

Realising the vision

Nirupama Soundararajan and Arindam Goswami consider the huge growth in e-commerce in India and the next steps that policymakers should take to release the potential

Why India is an attractive retail market

Much has been spoken about reaping demographic dividends, especially in India. It has been spoken of in terms of creating a capable workforce and it has been spoken about in the context of skilling. The downsides of a large population have also been discussed in terms of inequalities in incomes, low standard of living, and growing unemployment.

Notwithstanding all narratives, the one advantage of a large population that is often overlooked is the collective consumer demand that it can generate. India is quite easily one of the largest retail markets in the world.

While India's per capita income is one of the lowest in the world (USD2,104.16 in 2019, World Bank calculations), it is by no means a measure of the spending power of Indians. The number of middle-income households is expected to grow at a steady rate to reach 140 million households by 2025.

Another estimate of India's middle class was provided by the McKinsey Global Institute (MGI)². Even as early as 2007, MGI predicted that by 2025 India will become the fifth largest consumer market in the world owing to a growing middle class, whose numbers are likely to exceed the population of Australia. This growth in the middle-class has been attributed to the likelihood of poverty reduction. It is this middle-class that largely drives consumption in India.

In 2017-18 India's per capita consumption on groceries, clothing, and housing and utilities was collectively INR 40,269, which is over 50 per cent of total per capital consumer spending of INR 77,085³. This makes India an extremely attractive destination of all kinds of retail players.

Table 1. India's households and their annual income (in millions)¹

Household type	Annual income brackets	2010	2016	2025 (Forecast)
Strugglers	<US\$ 2,300	91	82	55
Next billion	US\$2,300 – US\$7,700	102	121	140
Aspirers	US\$7,700-US\$15,400	31	40	61
Affluent	US\$15,400-US\$30,800	12	17	33
Elite	>US\$30,000	4	7	16

The evolution of retail in India

India's retail sector is comprised of different formats, such as traditional mom and pop stores, organised single brand retail, organised multi brand retail, food retail, online marketplace models, online inventory models, and direct selling.

Up until two decades ago, India's retail sector predominantly consisted of traditional mom and pop stores (also known as kirana stores) and government cooperatives. Over the years, with steady liberalisation of foreign direct investment (FDI) rules, many foreign brands also made their entry into India as either single brand stores, or as part of joint venture with Indian brands.

More recently, as the retail market across the globe has transitioned into e-commerce platforms, so has India's own retail landscape. India is home to many foreign and domestic e-commerce brands, including the Government of

India's own Government e-Market (GEM) platform, that acts as a marketplace for all government and government owned entity procurements.

A larger part of the e-commerce transformation in India has been triggered by increasing internet and smartphone penetration. The ongoing digital transformation in the country is largely on account of internet penetration in India, that has gone up from a mere 8 per cent in 2010 to 25 per cent in 2016 and is expected to reach 55 per cent by 2025, taking the total number of users to over 850 million.

With per capita consumption expected to increase in both rural (4.3 times) and urban (3.5 times) and on the back of a growing young population, digitally influenced purchases in India are expected to reach USD550 billion by 2025, accounting for almost 30 per cent of all retail sales⁴.

... policymakers must take into consideration the vision set out for the country as a whole and the role e-commerce can play in realising this vision

Regulatory arbitrage in retail

FDI rules for each format of retail is different. For example, 100 per cent FDI is allowed in food retail and in single brand retail, but 51 per cent is allowed in multi-brand retail. This means that a foreign multi brand retail cannot set up a store in India on their own, but can do this as a joint venture with an Indian company.

The resistance to multi-brand retail came largely from traditional retailers who feared that they would be pushed out of business with the entry of large corporates. A May 2008 study, *Impact of Organised Retail on the Unorganised Sector*⁵ came to the conclusion that organised retail in India was not a zero-sum game.

Notwithstanding the impact large brands in retail have had on smaller stores in other countries, the study concluded that in India, the competition will only lead to modernisation of the traditional mom and pop stores and that Indian consumers will continue to shop at the local grocery store as well as in the larger hypermarkets or convenience stores.

Fifteen years since the report, and India's traditional retail businesses have not only modernised, but have upskilled and up scaled themselves to compete with larger brands. Even so permitted FDI in multi brand retail remains at 51 per cent.

The growth of e-commerce has also been met with similar challenges. India is probably the only country in which multiple formats of e-commerce exist. For instance, 100 per cent FDI is allowed in e-commerce marketplace models, but none is allowed in e-commerce inventory model.

This means foreign e-commerce companies are allowed to function in India, but are not allowed to hold a single piece of inventory. Hence in India today, a single brand retail store may open multiple brick and mortar stores

across India and hold inventory, however a foreign e-commerce brand, is allowed to operate in India only if they hold no inventory even if they only decided to sell their own branded merchandise.

The regulatory arbitrage is evident; single brand retail stores can also sell online, which is allowed, but e-commerce companies cannot hold inventory of even their own brand products. This is but one example. India's approach to regulating retail leaves much to be desired.

Yet, between 2014 and 2017 e-commerce in India grew at a phenomenal compounded annualised growth rate (CAGR) of 41 per cent, and from 2017 onwards, it has been consistently growing at a CAGR of 17 per cent till 2026⁶.

India's retail sector currently stands at USD795 billion and is expected to reach USD1.75 trillion by 2026. Of this, the share of e-commerce is expected to be USD 200 billion⁷. As a percentage of total retail it is still only 3.5-4.5 per cent. The share is likely to more than triple within the decade⁸.

The importance of e-commerce to the Indian economy

E-commerce has undeniably benefitted consumers, by offering them access to goods and services in semi urban and rural India at affordable prices. Inter-linkages within the sector has enhanced the potential for job creation, economic growth, and growth in export.

Anecdotal evidence also suggests that e-commerce has aided financial and digital inclusion, with more and more people becoming comfortable transacting online. However, the reason why e-commerce should become an area of sharp focus for India has to do with India's own macroeconomic vision for the next decade. Two inter linked initiatives of the incumbent government come to the fore.

The first is *Make in India*. Reinforcing the vision to develop India into a global manufacturing giant, the current government unveiled *Make in India* programme on 25th September 2014 to project India as a preferred investment destination⁹. The primary objective of this campaign was to encourage domestic and multinational firms to produce goods in India so that India's manufacturing is competitive in global markets¹⁰.

Under this initiative, there were 25 key sectors which were identified bearing in mind their potential to compete with the best in the world. Unfortunately, the impact of *Make in India* is yet to be realised¹¹.

Neither did India's manufacturing capabilities see any significant increase, nor did India manage to make a difference to global value chains. So much so that India was unable to attract the attention of businesses exiting China during the recent trade war between China and the United States of America (USA).

After the recent skirmishes with China at the border, India decided to react both strategically and economically. As part of India's economic response, imports from China were discouraged and the priority become self-reliance. With the introduction of Atmanirbhar Bharat and *Vocal for Local* initiatives, the second initiative, new champion sectors have been announced in 2020.

It is expected that in these sectors, India will reach self-sufficiency (so that India's dependence on imports will reduce) and also capture new global markets, especially with geopolitical changes afoot between many countries and China and its impact on their economies.

E-commerce in India can act as a channel through which *Make in India* and exports can be stimulated. Exports and *Make in India* are not mutually exclusive concepts. While, *Make in India* for India has its own advantages, the true

potential in terms of economic realisation can be through exports. This time India must act fast and e-commerce can act as an immediate enabler.

E-commerce as an enabler for exports

India has been working towards increasing her share of exports to the world. This has always been a challenge largely owing to poor price competitiveness. A lack of a robust domestic manufacturing sector only further accentuated the problem.

The sharp increase in India's current account deficit (CAD) has been evident in the last decade. It has therefore been with renewed focus that the incumbent government has been attempting to identify sectors that could contribute to Indian exports.

India has been working towards increasing her share of exports to the world. This has always been a challenge largely owing to poor price competitiveness. India has made excellent headway in the pharma sector and the electronics sector (largely owing to mobile phone manufacturing).

Traditionally strong sectors for India, such as leather, diamonds, and even meat, have seen a decline in terms of gross and/or net exports. Some sectors are more suited than others for exports through e-commerce. These have traditionally been textiles, footwear, apparels, gems and jewellery, to name a few, products of which can be sold directly to overseas consumers.

The entire mechanism of traditional export is fraught with challenges in its process. First, there is limited access to market information. The preliminary process of gathering information about a foreign market is not only challenging but is also a time-consuming process and through trial and error.

Second, there are many entry barriers for smaller businesses in terms of cost. Third, business or seller have little or no feedback from actual consumers and users of product. They are forced to rely on the overseas supplier/importer for feedback of the sold product.

Fourth, accommodating the local preferences of the export market often comes at a significant cost. Without proper feedback or any means of knowing how successful even a customised product could do, businesses are unwilling to take the risk to make changes to their existing product that has thus far worked well in the domestic Indian market.

Exports through e-commerce can happen either through the businesses' own website or through e-commerce companies that have a presence in foreign markets that can help facilitate the sale of domestically manufactured goods in international markets.

While the cost of setting up one's own website in itself may not prove to be an expensive affair, marketing and customer acquisition can also be a challenge. Existing businesses who have already built a brand identity may find it easier and ultimately maybe even more profitable, to set up their website and fulfil orders.

Selling through existing marketplaces has one big advantage, which is that of credibility. Marketplaces already have a large number of consumers that are loyal to it. Hence new sellers achieve a certain sense of acceptance. Other advantages of selling through existing marketplaces is that of managing logistics and the value addition offered by marketplaces like tools for market insights.

Using e-commerce as an enabler for export offers businesses a certain sense of control and independence over decision making. By nature, e-commerce connects sellers directly to the end consumer.

The dependence on intermediaries in foreign markets is reduced to a large extent. One of the biggest challenges that the traditional channels of exports presents is the inability of smaller businesses to participate in the process.

E-commerce creates a level playing field for any kind of business to access foreign markets. The low cost of investment and small quantities of export that is possible through e-commerce also means that the cost of failure for any business is not crushing.

E-commerce connects the seller to the end consumer directly. This means that the seller has direct access to feedback from consumers on multiple parameters. While label goods cannot be sold directly to consumers, e-commerce requires for brands to be built. While there may be a certain cost involved to building a brand from scratch, the long-term gains of this objective are manifold. For India, it is important to create brands.

Next steps for India

Policymakers in India have created two draft e-commerce policies, neither of which passed muster. The hope is another new policy will be drafted by the government. However, this time policymakers must take into consideration the vision set out for the country as a whole and the role e-commerce can play in realising this vision.

Different rules for different formats of retail have led to a whole host of fragmented regulations and policies in retail on the basis of format and origin of capital.

This could be a reason for why India has been unsuccessful in unlocking the huge potential, growth, export, and employment wise, that the sector can generate. Even under such sub optimum conditions, India's retail sector and e-commerce particularly have grown.

In the past the e-commerce policy has dealt with many issues that should not quite fall into its ambit, such as data localisation requirements. These are best left to the concerned departments. Instead, the e-commerce policy must concentrate on ensuring how best to optimise the advantages of this retail revolution.

It must also take into account the various issues that are emerging around competition and e-commerce across the globe and make provisions for the same. If India is keen to truly reach its vision of bettering her manufacturing output, becoming self-reliant, and plugging herself into global value chains, then it is time for the manufacturing and services sector (e-commerce) to work together cohesively, and this should be the focus of any new e-commerce policy. ■

Nirupama Soundararajan is the Head of Research & Senior Fellow, and Arindam Goswami is a Fellow, at the Pahle India Foundation

Endnotes

1. <https://www.statista.com/statistics/482584/india-households-by-annual-income/>
2. McKinsey Global Institute, *"The Bird of Gold': The Rise of India's Consumer Market"* (San Francisco: McKinsey & Company, 2007).
3. <https://www.valuechampion.in/credit-cards/average-consumer-spending#:~:text=Out%20of%20Spending-,Key%20Findings,per%20person%20in%202017%2D18>
4. Invest India
5. https://dipp.gov.in/sites/default/files/icrier_report_27052008_0.pdf
6. <https://www.statista.com/statistics/792047/india-e-commerce-market-size/>

7. Invest India

8. Invest India

9. http://indiabudget.nic.in/es2016-17/echap08_vol2.pdf

10. http://www.business-standard.com/article/sponsored-content/zero-defect-zero-effect-a-myth-or-a-reality-115060400462_1.html

11. For a detailed commentary on an evaluation of Make in India, please see, Pahle India Foundation's study titled "Make in India – Stoking the Manufacturing Sector," http://pahleindia.org/pdf/Make_in_India_Stoking_the_Manufacturing_Sector.pdf