Allowing FDI in e-Retail: The Pros and Cons

MONICA DUTTA

The debate on opening India's retail sector to foreign investments is a decade old, and has now extended to e-tailing. Government regulations allow 100 per cent FDI in the B2B segment for, both, retail and e-commerce. For B2C, these figures are 100 per cent and up to 51 per cent FDI for single brand and multi-brand retail respectively. But e-tail is not open to FDI yet.
This article examines the opportunities and obstacles in allowing FDI in e-tail.

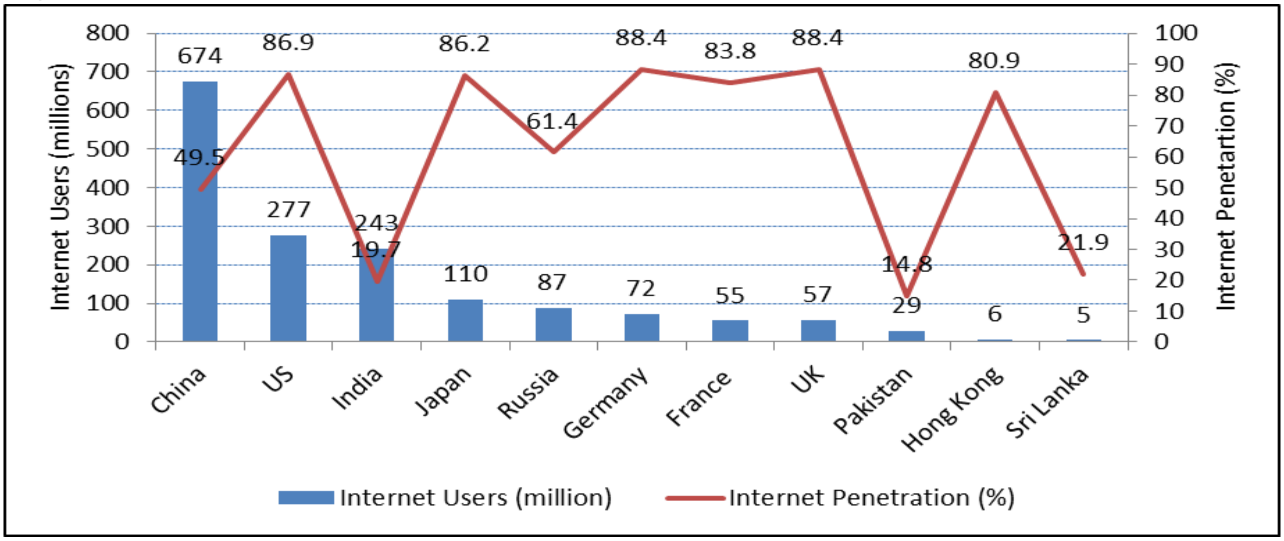
Keywords: *fdi; india; retail; e-commerce; e-tail; internet penetration*

The last decade has seen phenomenal growth in the world's e-commerce industry facilitated by the emergence of newer internet and web-enabled and mobile technologies. India, which has been somewhat slower in catching up with countries like the USA and China, has recently seen modest developments in this sector. One of the major challenges to the growth of e-commerce in India, other than the regulatory framework, is internet penetration. Figure 1 below shows that India has a mere 19.7 per cent internet penetration, compared to 86.9 per cent and 49.5 per cent in US and China respectively.

Data further shows that India is still at a nascent stage of development in this industry and lags behind many countries. The share of e-commerce to total retail is approximately 1.5 per cent in India vis-à-vis 5.8 per cent in the US. Among the two key business models: B2B and B2C[1], in India, it is the former which captures 90 per cent of the total market share with the remaining 10 per cent pertaining to the B2C segment.[2] With FDI restricted in the B2C segment of e-retail, most of the e-portals (like Amazon[3]) are forced to operate as pure marketplace[4] model in India as opposed to the inventory-based model in the US. This allows, for instance Amazon, to comply with the FDI norms in India as the online business entity provides only a platform for trade to take place and does not involve itself in any retail transaction or any direct sale to the consumer.

[1] Business-to-Business (B2B) electronic commerce refers to transactions between two enterprises (such as a manufacturer and wholesaler or a wholesaler and a retailer) as opposed to Business-to-Consumer (B2C) electronic commerce where the transactions take place between an enterprise and end consumer (http://www.digitsmith.com/ecommerce-definition.html).
[2] Discussion paper on e-commerce in India, Department of Industrial Policy and Promotion (DIPP) 2014
[3] Amazon launched its store in India in June 2013 in order to benefit from the booming e-commerce space in India. In India Amazon will be able to operate only as a marketplace which can sell only third-party products and not its own products because of stringent FDI regulations (http://www.business-standard.com/article/companies/amazon-to-follow-marketplace-model-113060500216_1.html)
[4] A marketplace model provides a platform to a large number of manufacturers/traders (especially MSMEs, Micro Small and Medium Enterprises) to advertise their products as well as manages related functions and in turn the entity earns commission from sellers for goods and services.

Figure 1: World internet users and internet penetration 2014

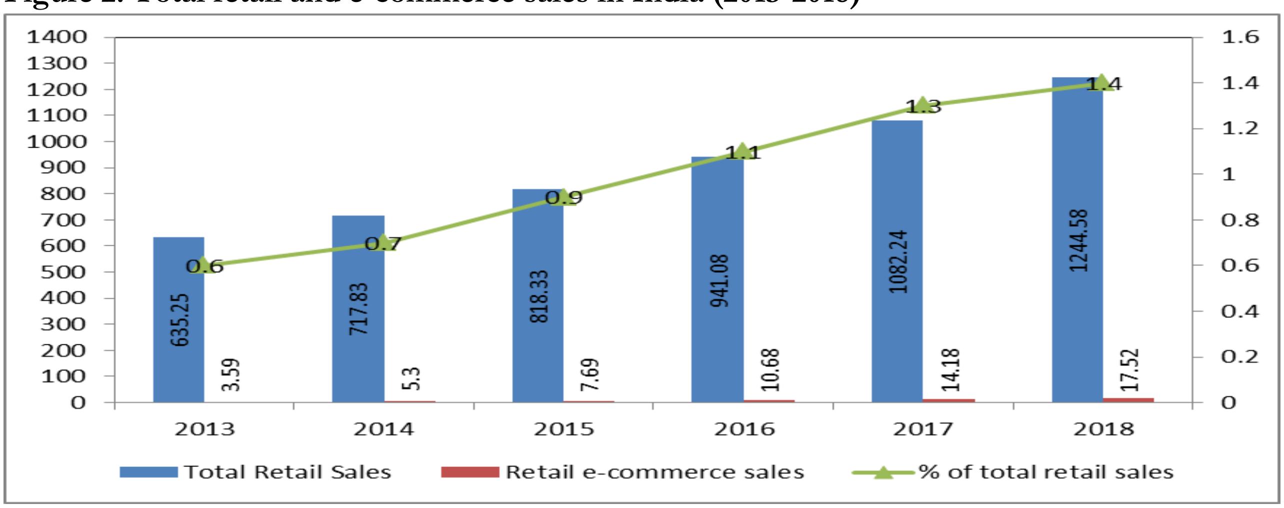


Source: Internetworldstats.com

Note: Data for China, Germany, France and UK is as on December 2014, U.S., Japan, Pakistan, Hong Kong, Sri Lanka and India is as on June 2014 and for the rest as on December 2013.

The retail e-commerce sales in India were $5.3 billion in 2014 and were expected to grow at 43.4 per cent per year and arrive at a figure of $7.60 billion in 2015 (eMarketer, Dec 2014). As a percentage of total retail sales, online retail trade in India accounts for less than one per cent presenting a very dismal picture. Even by 2018 the situation is not expected to be any better with e-tail contributing to only 1.4 per cent of total retail sales (Figure 2). The total retail sales in India increased at a rate of 13 per cent from $635.25 billion in 2013 to $717.83 billion in 2014. Online retail sales have also increased consistently over the years, but at a diminishing rate from above 55 per cent in 2012-2013 to 23.5 per cent in 2017-2018. Even as a percentage of total retail sales, the online retail sales have registered an increase from only 0.6 per cent of the total sales volume in 2013 to 1.4 per cent by 2018. However, the share is still small.

Figure 2: Total retail and e-commerce sales in India (2013-2018)

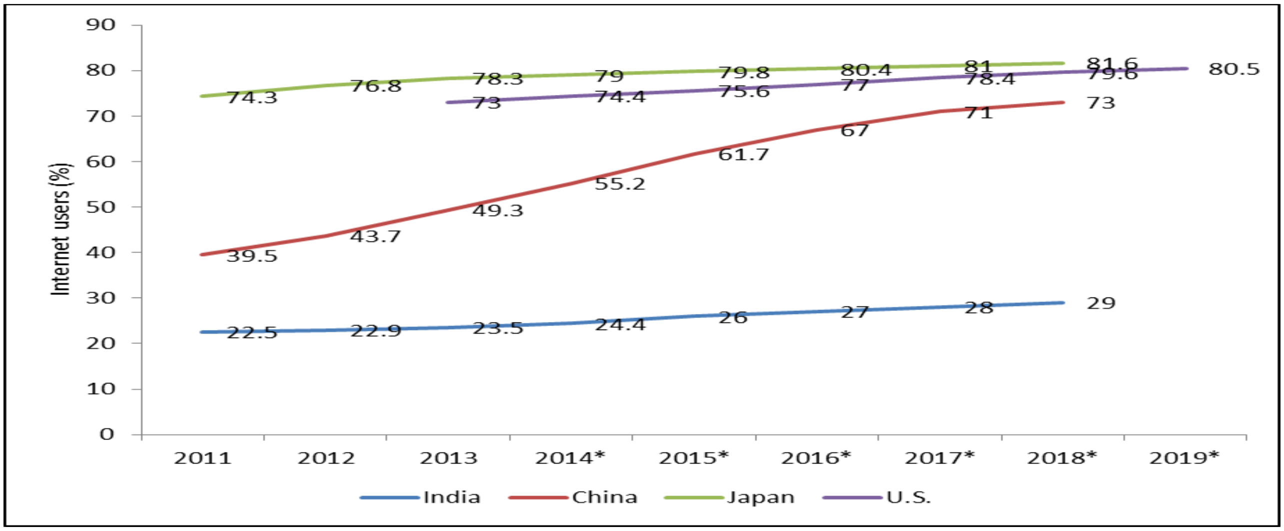


Source: eMarketer, Dec 2014

Note: All sales figures in $US billion

While e-commerce in India is on the rise, from 22.5 per cent of internet users in 2011 to 27 per cent in 2016 (Figure 3), and expected to reach 29 per cent in 2018, it lags behind Japan and China where 82 and 73 per cent of their respective internet users will be purchasing online.

Figure 3: Digital buyer penetration



Source: Statistica 2015 (www.statistica.com)

The discussion above reveals that the state of Indian e-commerce industry is not very attractive. Given the current status, it is important to assess whether the Indian economy will be able to reap benefits even if FDI is allowed in e-retail.

ALLOWING FDI IN RETAIL AND NOT IN E-RETAIL

The Department of Industrial Policy and Promotion (DIPP), Government of India, released a discussion paper (DIPP, 2014) inviting comments on allowing FDI in B2C e-commerce segment from different stakeholders. There have been arguments from the stakeholders both in favour of and against this regulation which are discussed below.

Proponents of the e-commerce industry have suggested that e-retail can be a boon for the Indian economy, as also help in the development of many Indian brands, thus supporting the 'Make in India' initiative. Allowing FDI in e-retail can potentially lead to influx of capital, enhance the growth potential and improve supply chain efficiency.

One of the major arguments against opening up of FDI consists of rise in competition from international players, monopoly in manufacturing and logistics and large scale unemployment.

However, evidence from China, Brazil and Russia indicates that global online retailers are actually facing tough competition from local players in these markets. In China, the market share of leading US online retailers has been minimal (less than one per cent of the overall e-tailing market) vis-à-vis local players who have a double-digit market share.[5] Overcoming the language and cultural barriers and a full understanding of consumer behaviour within the sub-geographies are tough for international sellers. The global players will face barriers in India where the local *kiranas* (corner shops) have a natural advantage. When we factor in the

[5] http://archive.financialexpress.com/news/column-indian-etailers-need-fdi/1219713/0

low internet penetration and other technology-based challenges, it is unlikely that the global sellers will become monopolies and cause harm.

SUMMING UP

International evidence suggests that opening up the e-retail sector for foreign investments can lead to efficiency gains, support the growth of incomes and infuse advanced technologies in the supply chain management practices of India. It will also reduce transaction costs for the ultimate consumers who will be somewhat better connected with producers with the technology companies offering multi-sided market accesses. Trade diversion will take place and to the extent that the e-retailers add to their customer base, the local *kiranas* lose.

However, one needs to look at the current state of e-commerce in India before arriving at any conclusion regarding benefits of opening up of FDI. In spite of growing usage of internet[6] in India, online retail sales have been far behind total retail sales; the key reasons are low internet penetration and usage. Online retail in India also faces various hurdles — rising onset of cybercrimes, increasing concerns regarding the quality of online goods and services, lack of in-store shopping experience — which act as deterrents to the growth of this sector. Historically, it has been found that traders have had huge political clout in India, with their powerful associations and lobbies, and the governments have to manage this pressure. The government's decision to allow FDI in this space or not is also as much a political one as it is economic, given the seriousness of this move and given that India is a democracy.

It seems that given the present state of the Indian e-commerce industry, even if FDI is allowed in the e-commerce B2C segment, the Indian economy will take time to be able to reap benefit from it.

BIBLIOGRAPHY

ASSOCHAM-Deloitte Report (2015). "Future of e-Commerce: Uncovering Innovation", A joint study by ASSOCHAM-Deloitte available at http://timesofindia.indiatimes.com/tech/tech-news/E-commerce-market-to-touch-16-billion-in-India-this-year/articleshow/46864759.cms

Deutsche Bank Research (2015). "Indian e-Commerce Industry", Deutsche Bank Markets Research, February 3, 2015 available at http://ivca.in/pdf/bnncddhexgpnt6i.pdf

DIPP 2014. "Discussion Paper on E-commerce in India, Department of Industrial Policy & Promotion", Government of India available at
http://dipp.nic.in/English/Discuss_paper/Discussion_paper_ecommerce_07012014.pdf

Prasad, BVS and J.A.B. Miranda (2014). "B2B E-Commerce in India", National Monthly Refereed Journal of Research in Commerce & Management, Vol. III, February 2014.

Ray, Sarbapriya (2011). "Emerging Trend of E-Commerce in India: Some Crucial Issues, Prospects and Challenges", *Computer Engineering and Intelligent Systems*, ISSN 222-1719 (Paper) ISSN 2222-2863 (Online) Vol. 2, No. 5, 2011.

[6] The key drivers of the rising use of internet being increasing disposable incomes, growing time constraints, increasing smartphone penetration, rising usage of computers and increasing access to internet.