RedSeer Consulting

How was 2016 for the Indian e-tailing Industry

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Contents Highlight

2016- A stumbling block year?

2016 for e-tailing will be at best remembered as the speed-breaker year. The industry GMV, which was growing at an annualized triple digit rate from 2013 onwards, dropped down to ~15% in 2015. A lot of sceptics announced this as the doomsday for the Indian e-tailing market (and consumer internet in general)- with their views being further fuelled by the devaluation of Flipkart, the bellwether for the industry, by various funds.

At this point, it would be prudent to take a step back and answer certain pressing questions- *How bad was the year 2016 in reality? What were the reasons for the challenges faced by the industry during the year? How would the market evolve going forward?*

2016- Hampered by external factors

Considering that the e-tailing industry grew at 100+% for two consecutive years before 2016, most analysts have forecasted the 2020 numbers to be USD 65-120 Billion, with RedSeer estimates putting the figure at USD 80 Billion. For these numbers to be achieved, the industry would need to grow at 45% CAGR over the next four years, from the exit GMV run rate of 2016. The billion-dollar question - *Is such a strong, sustained growth achievable for the industry?*

This question can be split into two parts: One- What happened in 2016 which pulled the growth down, and were these levers fundamental in nature or one-off events?

Two – how do the fundamental drivers, which will determine the growth for the next few years, look like for the industry?

Let's attempt to answer the first part of the question in detail as a year-end review.

Indian retail consumption and online share

Large market and growing fast	Fast growing online population	Small online Market, Flushed funding	Abysmal Growth Rate for e-tailing
Indian retail consumption – USD 750 Billion	Internet access - ~375 Million	e-commerce industry as % of over all spend – 4%[1]	Growth of e-tailing industry (2015-16) ~ 15%
Growth in Retail consumption – 18-20% (2015-16)	Growth in Internet Penetration – 40% (2015-2016)	Total funding in Consumer Internet in 2016 – 2.5 BN $	

[1] Includes OTA market as well

It’s not every day you see such figures in context of fast growing industry.

Despite fast growing consumer spending, globally fastest growing internet penetration and a funding splurge by investors, why did the Indian e-tailing industry fail to deliver on the expected growth metrics in 2016?

The answer to this question takes us to a combination of events which happened in 2016- a rare happening in an industry, and more so in such a short interval of time.

‘Speed-Breakers’ of 2016

a. **Circular trading Correction:** Due to heavy discounting by e-tailers throughout 2015, there was a significant percentage of GMV (varying estimate puts this numbers to be 20- 30%) which was being driven by retailers and wholesalers buying goods, and in-turn selling it to the end customers- with some e-tailers facing this issue more than others. However, post the completion of the festive season 2015, e-tailers started to clean this mess, resulting in an immediate fall in retailer orders and bringing in a much-needed correction for the market

b. **Market leader restructures:** The first quarter of the year saw the mass exodus of senior leadership from Flipkart, followed by a quest on how to fill the gap and what the new leadership structure should be like. It took 3-4 months for Flipkart to fix the internal organization and associated strategies, and they practically lost this time to do anything significant around growth. A flat growth for the leader in first two quarters contributed to pulling the market down.

c. **The next one also slows down:** Snapdeal, which was the second largest e-tailer by GMV share at the end of 2015, and was growing with the fastest rate, reversed its trajectory. It not only stopped growing but shrank significantly, to give up the second position to Amazon. While there are various theories on what led to this drop, we believe it was caused by a combination of- a) industry wide circular trading correction, and b) new found discipline around cash burn C) Focus on Revenue vs. the GMV

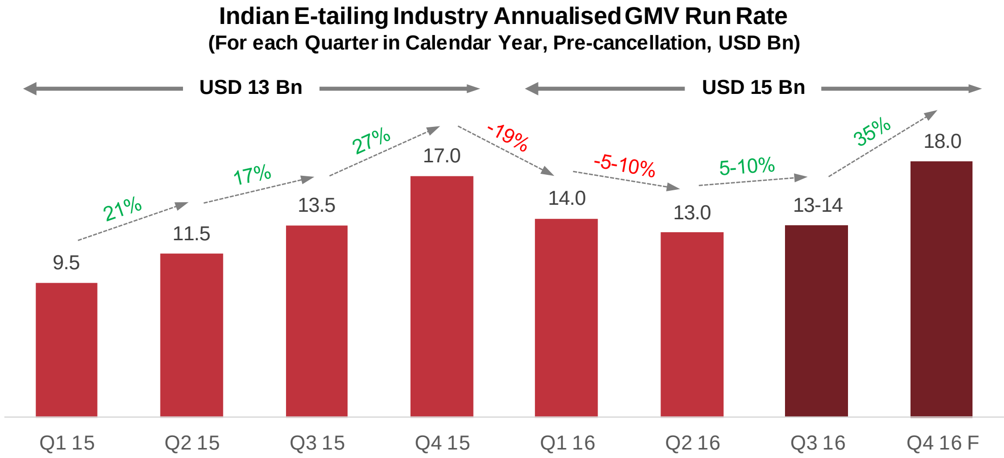
d. **Govt. Regulations on Discounting and marketplace:** The first quarter of 2015 also saw another blow for the industry, in the form of the DIPP regulations on the extent of discounting and the % GMV contribution by captive selling arms of e-tailers. While the first regulation put all the e-tailers in a fix for first few months on how to realign their strategy (which earlier was so heavily dependent on discounting) , there was also heavy operation jugglery to be done to “manage” the 25% limit on captive sellers- which again shifted the focus of the e-tailers from driving growth

e. **Demonetization:** Demonetization was the final big blow of 2016 for the e-tailing industry. In an industry which relies so much on cash (65%-70% orders are CoD), demonetization put brakes on the the momentum achieved post a successful October festive period. The industry lost ~20% of the GMV in Nov and early December, and the growth from there-on was not so great.

With the above five levers pulling the growth down, it had a domino effect on a fragile and young industry, leading to further two more impacts:

f. **Slow new customer acquisition:** The leading players were focused on the market share fight, rather than going aggressive and creating new markets. This did lead to a change in the pecking order of e-tailers, but the new players didn’t drive growth in the overall market- with the proof coming from the slowing growth in addition of first time customers

g. **Funding Cease:** The slowing macro of Indian e-tailing industry didn’t please the global investors, particularly the mutual funds. This led to an uneasy calm in the funding cycle of big e-tailers, driving them to focus a lot more on controlling the cash burn, which in turn led to challenges in adding infrastructure, sellers and customers to the ecosystem



Redseer estimates on pre-cancellation, pre return, post discounting Gross GMV

The fundamentals of e-commerce and India's position in it

Now for the big questions- how do the fundamental drivers, which will determine the growth for the next few years, look like for the industry? How will the year coming ahead and the much talked about 2020 look like? What will ensure that we do not see a repeat of 2016's timid growth rate?

Looking back at the major speed breakers of 2016, we see none of them are fundamental to the e-tailing industry. They are all external or organization-centric rather than "consumer's vote" on not going online to buy.

Therefore,

a. We do not expect the repeat of DIPP regulation, demonetization, heavy correction due to circular trading

b. We might see the leadership order changing in the industry due to winning or losing strategies

But the key message here is that the overall growth platform is fundamentally robust.

Technology and internet will play a key role in Indian retail market going forward, especially considering that retail space is expensive and the customer offline shopping experience is not world class due to lagging infrastructure and poor selection.

e-tailing is here to stay and will surely transform the way we shop. How much and by when is the question. We will take this up in second part of this article.

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