



THE RISE AND RISE OF E-COMMERCE IN INDIA

January 2013

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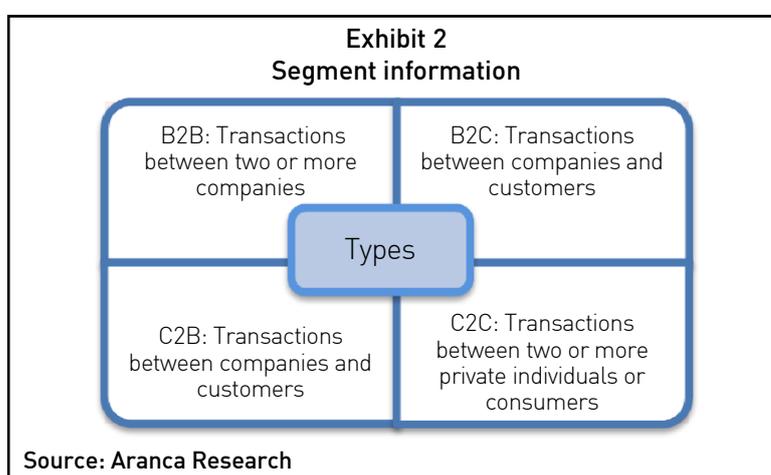
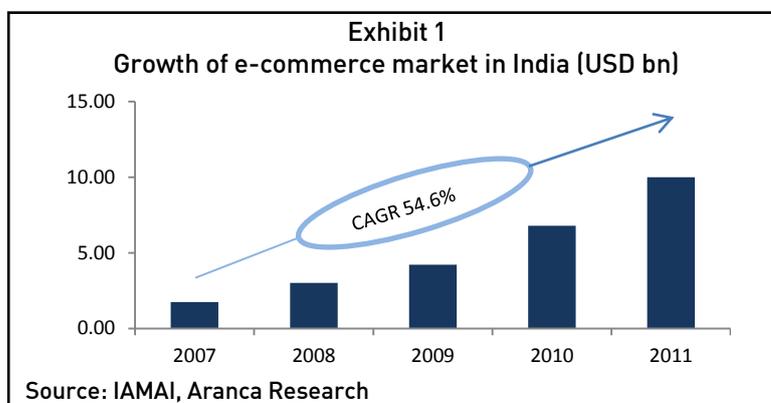
1. E-COMMERCE – A PROVEN HAVEN FOR INDIA’S ECONOMIC GROWTH

From a buzzword to a current-day reality, e-commerce in India has been experiencing remarkable growth, successfully changing the way people transact. People today can shop literally everywhere within minutes, be it their workstations or homes, and most importantly, at any time of the day at their leisure. The online market space in the country is burgeoning in terms of offerings ranging from travel, movies, hotel reservations and books to the likes of matrimonial services, electronic gadgets, fashion accessories and even groceries. India is home to 3,311 e-commerce hubs, 1,267 rural hubs, 391 export hubs and 2,217 import hubs¹. To capitalise on the anticipated growth potential, a host of investors, including venture capital (VC) and private equity (PE) firms, are closely eyeing opportunities in e-commerce start-ups. At the same time, the sector is witnessing a swathe of consolidation owing to various mergers and acquisitions. However, industry experts believe this is just the start of the e-commerce wave in India. The growing penetration of technology facilitators such as Internet connections, broadband and third generation (3G) services, laptops, smartphones, tablets and dongles, coupled with increasing acceptance of the idea of virtual shopping, is set to drive the e-commerce eco-system. The e-commerce story in India would surely witness a new world of digitalisation in the coming decade, with a host of start-ups emerging to compete with existing players in order to draw benefits from the new and existing markets.

2. THE E-COMMERCE SECTOR HAS BEEN GROWING AT A BREAKNECK PACE

The sector is classified into four major types, based on the parties involved in the transactions – Business-to-business (B2B), business-to-customer (B2C), customer-to-business (C2B) and customer-to-customer (C2C) (Exhibit 2). According to an Internet and Mobile Association of India (IAMAI) report, the overall e-commerce market in India has recorded a robust CAGR of 54.6 per cent and crossed USD10.0 billion during 2007–11. It is estimated to add another USD4 billion and reach USD14 billion by end-2012. Segment-wise, B2C dominated the sector with a 56.0 per cent share in 2010–11. Together, the B2C-C2C segments have shown significant growth; their aggregate market size stood at USD9.9 billion in 2011, while that for B2B segment was estimated at around USD48.8 million. However, B2B’s acceptance is on an upward trend due to its rising awareness amongst Small and Medium Enterprises (SMEs), which are close to 13 million in number.

¹ The eBay Census Guide 2011

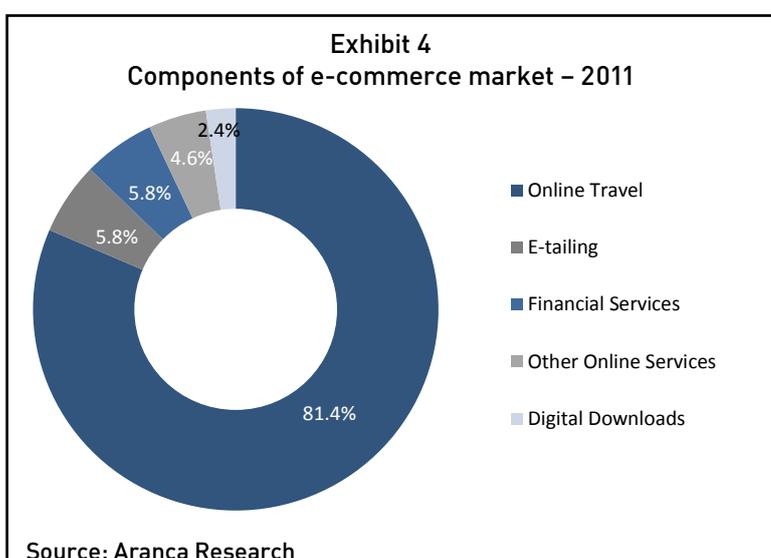
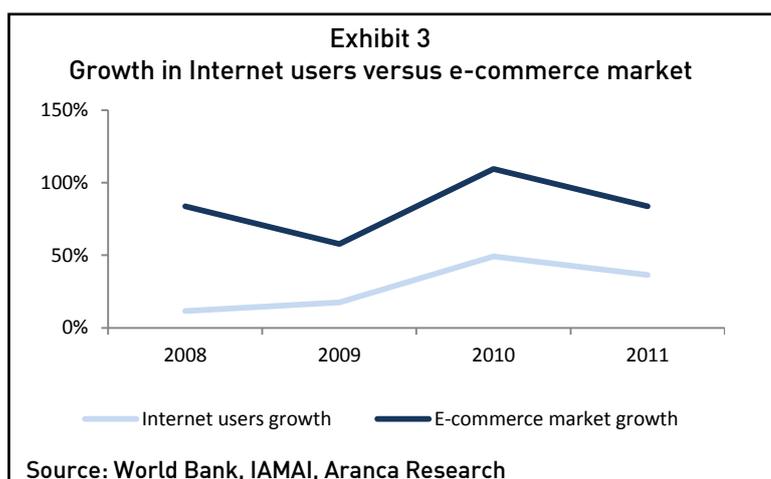


3. ONLINE TRAVEL, THE CURRENT MAJOR CONTRIBUTOR TO THE B2C SEGMENT'S SALES

In India, online travel accounts for majority of the sales of the largest segment, B2C. Indian customers are less sceptical in purchasing services such as train and airline tickets online. This enables e-sellers to avoid logistics and delivery issues linked with physical goods. As per 2011 statistics, the online travel sales division captured the biggest pie and accounted for 81.4 per cent of the entire market (Exhibit 4). Online travel sites such as Indian Railway Catering and Tourism Corporation (IRCTC) and makemytrip.com have been the most influential and successful in this regard, as these portals save buyers from the travails of waiting in queues. Today, almost 40.0 per cent of the total IRCTC bookings are done online. According to an eMarketer report titled "BRIC Travel Markets in Transition: Trends Influence Overall Ecommerce", India is expected to register a CAGR of 30.6 per cent for online travel sales, surpassing the rate forecast for South Korea (19.8 per cent), Brazil (18.2), China (14.1), Russia (9.8), Australia (7.4) and the US (7.2) during 2011-16.

4. ONLINE RETAIL DIVISION TO CONTINUE TO OFFER IMMENSE SCOPE

Currently, the retail division, which includes online sales of physical and digital goods, enjoys only a nominal share. Notably, in this division, e-tailing and financial services are the fastest growing segments with each capturing 5.8 per cent of the market as per 2011 statistics. E-commerce has expanded its foothold in the finance-based segments such as mutual funds and insurance. The Indian online retailing market is still evolving and certainly has room for growth; e-commerce accounts for just 0.1 per cent of total retail sales vis-à-vis more than 2.9 per cent in China. This number is quite low compared to the online retail penetration enjoyed by developed markets such as the US (7.0 per cent). However, this scenario is likely to change with the expected surge in Internet penetration and advent of 3G/4G telecom services. In addition, major retailers are providing warranties and discounts to attract customers to online stores.



5. SECTOR ENJOYS LARGER REVENUE CONTRIBUTION FROM TIER I, II AND III CITIES

According to a study², Tier I, II and III cities accounted for almost 57.0 per cent of the total revenue derived from the various e-commerce product sites, while the remaining 43.0 per cent came from the eight metro cities. Similarly, for the service sites as well, tier I, II and tier III cities accounted for 54.0 per cent as against 46.0 per cent by the eight metropolises. Geographically, southern India leads with 41.0 per cent share of the entire Indian e-commerce landscape, followed by western India (27.0 per cent), as per 2011 numbers. This can be attributed to the high literacy rate in the south compared to the rest of India.

6. ANTICIPATED GROWTH IN INTERNET ACCESSIBILITY BACKBONE FOR THE INDIAN E-COMMERCE LANDSCAPE

One of the major catalysts for e-commerce is the breadth of Internet penetration in a country. The current penetration rate in India is at 10.1 per cent penetration rate, India has a huge Internet consumer base of around 125.0 million (as of 2011), the third largest in the world after US and China. By end-2012, the number of Internet users is expected to increase to 150.0 million. A study conducted by IMRB and IAMAI observed that of the total 99.0 million urban Internet users, 80.0 million were active compared to 31.0 million active users out of the total 38.0 million in rural areas as of June 2012. At its current pace, this number could multiply three-fold to nearly 380.0 million by 2015, surpassing the US and China. Notably, rural India has witnessed a significant increase in penetration of active Internet users – from 2.1 per cent in 2010 to 3.7 percent in June 2012. By end-2012, the number of active rural Internet users would touch 38 million as against 24 million a year ago. However, even with its large consumer base, just 1.0 per cent of the total (less than 10.0 million Internet users) is engaged in e-commerce activities, thus reflecting a huge untapped opportunity. This number is expected to touch 39.0 million users by 2015 as Internet penetration increases and e-commerce becomes more secured³.

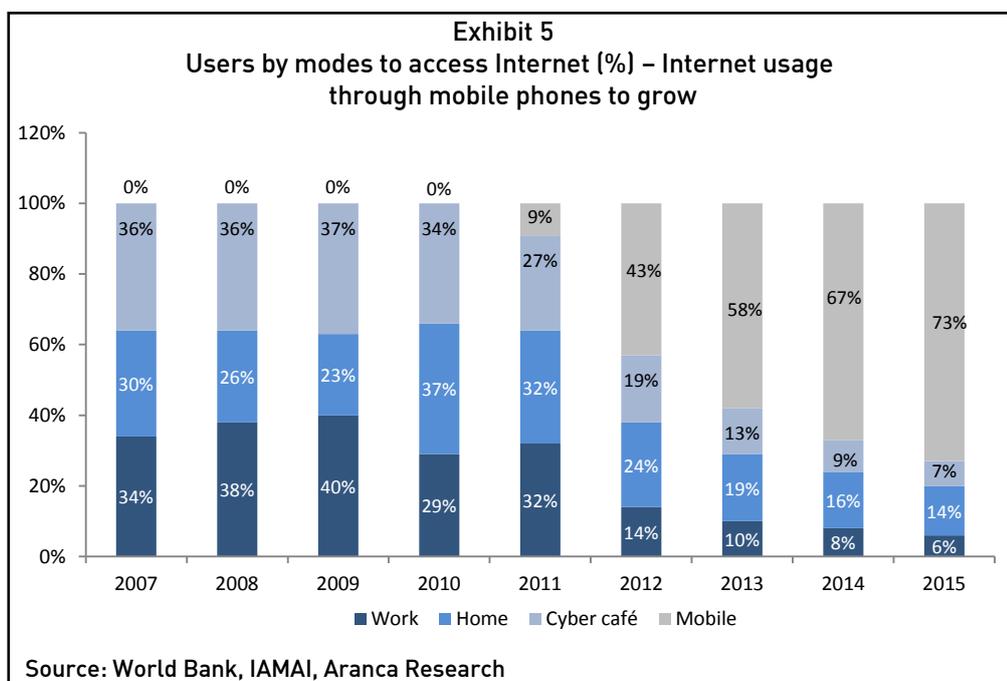
7. “ON-THE-GO” SHOPPING FORMULA NEED OF THE DAY

Mobile phones are proving to be an important factor in the e-commerce ecosystem owing to its easy compatibility with the Internet. India has more than 900.0 million mobile users, of which around 300.0 million use data services. This number is expected to touch 1200.0 million by 2015. Also, more than 100.0 million mobile users are expected to use 3G and 4G connectivity in the coming few years. Of the total 900.0 million mobile users, a meager 27.0 million are active on the Internet. Moreover, only 4.0 per cent of the active mobile internet users buy

² Vizisense –report on e-commerce 2011

³ A study by Avendus Capital

products through mobiles. However, mobile shopping is on an upward trend and is expected to increase five-fold to 20.0 per cent in the medium term.



8. E-COMMERCE MARKET WOULD CONTINUE ITS GROWTH STORY

The changing consumer lifestyles, supported by the younger population base of India, have given a boost to the e-commerce business. More than half of the total 1.2 billion population of India falls under the 'below 25 years of age' bracket. Also, 65.0 per cent of India's population, representing the working age group of 15 to 64 years, would aid the further growth of e-commerce, driven by their rising disposable income. Notably, discretionary spending in India is expected to jump to 70.0 per cent by 2025 from 52.0 per cent in 2005. Also, the growing inclination towards purchasing online is reflected in a trend for higher value online transactions. Shoppers are ready to shop for values exceeding USD500.0, which earlier hovered in the range of USD40.0–100.0.

9. INDIANS BECOMING MORE AWARE AND EMBRACING THE IDEA OF SHOPPING ONLINE

It has been observed that Indian consumers have matured over the years and increased their acceptance for various payment approaches such as net banking and prepaid wallets. E-commerce horizon has thus widened owing to acceptance of online shopping as a safe shopping medium. Of the total 200.0 million credit and debit card holders, just about 10.0 million people transact online, indicating a

huge untapped market. A study showed that there are around 150 million users willing to shop online⁴.

10. NUMEROUS CUSTOMISED FEATURES HAVE BEEN ADDED TO THE E-COMMERCE SECTOR

To capitalise on the benefits offered by the unique Indian consumer base, e-commerce companies have been innovating with policies traditionally not available in a brick-and-mortar store. Companies have introduced return policies ranging from 7–30 days, free home delivery and the most recent “cash on delivery” model. The last innovation has led to a lot of momentum in Internet sales and changed people’s perception towards online shopping as shoppers can now purchase without disclosing their credit/debit card details. It is believed that more than 50.0 per cent of all online transactions in India are based on the cash on delivery (COD) payment methodology. As Indian consumers are showing increased interests towards the COD mode of payment, companies are investing to resolve issues such as refusal to pay cash, rising inventories and managing returns in order to provide this facility without hassles.

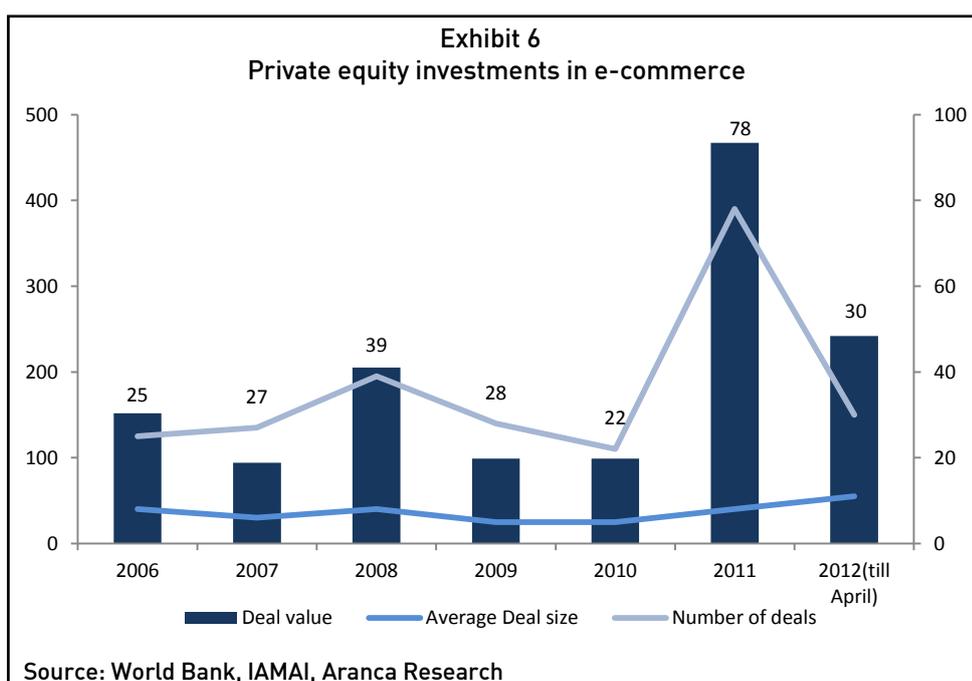
11. RURAL REGION OFFERS EQUAL OPPORTUNITIES TO THE E-COMMERCE LANDSCAPE

Companies from rural India have started understanding the growth potential from this sector, and are accordingly incorporating e-commerce activities in their business models. The unavailability of attractive offline channels in under-developed cities has encouraged the brand-aware population to shop online. According to the, around 3,311 Indian cities were engaged in online shopping between July 2010 and June 2011, of which over 1,267 were non-metro cities. This reflects how e-commerce has helped in overcoming the discrimination factor across cities, facilitating access for consumers from smaller towns to the same branded and quality products which earlier were a distant dream. Companies are working towards providing more online content in regional languages to tap the niche consumer base. While majority of the Internet population use the English language-based platform while surfing, offering content in local languages such as Hindi, Marathi, Telugu and Tamil might widen the target audience. Going forward, the rural population is well positioned to reap the benefits from the available low-cost technology platforms, efficient logistics management, increasing vernacular content and secured payment modes.

⁴ Report by First Data Corporation and ICICI Merchant Services

12. SECTOR HAS BEEN CONSTANTLY ATTRACTING HUGE INVESTMENT

With the underlying opportunities, the industry is set to benefit, driven by strong fundamentals and provision of continuous assistance by various PE and VC firms to fund their expansion plans. Notably, on the investment front, the sector enjoyed inflow of around USD800 million in 2011, up from USD110 million in 2010. Investments made in e-commerce businesses by PE firms alone more than quadrupled to USD467 million in 2011 compared to USD99 million in 2010. The number of deals increased to 78 compared to just 22 in 2010. The robust deal activity continued in 2012, with USD242 million invested during the January-April period. The trend over the period reflects that the average deal size has more than doubled due to increasing traction in e-commerce activities, which requires larger investments for growth.



13. COMPANIES IN THE SECTOR HAVE BEEN CONSTANTLY INNOVATING

The e-commerce sector in India is estimated to have hundreds of players. To capture a larger pie of the growing Indian e-commerce market, most of these e-tailers are constantly innovating, increasing their offerings and providing better deals. The trend in the e-commerce segment is that most of the e-tailers start with a single product and later diversify their product portfolio with multiple offerings. Notably, the market leader Flipkart.com broadened its offerings with various products such as mobile phones, computers, movies, music, baby products and stationery from its initial set-up of selling books online.

Furthermore, Snapdeal.com, the second largest e-commerce company that began operations as an online group discounting site in 2010, got converted into a marketplace with thousands of products. In order to survive, e-commerce players need to make a quick turnaround and minimise fixed costs as much as possible. Accordingly, different companies are resorting to different business models. Nevertheless, operating in a highly competitive environment with very low margins is not an easy job.

14. COMPANIES ARE RESORTING TO DIFFERENT STRATEGIC MODELS

Overall, the e-commerce sector is still considered to be in its nascent stage with newer business models yet to be tested. While some companies such as Flipkart and Snapdeal have a horizontal business model with varied offerings, other portals such as Zivame, BigBasket and FirstCry are having vertical business models with specialised product offering. Companies are even differentiated on the basis of their distribution network. Some of the large players such as Flipkart, Naaptol and Myntra are building their own warehouse and supply chain logistics with huge investments, while others such as Indiaplaza use a third-party supply network. In addition, the business model adopted by companies such as eBay is of providing a platform for third-party transactions, wherein a seller sells various products to registered users. This way, the company saves on building an inventory.

15. THE SECTOR WOULD BENEFIT FROM RESOLVING THE VARIOUS BOTTLENECKS

E-commerce giants are making huge investments in developing their own distribution networks as delivering charges form a major component of the product cost – ranging between USD1.0–4.0 per item. The huge investments will yield benefits in the medium-to-long term as e-commerce companies would be able to leverage upon a larger customer base. Improved distribution system is expected to reduce the average turnaround time for delivering a product to 1–2 days from 4–5 days previously. Furthermore, quicker delivery time coupled with the rising emphasis ascribed to customers would improve the customer retention rate. Retaining an existing customer is more profitable for a company since acquiring a new customer; on average costs USD15.0–20.0. Moreover, going forward as the sector undergoes consolidation, this cost is ought to decline further as fundamentally weaker companies would lose out to established players. Also, bottleneck arising out of regulatory and taxation issues with respect to movement of products between states is being addressed supporting the e-commerce growth story.

16. GOVERNMENT DECISION TO DISALLOW FDI IN E-COMMERCE TO HELP INDIAN E-COMMERCE FIRMS

The Indian government has restricted foreign companies from selling their products in India through the online medium. This regulation safeguards Indian companies against competition from global leaders such as Amazon. The restriction is also extended to foreign retail companies that have entered India. However, in the longer term, Indian companies have to evolve and shield themselves not only from their Indian counterparts but also from the global e-commerce giants as the government might allow FDI in the segment. Eyeing on the vast opportunity, Amazon has already entered the Indian market through Junglee.com. In addition, it has even got approval from the government to build large warehouses to stock third-party goods. Strategic moves such as these would support its expansion plans once FDI is allowed. Moreover, the government's plan to interlink every panchayat (village council) of the country through high-speed broadband service by 2014 would aid the sector's growth. Also, government organisations' increasing reliance on the e-commerce methodology for their money-related transactions would help the upward trend.

17. THE PROMISING E-COMMERCE SEGMENT

Size of the total e-commerce market in India is estimated to expand at a CAGR of about 40.0 per cent during 2010–20 to USD200.0 billion⁵. Likewise, India is expected to record the highest growth in the Asia Pacific region during 2012–16⁶. The trend would shift with the online retail segment contributing equally to the total market size, considering it is expected to grow significantly in the coming years. The B2C segment would continue to lead the e-commerce market, thanks to the budding Indian Internet population, supporting demographics, ease of payment modes and customer-centric innovative policies. In the coming decade, we expect the sector to offer much more revolutionary practices such as transacting with the help of Mobile money, and having access to virtual trial rooms. Continue shopping online as the sector is set to mature!!

⁵ IAMA study

⁶ Study by Forrester, a leading global research and advisory firm

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