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FDI in marketplace: what changes have the regulations brought?

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Walmart is likely to enter the Indian e-commerce market, thus intensifying competition

While e-commerce companies are supposed to operate as technology platforms, that is, bringing the buyer and seller together for a fee, they have moved beyond that and operate like retail stores — carrying inventory and having their own private labels. In effect, they have been eating away at the livelihood of brick-and-mortar retailers.

All major Indian e-commerce players have overseas investors. Be it Amazon, Flipkart, Snapdeal or Paytm, they all have overseas equity investors. Some have convoluted equity holding structures that involve several companies; others are registered outside India and some within.

The Retailers Association of India (RAI) has been urging the Government of India to enact regulations that clearly firewall the marketplace model from the inventory holding model, ensuring protection of retail stores and its employees. They contend that foreign-funded e-commerce companies are selling products much below ‘cost’ and funding such deep discounts through monies flowing from overseas investors; a form of ‘e-commerce dumping’ that creates huge distortions. The RAI urged the Centre to act against such a practice, in line with anti-dumping policies which are already practised in other sectors.

Finding loopholes

E-commerce companies have also carved out their own ‘seller’ entity into a separate company, which sells on the platform (Flipkart’s WS Retail and Amazon’s CloudTail), thereby having better control on the seller and discounts that can be offered to customers. This happens to be a key differentiator in the business today. Such entities also help generate sales from ‘private’ labels which offer substantially higher margins to the online retailer.

The FDI in marketplace model was introduced by the Department of Industrial Policy and Promotion (DIPP) in March 2016 to address the retailers’ concerns. The regulation primarily restricts e-commerce companies from owning inventory and offering discounts, which today form the very basis of survival of such companies. The regulation further restricts their group companies or any ‘one’ seller or merchant on the marketplace from contributing more than 25 per cent of the sales generated by the e-commerce company on its platform.

What has changed?

Almost a year after these FDI regulations were passed, has there been any impact? Has the government’s intent been achieved? Has the marketplace business model evolved as per the DIPPs original intent?

During 2016’s last quarter festivity sale, retailers continued to complain that FDI laws are still being flouted, and generous discounts are still offered by the e-commerce players, evidenced by the highly visible, lavish advertisements by Amazon, Flipkart and Snapdeal.

However, DIPP has confirmed that the discounts were in fact being directed by the sellers (which they are allowed to do under the FDI laws), rather than the e-commerce player.

So, the allegations have been put to rest, at least temporarily. Most of the current large players continue to secure much more than 25 per cent of their total sales from their own companies, clearly flouting FDI laws.

Emerging trends

The FDI in marketplace is a very relevant piece of regulation. Not only are its provisions relevant because they firewall e-commerce players from inventory-holding and protect ‘brick and mortar’ retailers, but a ‘pure play’ market-based model could allow such players to differentiate and deliver value to customers, if emerging trends in the e-commerce space are anything to go by.

The trend is quite clear — more business is coming from smaller towns. Expectations of an enhanced 'customer experience' in terms of free and quick shipments, wider choice of products and ease of return policies, will define customer engagement and competitive advantage in coming days.

These are already creating a major shift in the way Indian e-commerce companies look at their business models. From the current inventory-led model, large players like Flipkart and Amazon are moving towards a marketplace-led model. The process is still evolving and FDI laws have helped hasten it.

This will make the platforms 'asset light' and enhance their profitability. More importantly, it allows these companies to focus, both in terms of financial resources and management time, towards enhancing customer experience — which is likely to be the key differentiator moving forward.

FDI regulations are already driving e-commerce companies to diversify their seller base. But still, by sourcing a large part from their own subsidiaries, they are virtually moving the losses (of deep discounting) from themselves to such subsidiaries, which will not be sustainable in the short to medium term.

For example, CloudTail has grown aggressively in sales, but losses are mounting in recent quarters. It is only a question of time before the e-commerce companies diversify their merchant and seller base, and move away from the 'discounting' mindset.

Investing in customer experience

Attracting customers, increasing online traffic, managing scale, and choice of customer segments and product portfolios in a highly competitive environment will become critical. Capabilities that will provide seamless and rapid delivery and return services, and enhancing customer experience across multiple touch-points will drive success. Platforms need to build deep analytics skills to understand and make the right choices and trade-offs.

Investment in technology

Firms have to ensure ease of ordering when the customers are moving from PCs to tablets and mobile phone devices. This entails high spend on technology that should support availability of mobile apps, integration of back-end and front-end infrastructure and analytics. Managing returns and possibly providing a touch and feel ahead of ordering could also become an important and sophisticated service (many companies are already working on more sophisticated sizing and fitting tools).

Hence, creating a superior customer experience needs enormous investments on many fronts. This will drive the need to go 'asset-light', which means doing away with the inventory-led model, diversifying the seller and merchant base, expanding the number of sellers on the platform, and shifting focus away from gross merchandise value (GMV) to customer experience. In essence, positioning as a 'pure play' marketplace player will become compelling.

Middle and last mile delivery are key components impacting customer experience. They constitute close to 15 per cent in terms of cost to the net sales. Currently, a large part of logistics and warehousing is outsourced. Most companies don't have an integrated end-to-end logistics platform, resulting in poor customer experience. High rejection rates in cash on delivery (CoD) transactions, especially in rural areas and remote pin-codes, is a logistics nightmare.

Evolving business model

Efficient players who base their business model on the marketplace are likely to gain longer-term competitiveness; and this is likely to be the game ahead.

Amazon is the frontrunner, steering the industry in this direction. It has pledged $5 billion in investments to India and money is flowing in. The American company is spending a large part of such investments in logistics — 'middle mile' delivery and enhancing customer experience. To reach the remotest parts of the country, it recently created 20 'fulfilment centres' across the nation.

Amazon's focus to control the logistics chain and take control of the trucking market is also evident — it is said to be working on an 'Uber' like app that matches truck drivers with shippers, thereby eliminating brokers who currently charge a large commission for such services.

With its globally scaled R&D capabilities (floating warehouses with drone delivery are being patented in the US), what it could bring into the Indian logistics market over time could set industry standards.

More importantly, Amazon is striving to diversify its seller and merchant base. Over the last year, it has doubled its sellers on the platform to around 150,000 and almost tripled its product selection to around hundred million, leaving Flipkart behind by miles!

Through 'Amazon Tatkal', it runs a specially designed studio-on-wheels travelling to more than a hundred cities, in areas densely populated with small and medium sized businesses, to register, provide image-cataloguing services, train, and onboard sellers on its platform. The on-boarding is rapid and happens within 60 minutes. Amazon helps these businesses sell on its platform and everything else, including warehousing and swift delivery, is managed by Amazon's state-of-the-art infrastructure.

Walmart's entry

The new year is likely to see competitive rivalry intensifying. Walmart will, for sure, bring its rivalry with Amazon into India. The former will enter the Indian e-commerce space, either through Flipkart equity infusion or otherwise. Although a bit late in the game, Alibaba has been mulling an India entry through acquisition of ShopClues, partly owned by GIC of Singapore, and possibly merging it with Paytm's e-commerce business, which it already owns in part.

Given all this, players who are able to swiftly cut into a 'pure play' marketplace model with focus on logistics and delivery capability will take the market share in the medium to long term.

This is precisely what the game seems to be about.