Abstract

The government recently allowed 100 per cent foreign direct investment (FDI) through the automatic route in the marketplace model of e-commerce retailing, bringing in clarity on FDI policy for the sector as well as definition of marketplace format. Industry players, Evangelists and analysts see the notification issued by DIPP on FDI in online marketplaces as providing clarity on the issue. But, certain conditions that have been imposed will mean that some players in the business will have to change their operational models. The present study is an attempt to understand the subtle nuances of FDI in online market places and its implication on E-commerce players, Bricks and Mortars and SME’s.

1. INTRODUCTION

The developments of Electronic Commerce applications origins back to the early 1970s and were primarily used within the financial sector. Innovations like EFT (Electronic Fund Transfer) were among the first, used mainly by large financial institutions. Then EDI (Electronic Data Interface) evolved, which extended the usage from solely financial transactions, to other types of business such as manufacturing. Later in the early 1990s, as the Internet became more commercialized and users rushed to participate in the World Wide Web, the term electronic commerce was invented (Turban et al., 2002).

The term commerce is by some defined as “transactions conducted between business partners”. However, using this definition within e-commerce (electronic commerce) might be too narrow. Therefore many also use the term e-business (electronic business), which also include serving customers, collaborating with partners, and electronic transactions within an organization (Turban et al., 2002).

E-commerce means sale or purchase of goods and services conducted over network of computers or TV channels by methods specifically designed for the purpose. Even though
goods and services are ordered electronically, payments or delivery of goods and services need not be conducted online. E-commerce transaction can be between businesses, households, individuals, governments and other public or private organizations. There are numerous types of e-commerce transactions that occur online ranging from sale of clothes, shoes, books etc. to services such as airline tickets or making hotel bookings etc.

As the potential of E-commerce was recognized its use also reached into other sectors. The trend according of intensively, increasing sales is persistent and areas such as music, books and tickets are predicted to have the largest increase.

The escalating development of e-commerce and e-business in the era of information technology has had its ups and downs. Recently the tone in media has been increasingly positive. From the negative tone during the early “pre-bubble” period, to a much more positive atmosphere in contemporary articles and research. The first gloomy forecasts about the so called Hackers, security faults, and unserious vendors, did well in implementing scares and lack of trust in the eyes of the customers.

The biggest e-commerce markets are U.S.A. followed by U.K. and Japan. In Asia, China, India and Indonesia are the fastest growing e-commerce markets. Major global e-Commerce companies are Alibaba.com, Amazon.com, Walmart, Apple, Dell, e-bay, Mercadolibre Inc., Rakuten Inc., Crate & Barrel, Symantec, Autozone, Microsoft, Gap, Nike, Disney stores, HP, ASOS PLC, Blue Nile Inc. etc.

E-commerce in recent times has been growing rapidly across the world. According to the report of Associated Chambers of Commerce and Industry (Assocham). India’s e-commerce market is likely to touch $38- billion-mark in 2016, a 67 per cent jump over the $23 billion revenue it clocked last year. Increasing internet and mobile penetration, growing acceptability of online payments and favourable demographics has provided the e commerce sector in India the unique opportunity to companies connect with their customers. According to the Assocham’s latest report, Buying trends during 2015 have witnessed a significant upward movement due to aggressive online discounts. India’s e-commerce market was worth about $3.8 billion in 2009; it went up to $17 billion in 2014 and to $23 billion in 2015 and is expected to touch $38-billion mark by 2016.

Industry sources indicate that this growth can be sustained over a longer period of time as e-commerce will continue to reach new geographies and encompass new markets.

The bookings done through electronic communication could be Business to Business (B2B) or Business to Consumer (B2C). Business to Business i.e. B2B is e-commerce between businesses such as between a manufacturer and a wholesaler or between a wholesaler and a retailer. As per the WTO report WT/COMTD/W/193, global B2B transactions comprise 90% of all e-commerce. According to research conducted by USA based International Data Corporation, it is estimated that global B2B commerce, especially among wholesalers and distributors amounted to US$12.4 trillion at the end of 2012.

The bookings done electronically between Business to Consumer for purchase or sale of goods and services are known as B2C e-commerce. Although B2C e-commerce receives
a lot of attention, B2B transactions far exceed B2C transactions. According to IDC, global B2C transactions are estimated to have reached US$ 1.2 trillion at the end of 2012, ten times less than B2B transactions. B2C e-Commerce entails business selling to general public/ e-catalogues that make use of shopping place. There are several variants in B2C model that operate in e-commerce arena.

**From the business point of view, there are two models of e-commerce:**

- **Marketplace based model of e-commerce:** Marketplace based model of e-commerce means providing of an information technology platform by an e-commerce entity on a digital & electronic network to act as a facilitator between buyer and seller.

- **Inventory based model of e-commerce:** Inventory based model of e-commerce means an e-commerce activity where inventory of goods and services is owned by e-commerce entity and is sold to the consumers directly.

2. **SCENARIO OF INDIAN E-COMMERCE INDUSTRY**

The unrivalled population in India armed with smart gadgets is spoilt for a choice. Aided by declining broadband subscription prices and launch of 3G and 4G services, consumers have become the driving force of e-Commerce in the country. From buying groceries to furniture, movie tickets, trains tickets to steel, coal and tea – e-Commerce has empowered the consumers. As per reports, India will see more people come online than any other country in the next 15 years. With digital device and social media, online sellers are getting unprecedented opportunity for growth and have thus become continuously more attractive for investors. Even though B2C is getting all the attention B2B is not far behind. Both in Direct and Online Marketplace B2B have significant presence. The marketplace model gives customers a plethora of choice and the best prices under a single platform. It also gives vendors a level playing field. Most B2B players have tied up with banks and financial institutions for supply chain finance that helps in improving access to credit. B2B e-Commerce has brought in efficiency, convenience, choice, reach and lower transactional cost for buyers. For SMEs, a B2B portal is one of the best things that have happened. For any SME, marketing and advertising costs are huge and many do not have adequate technical expertise to reach out to larger markets. Those areas are now taken care by B2B portals. Basically, B2B wipes out the weaknesses of SMEs. Having a B2B platform takes care of the distribution, advertising and gives access to markets. B2B has enabled SME’s growth in sales and helped them acquire new customers. The steady growth of e-Commerce in the country is, is poised for a big leap in the next four years, according to a report by the Confederation of Indian Industry and Deloitte Touché Tohmatsu India LLP. While the business to business (B2B) segment is expected to more than double from $300 billion in 2014 to $700 billion in 2020, the business to consumer (B2C) segment will grow more than seven times from $13.6 billion to $101.9 billion, the report said. The growth in B2C e-commerce will be supported by a spurt in number of online shoppers, from 20 million in 2013 to 220 million in 2020, as well as a three-fold increase in average spending by online shoppers, from $147 in 2013 to $464 in 2020. The
report, however, has a word of caution for online retailers who have splurged on
discounting to acquire customers, a move that has helped them increase gross sales.
Combined losses for e-commerce companies such as Flipkart Ltd, Snapdeal (Jasper
InfoTech Pvt. Ltd) and Paytm (One97 Communications Pvt. Ltd) last year stood at $557
million, the report said.
“A majority of B2C e-commerce companies, globally, despite being operational for 5-20
years, report low profitability. The situation in India is no different, i.e., a growing gross
merchandise (GMV) value but at an overall loss as the e-commerce companies establish
themselves,” the report says.
“This trend however does not hold true for the B2B e-commerce companies which are
profitable with greater GMV values. The higher profitability in the B2B segment is
attributed to reasons such as lack of heavy discounts, greater emphasis on quality rather
than on price, and higher volumes of purchases,” it added.
A valuation correction is underway in the domestic e-commerce segment. Morgan Stanley
Institutional Fund Trust, a mutual fund investor in Flipkart, slashed the value of its
holding by as much as 27% to $58.9 million as of 31 December, down from $80.6 million
in June 2015, Mint reported on 27 February. Another mutual fund T Rowe Price has cut
the value of its stake in Flipkart by 15%, Mint reported on 16 April.
In context, India’s retail opportunity is substantial and spurred by several factors such as
the demographic dynamics (hyper-connected young population, rising standards of living
and upwardly mobile middle class), deeper internet penetration, explosion of social-media
platforms, and increased smartphone penetration. Thus, a significant growth of e-
Commerce is imminent in the next two years.

3. GUIDELINES ON FOREIGN DIRECT INVESTMENT IN E-COMMERCE

Last year, the Retailers Association of India and the All India Footwear Manufacturers &
Retailers Association filed petitions in the Delhi High Court alleging that e-commerce
companies were circumventing FDI rules using the marketplace model.
In January, the DIPP told the Delhi High Court that the marketplace model is “not
recognised” in the FDI policy. It also said that it was up to the Enforcement Directorate to
investigate whether FDI rules had been violated by online retailers. The Centre’s latest
clarification, which clears the air, has been criticized by the Confederation of All India
Traders. As per the guidelines issued by the Department of Industrial Policy and
Promotion (DIPP) on FDI in e-commerce, contained in the Consolidated FDI policy
 circular 2015, foreign direct investment up to 100% under automatic route is permitted in
the marketplace model of e-commerce retailing— an arrangement where e-commerce
companies provide an online platform to other vendors to sell their products, bringing in
long overdue clarity on FDI policy for the sector as well as definition of marketplace
format. No FDI is permitted in inventory-based model of e-commerce.
This ends the policy ambiguity that had led to litigation and uncertainty for foreign
investors as well as domestic e-retailers. Global e-commerce majors such as Amazon and
eBay as well as domestic players with foreign investments such as Flipkart and Snapdeal, which have been operating through the marketplace model, can breathe easy as their activities have been legitimized.

Other conditions in nutshell

i) Digital & electronic network will include network of computers, television channels and any other internet application used in automated manner such as web pages, extranets, mobiles etc.

ii) Marketplace e-commerce entity will be permitted to enter into transactions with sellers registered on its platform on B2B basis.

iii) E-commerce marketplace may provide support services to sellers in respect of warehousing, logistics, order fulfilment, call centre, payment collection and other services.

iv) E-commerce entity providing a marketplace will not exercise ownership over the inventory i.e. goods purported to be sold. Such an ownership over the inventory will render the business into inventory based model.

v) An e-commerce entity will not permit more than 25o/o of the sales affected through its marketplace from one vendor or their group companies.

vi) In marketplace model goods/services made available for sale electronically on website should clearly provide name, address and other contact details of the seller. Post sales, delivery of goods to the customers and customer satisfaction will be responsibility of the seller.

vii) In marketplace model, payments for sale may be facilitated entity by the e-commerce in conformity with the guidelines of the Reserve Bank of India.

viii) In marketplace model, any warrantee/ guarantee of goods and services sold will be responsibility of the seller.

ix) Ecommerce entities providing marketplace will not directly or indirectly influence the sale price of goods or services and shall maintain level playing field.

x) Guidelines on cash and carry wholesale trading as given in para 6.2,16,1,2 of the FDI policy will apply on B2B e-commerce

4. FDI IN ONLINE MARKET PLACE AND ITS IMPLICATION ON STAKEHOLDERS

The clause that online marketplaces cannot influence the pricing of products sold on their platforms as per the recent FDI guidelines for e-commerce retail, is giving sleepless nights to the $11-billion online retail industry. In layman’s terms, not being able to influence pricing would mean the end of attractive discounts on online marketplaces such as Flipkart and Snapdeal. Can e-commerce companies afford to completely do away with discounts? As per a report by the Boston Consulting Group, 45 per cent of Indians shop online to avail discounts. Marketplaces buy merchandise from brands at regular prices and sell at huge discounts to the consumers. So, a pair of Nike shoes that a customer buys from an online marketplace for a cool 20 per cent off, may have actually been given to the
online store at a 10 per cent discount. The online marketplace would have discounted it further to lure customers.

It is this deep discounting strategy that has led to the exponential growth of online retail in India, albeit at the expense of physical retail. In fact, brands selling on these marketplaces have, since the past year, mandated that discounts are offered only on their older merchandise. Attractive discounts, ability to compare brands, the convenience of cash on delivery and an easy return policy have wooed Indian consumers to these platforms.

Much before the FDI guidelines came through, marketplaces were beginning to reduce their discounts as they were burning huge amounts of funds, with profitability being nowhere in sight. Most of these marketplaces, be it Flipkart (raised $3.4 billion) or Snapdeal (raised $2 billion) have raised huge amounts of money from foreign investors and, hence, come under the FDI purview.

5. IMPACT ON E-COMMERCE GIANTS

Curb on cash burning:

E-commerce in India has now thrived for almost half a decade and that too largely by way of offering huge discounts to buyers. However, the latest move by the Narendra Modi-government, restricting e-commerce marketplaces from directly or indirectly influencing the sale price of goods or services, may turn out to be a litmus test for these players. While, the Department of Industrial Policy and Promotion, in its notification on Tuesday, has not used the words “discount” or “predatory pricing”, the new rules indicate that companies such as Flipkart, Amazon or Snapdeal cannot sell anything below the selling price. This means, the companies will have to either stop offering discounts in any form or go back to restructure their business models. It is a known fact that the discounts offered by the online marketplaces today are funded by burning cash that comes from PEs/VCs, something which offline players are dead against as they have not been able to compete with the online retailers. Ecommerce players may have to focus on more value-added services to stay ahead of the competition.

E-commerce firm will not be permitted to sell more than 25 per cent of total sales from one vendor or its group companies. According to the notification, an e-commerce firm will also not be permitted to sell more than 25 per cent of total sales from one vendor or its group companies. This will prevent marketplaces from behaving like pseudo retailers and ensure that they stay true to their claim of being ‘technology platforms’. Also, e-commerce companies will not directly or indirectly influence the sale price of goods or services and shall maintain a level playing field; the warrantee or guarantee of goods and services will be the seller’s responsibility. An e-commerce marketplace may, however, provide support services to sellers in respect of warehousing, logistics, payment collection and other services. Online retailers will also have to broad base their vendors with the DIPP placing a cap on the goods/service that can be sourced from a single vendor. This is good news for the many small vendors who have been losing out as large e-tailers source much of their stock from few select vendors. E-trailers may also feel the heat as the new guidelines may not go well with their PE/VC
investors. On one side, while they will save money with lesser discounts, on the other they may lose revenue. The rule helps Snapdeal the most. The Company has been set up as a true marketplace from the very beginning. Flipkart and Amazon will both be affected. For Flipkart, WS Retail (a former Flipkart subsidiary) accounts for over 25% of its purchases. Flipkart will have to rely less on WS Retail, which should suit its own decision to become more like Alibaba in China (a marketplace) rather than Amazon in the US (inventory-led B2C model). For Amazon again, it will have to ensure that Cloudtail, which is partly owned by Amazon, will have to be less than 25% of sales. Nasscom said the cap of 25 per cent on sales by a single vendor in a marketplace may prove to be restrictive, more so if the vendor sells high value items. “The industry might face difficulties in case of sale of electronic items, where a vendor may be offering exclusive access to certain items or discounts. Marketplaces have no control on how a product is priced and only organise ‘sales’ where vendors participate.

6. IMPACT ON BRICK AND MORTAR RETAILERS

The Brick and Mortar have welcome the decision of allowing FDI in online marketplaces, a move that will ostensibly come as a relief to ecommerce companies such as Flipkart, Amazon India and Snapdeal but the conditions imposed have been hailed as a victory by their brick-and-mortar rivals. The government said in a press note, clearly defining ‘marketplace’. This ends the uncertainty over the business model being used by India’s biggest online retailers which has been challenged in court by brick-and-mortar stores. The FDI policy had previously left the term undefined. The government also appears to have taken a firm stance against deep online discounting to protect neighborhood stores. The government also feels that if any portal is providing discounts on goods it’s holding, then it amounts to inventory based model, which is in contradiction to the marketplace definition. Traditional retailers welcomed the clarification, arguing that this would put an end to what they said was unfairness inherent in the current system. The consumer electronics and cell phone makers, which are among the hardest hit by ecommerce discounts, are hoping Tuesday’s notification on pricing parity will put an end to predatory pricing in the industry and lead to sustainable growth of ecommerce marketplaces. The industry has been up against online discounting, since almost 70%-75% of online sales in the country were generated from mobiles, televisions and other electronics, mostly on the back of discounts, which had impacted sales of brick-and-mortar retailers.

Kumar Rajagopalan, CEO of Retailers Association, a group representing brick-and-mortar retailers, said marketplaces cannot play ‘pseudo retailers’ any longer. “They cannot be influencing prices, they cannot be calling themselves as dukaan, they cannot be dealing with one of their suppliers dramatically, which are nothing but their own retailers.

7. IMPACT ON SMALL AND MEDIUM ENTERPRISES (SMES)

The advent of online marketplaces presents the Indian SME sector an unprecedented growth opportunity. For the first time, SMEs have a level playing field with bigger...
enterprises to access new markets and tailor their offerings to customer preferences at almost no incremental cost. More than two lakh early SME adopters of e-commerce are unleashing a silent revolution in the country by riding this wave and, as digital adoption increases, these numbers are set to grow exponentially.

Currently, there are approximately 48 million SMEs in India, employing around 40 per cent of the country’s labour and contributing 17 per cent of India’s GDP. Indian SMEs have long suffered on account of systemic constraints which have prevented them from tapping new markets, access new capital, adopt technology and scale their businesses. However, this narrative is changing quickly, often left unnoticed in the high-decibel growth of e-commerce. Snapdeal recently released a study in partnership with KPMG titled ‘Impact of Ecommerce on SMEs in India’ which found that with a mere investment of Rs 3,000 on an average, SMEs can successfully enter the e-commerce space. Around 27 per cent of Indian SMEs that have a web presence and use e-commerce have reported 49 per cent more profits, 7 per cent broader customer base and a whopping 60-80 per cent of spend reduction. These opportunities are being leveraged by small and medium-sized retailers and manufacturers dealing in all kinds of goods — electronics, fashion, home décor, and so on. They are being initiated into online inventory management, digital payments, new-age packaging, data analysis-based inventory and pricing planning as they learn to do business with online marketplaces.

The government is actively taking initiatives to help in overcoming awareness barriers, technological hurdles, funding and training barriers that surround the SME sector. The enthusiasm among SMEs, online marketplaces and the government is based on proven models in global markets such as China. A recent study by Credit Suisse showed that the Indian economy with its current level of internet penetration and demographics is at a similar inflection point at which the Chinese economy was 8-10 years back. Today, 8.5 million+ SMEs sell through Alibaba’s platform in China, Which also includes farmers, traditional craftsmen and home-preneurs. Drawing further parallels, we are witnessing similar energy from all sectors, including traditional handicraftsmen, home bakers, micro enterprises and first generation businessmen. Another encouraging trend is that this growth is very broad-based. Snapdeal alone has sellers registered from more than 500 cities and towns of India. The outlook for the SME sector has never looked this bright ever before. The latent need of SMEs to grow is coming to the surface and they are being actively hand-held by marketplaces to achieve their business goals.

8. MANAGERIAL IMPLICATION

The implication of FDI in online market place will have cascading impact on E-commerce players, Brick and mortars and consumers. Ecommerce market places will try to leverage loopholes in the system to offer discounts, which may not be that attractive as before. Even if they give sellers discounts on listing price, and concessions to use their warehousing and logistic services, the discount they will ultimately pass on to the consumers won't be more than 4-5 per cent. Among other tactics to survive in an
environment of no discounts, e-commerce companies could offer discounts through digital wallets. All big marketplaces have their own e-wallets - Flipkart has FX Mart and Snapdeal has Freecharge, adoption of digital wallets is steadily increasing. Some of the existing players may need to revamp their operational structures to meet these norms. 

“Although some of the structures practiced by existing players may require alteration, it will give much needed clarity to undertake business with certainty in the longer term. Online marketplaces will now have to focus on value-added services and improving margins.

9. CONCLUSIONS

The FDI guidelines have sprung up umpteen challenges for online retailers, leaving them with little choice but to reinvent, unless they succeed in lobbying with the government to turn the guidelines in their favour.

The guidelines are a step towards creating a level-playing field for online and offline retailers. “The healthiest thing to do is collaborate with various brands or retailers of this country and truly behave like a marketplace. They should behave like malls online.

Marketplace models are perfect for India, which is the land of Lilliput, with myriads of small buyers and small sellers. The share of the organized sector or of known brands within it is very small. India Inc. has not invested in mega factories to get huge economies of scale to play the high-volume low-margin game that Consumer India demands. There is also far more innovation and customer intimacy in the offerings of the millions of small suppliers than in large companies (just take a walk around pavement markets and small shopping centres in your city), and they don’t have the money or the knowhow to expand their footprint and showcase their wares. And a marketplace connecting the two lands of Lilliput has got to be a winner.

In the marketplace model the marketplace owner has to slog to provide value-added services to its suppliers and to scour the face of the earth for interesting supply that adds value to customers. However from a customer perspective, what we have is a mall owner who is not responsible for his tenants’ behaviour. He does enable them to do better by offering many kinds of business assistance that a physical mall owner doesn’t even dream of but in the end it is a “buyer beware” situation and yet untested at large scale. Will consumers understand the idea of an emarket place to evaluate the difference between supplier X and supplier P as they do in Lajpat Nagar in south Delhi or Manish Market in south Mumbai? Or do they think it’s all from the Snapdeal shop, without a care to where the stuff comes from? The Snapdeal founders have said they will keep working on the business model till they get it right, so we can expect the core customer-facing issue of “who is in charge out here, whose brand is giving me the guarantee of trust and quality and service” to be addressed alongside all the steps they are taking to serve suppliers better (king-size sheets packed into queen-labelled boxes was my experience). The middle majority of customers suffer in silence than complain, unless you provide them clear avenues and encouragement to do so. Any marketplace must serve both parties. Perhaps a
stock exchange inspired listing agreement would be a good idea. Finally we needn’t worry too much about whether a business is pure-play or not. India is about hybridism, consumers believe in “this AND that”, not “this OR that”. We want to be, and have been spoilt so far, by high-tech as well as high-touch. I am a seasoned online buyer but I also want to physically see the five types of vacuum cleaners listed and talk to someone even virtually on whether the steam mop will work. The dharma of business is to add value and extract value from consumers, not drag them kicking and screaming to some supply-side notion of business model pristineness.

10. LIMITATIONS OF THE STUDY AND DIRECTIONS FOR FUTURE RESEARCH

As the E-commerce and online shopping trend is growing in leap in bounds, the trend will continue to evolve irrespective of the Impact of FDI on ecommerce market. The study has some limitations, providing pointers for future research. Firstly in long run, eventually government policies or regulations on ecommerce market may change in future and some of the existing laws would cease to exist. Such policies could be studied to under their impact on all the stakeholders. Secondly, the norms and Implication of FDI in Ecommerce were identified from leading newspapers, magazines and the website of DIPP. No experts were contacted in this regard. Therefore, the norms and government regulation on FDI can be shared with experts in the field of ecommerce and then qualitative research technique, such as Delphi technique could be used to gain insights on the impact of FDI in ecommerce. Thirdly quantitative research to identify the perception of retailers (Brick and mortar stores), Consumers and E-commerce players for the norms of FDI in ecommerce can be undertaken. Fourthly, this study is limited to the ecommerce of Indian market. Similar studies can be undertaken for other emerging economies in the world and further, a comparison could be done.

11. REFERENCES


