Online sites shake up hidebound retailing in India

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Finding a way into India's vast but vexing market has long frustrated foreign retailers. Now, overseas investors are pouring billions of dollars into e-commerce ventures that are circumventing the barriers holding back retail powers such as Wal-Mart and Ikea.

Some investors see India as the world's next big e-commerce opportunity, with the upcoming mammoth public stock offering of Chinese online giant Alibaba hinting at the potential.

Online shopping is still in its infancy in India at $2.3 billion of an overall $421 billion retail market in 2013, according to research firm Crisil. But it is growing fast and the potential of reaching a mostly untapped market of 1.2 billion people has sparked a funding-and-expansion arms race.

Flipkart, a Bangalore-based company founded in 2007 by two former Amazon employees, last month announced it had raised $1 billion in mostly foreign capital after building its registered users to 22 million.

A day later, Amazon raised the stakes with founder Jeff Bezos saying the company would pour $2 billion into developing its India business.

Snapdeal.com, whose investors include eBay Inc., has raised at least $234 million in the past year, and recently local media have reported that Rajan Tata of India's Tata Group conglomerate is considering a personal investment in the company.

The flood of overseas capital comes even though foreign investment in online retailing is not permitted in India, which would seem an even more stringent barrier than the local product sourcing requirements that caused Wal-Mart and IKEA pull back on plans to build megastores. However, e-commerce businesses that are partly or wholly foreign owned have found a way to work around the rules to offer books, clothes and electronics on their sites.

Neither Flipkart nor Amazon technically engage in online retailing. Instead, to get around the foreign investment ban, both companies serve as Internet-based hosts for thousands of third-party sellers, taking commissions in exchange for marketing and, often, arranging shipping of the products.

Even Amazon's Kindle e-reader is not sold directly by the company. On the Amazon.in site, the latest Kindle reader is sold by Infinity Retail Ltd., a subsidiary of Tata Group, which purchases the device from Amazon. Customers get the device but pay more for the extra layer of reselling: the Kindle that sells for $119 on the U.S. online store goes for 9,999 rupees ($167) on the Indian website.

India's Finance Minister Arun Jaitley mentioned liberalizing e-commerce in his July budget speech, but so far the government has not taken any steps to change the foreign investment restrictions.

It may be a while before the big investment outlays translate into profits. Most of the billions raised by e-commerce businesses will be plowed back into building up the companies, from acquiring warehouses to developing shipping networks and also offering deep discounts to squeeze smaller players out of the market, said Ajay Srinivasan, director of Crisil Research , which is majority funded by Standard & Poor's.

"Financial muscle ensures you are able to withstand the initial few years when you are not going to be making money and you'll be burning cash," Srinivasan said. "It also allows you to offer better deals to customers to build market share."

The battle is playing out on TV and in newspapers.

Amazon.com India is running front-page spreads touting its next-day delivery service and easy return policy. Snapdeal has a television ad with a put-upon housemaid unpacking all the purchases a happy middle class family has made online and complaining that with all the money they are saving, she should get a raise.

India's e-commerce revenue has grown explosively over the past three years despite only 11 percent of Indians having access to the Internet, according to a report by KPMG and the Internet & Mobile Association of India.

Online sales are growing at more than 50 percent annually and are on track to reach $8.3 billion by 2016, Crisil estimates. KPMG estimates that e-commerce could contribute 4 percent of India's GDP by 2020, compared to a projected 10 percent for the country's IT and call-center outsourcing industry.

Such big potential for online retail is made possible in part by India's continued restrictions on big box retailers that have Indians starved for choice.

India is one of the last major markets to mostly keep multinational retailers from setting up shop. Despite approving 51 percent foreign investment in retail businesses in 2012, India has set stringent regulations intended to protect small manufacturers and mom-and-pop shops that still make up 93 percent of the country's retail sales.

As a result, big players such as Wal-Mart and IKEA have put opening their own retail stores on hold. India has a few large retail chains, Tata Group's Croma for electronics and department store chain Big Bazaar, but they are mostly limited to major cities.

Still, India's e-commerce businesses face several other challenges.

Fewer than 12 percent of Indians have credit or debit cards, meaning that to expand, Amazon, Flipkart and Snapdeal have had to accommodate cumbersome cash payments.

"Cash-on-delivery is very important. It's a very Indian concept," said Ashwin Vellody, an information technology expert at KPMG. "But that is inefficient and expensive for companies."

The companies must also develop logistics and distribution systems in a country notorious for creaking infrastructure and inefficient transport.

The biggest challenge, though, will likely be price wars in the fierce fight for market share, said Srinivasan, the Crisil director.

"From a consumer perspective, it means better days to come," he said. "I think the bargains they will be able to get online will only get better."