an innovative hub.
16) Rapidly evolving customer segments, product portfolios.
17) Market intelligence; growth, size and share.
18) Multiple customer engagement platforms.
19) Customer experience – rich, fresh and simple, not geared towards discovery
20) Cross-border tax/ regulatory issues.

Further, it is extremely important that whatever may be nature of business and scale of operations, it must be sustainable. As sustainability implies halcyon days for the stakeholders and a turbulence free voyage. In view of this, it can be opined that sustainability also forms an integral component of corporate governance. E-commerce companies needs to focus on the following factors in order to ensure sustainability of their operations-

a) Consumer Demographics: In India, approximately 75% of internet users are below the 35 years of age. Hence, the industry has failed to focus on the "above 35" segment who is financially independent and has the capability to buy! Also, the rural population of India is estimated to catch up with urban India by 2020 (48% of the total online population). This indicates the enormous potential of the Indian rural segment. Also, industry experts recommend companies to target women as their potential customers looking at the fast changing lifestyles.

b) COD to Cashless Payments- A Significant Metamorphosis: As per an EY survey, the people in the age-group of above 30 preferred opting for cashless payments which is clearly due to their financial independence and strong spending ability. Whereas, remaining respondents who were below 30 years of age preferred Cash on Delivery (COD). Though COD is the most popular form of payment in the e-commerce industry and drives 60% of the sales, it is not a sustainable option for the players. Companies can achieve a shift from COD to cashless payments by providing incentives or exciting offers to people opting to pay via the cashless route. Industry can also increase the confidence of the consumers by enhancing cyber security measures.

c) Mode of Marketing Communication: The e-commerce companies should use the opposite medium of communication depending on the immediate target audience. According to a statistics, television ads influence and impact more that 60% of Indian audience. Social media promotions and offers tend to influence consumers who fall below 21 years of age. Family and friends also influence a woman's opinion. Thus, looking at the trend, dynamic integrated marketing communication is the need of the hour.

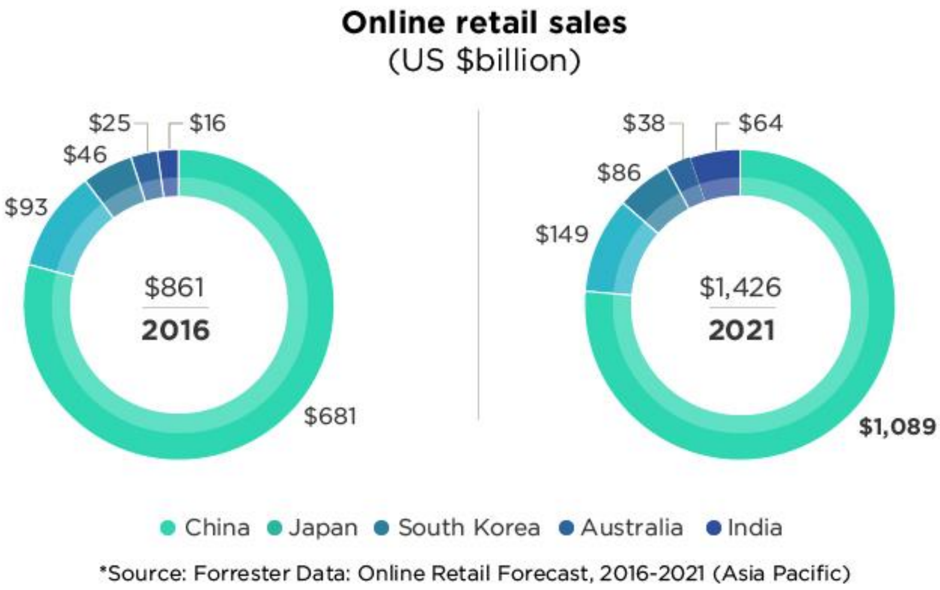
d) Heavily banking upon discounts: The e-commerce industry used the market penetration strategy to gain consumer attraction by offering discounts at an early stage. Instead, they should concentrate on delivering value to consumers via other means in order to sustain in the long run. With "show rooming" coming in the limelight, consumers have high expectation of the quality of product/service. Thus, the industry should focus on delivering value by meeting consumer's expectations through excellent quality of service. Some ways to achieve this can be – Hybrid Pricing strategies, charging for fast delivery, bridging the huge gap between online and offline, streamlining the return policies etc.

e) Innovate Constantly: The e-commerce companies should be focal on rapid innovation techniques to adapt to the fast changing ecosystem and tastes. Use of analytics to target "real-time" opportunities can be the next step to overcome challenges of maintaining vast consumer base. Many companies are venturing in the B2B E-Commerce space which can be more profitable than B2C space. A few avenues can be industries like textile, electronic products, GRC services, financial services etc.

Way Forward

No doubt, online buying and selling is gradually occupying the centre stage and in the years ahead it may substantially replace the physical buying and selling, but in all these what is utmost important is adhering to best corporate governance practices by taking care of all its critical facets. There have been cases of some e-commerce companies becoming financially sick resulting into acquiring attempt by other e-commerce companies, thereby having a deleterious impact on stakeholders. Further, with the changes in legal, economic and business environment they need to follow the compliances and change business strategies. Most importantly, they must espouse a sustainable business model. As without sustainable model, a business witnesses an untimely death. Last but not the least, in order to expand the market, it is essential to ensconce the tenet of legendary Management Guru CK Prahalad, i.e., 'To focus on the bottom of pyramid'. Thus, as discussed above, they need to target rural and semi-urban populace also along with Tier-I and Tier-II towns.

Exhibit 1


Online retail sales
(US $billion)
$25
$16
$46
$93
$861
2016
$681
$38
$64
$86
$149
$1,426
2021
$1,089
China
Japan
South Korea
Australia
India
*Source: Forrester Data: Online Retail Forecast, 2016-2021 (Asia Pacific)

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