

Indian Online retail Ecosystem – A study on FLIPKART deal with WALMART

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Abstract

US retail giant Walmart acquisition of 77% controlling stake in Flipkart in May 2018 has set a new chapter in the Indian online retail market. The deal gave the much-needed confidence to online retail stores who are already cash starving after giving away highly competitive deals and offers for the Indian shoppers. Walmart wishes to use this opportunity to enter the India market where its global competitor Amazon is already present. On the other hand, Flipkart wishes to use the much-needed cash infusion to smoothen out its operations and to get access to international markets.

This research article is an attempt to study the dynamics of the Indian online retail industry and factors contributing and determinantal for its growth. The Walmart style of going global is examined and why this Indian acquisition is important. The Flipkart story is examined to understand how it rose from being a simple online bookseller to become gigantic challenging even global giants. This study is of significance in understanding the dynamics of the online retail sector and derives implications for various stakeholders.

Keywords: Online retail, online shopping, retailing, acquisition, walmart, flipkart, amazon

INTRODUCTION

US-based retail giant Walmart acquired 77% stake in India's top e-commerce market place Flipkart for US \$16 billion on May 9, 2018. The M&A is India's largest deal of the year and has put Flipkart's valuation at a whopping US \$20.8 billion. The remaining 23% Flipkart stake was held by Binny Bansal (Co-Founder), Tencent Holdings Ltd., (China), Tiger Global Management and Microsoft Corporation.

Prior to this, both Amazon and Walmart are competing for Flipkart's stake. Walmart first entered into talks in 2016 for buying stake in Flipkart. At almost the same time, Amazon too tried with a non-compete agreement to buy 60% stake in Flipkart and offered a breakup fee of US \$2 billion. Amazon is Flipkart's major rival and is #2 in Indian E-commerce market. The deal faced regulatory hurdle because it will obviously create monopoly in ecommerce. This almost paved way for Walmart to seize the opportunity.

Flipkart's undisputed leadership got tested with the entry of Amazon who sort of disrupted the industry forcing Flipkart to offer discount pricing to stay in the race. Despite lack of enough funding, Flipkart managed with several innovations in products and services. It reported accumulating US \$3.6 billion loss in March 2017. With Walmart now becoming the major shareholder, the company can develop strategies to contain losses and stand-up and give stiff competition.

OBJECTIVES OF THE STUDY

1. To study the structure of the Indian online retail industry
2. To study the business model and acquisition strategies of Walmart and Flipkart
3. To study valuations, challenges & implications of the merger

SIGNIFICANCE OF THE STUDY

1. This study is of significance because it gives us better understanding on the mergers happening in the retail shopping arena.
2. The study helps us understand the path chosen by an international retail giant to enter into a potential market like India.
3. The study helps the retail companies (both online and offline) to make appropriate business model changes so as to face future challenges.
4. The study helps other stakeholders including the Governments to make appropriate policy changes to foster the development of the industry.

INDIAN ONLINE RETAIL INDUSTRY

E-commerce retail industry is a perfect disruptive market strategy with technology acts as a disruptor. This globalized the concept of brick-and-mortar retail services which were traditionally constrained to limited and localized radius. E-commerce made

buying and selling of goods and commodities very simple without spending days of time scouting for the right outlet and right price. It drastically changed the consumers shopping habits and patterns, reduced physical involvement, offered wide variety of choices at competitive prices. All 4 forms of trading (B2B, B2C, C2B and C2C) can be offered from a single platform empowering both consumers and businesses. The Indian online market is growing rapidly with a wide variety of offerings ranging from fast moving consumer goods to services. Both services (such as pilgrimage, movies, hotel, travel reservations and matrimonial services) and Goods (electronic gadgets, fashion accessories, groceries, vegetables, and even processed food) can be ordered and delivered at consumer door step.

The Indian online retail space is tiny compared to the overall retail industry. However, it has an amazing exponential growth rate. It has grown from US \$14 billion in 2014 to US \$39 in 2017 and is poised to surpass the US by 2034 (IBEF, 2018). Indian e-tail industry players followed either the inventory-based model or the non-inventory-based model. As of August 2014, major inventory-based model followers are Jabong.com, Myntra.com, Firstcry.com, zovi.com (all were online retailers) while major non-inventory-based model were Flipkart.com, Snapdeal.com, ebay.in and Amazon.in (all were marketplaces).

E-commerce growth is proportional to internet users' growth (Saurabh & Vikas Kumar, 2018). A major section of internet users who logged in to internet were from metro cities. This trend is soon changing and the number of internet users logging in from tier-2 and tier-3 cities is increasing rapidly. Mobile phones internet users are out numbering those accessing the internet through personal computers. India's internet economy is expected to double from US \$125 billion as of April 2017 to US \$250 billion by 2020 and this will increase ecommerce penetration. Internet users were 429.23 million on September 2017, and were expected to increase to 829 million by 2021.

Low internet penetration and low conversion rate are the major industry challenges. Poor banking service penetration leads to fewer debit and credit card transactions and a majority of online shoppers preferring to use Cash-On-Delivery (COD) as the payment option. COD is expensive because a huge number of COD users refuse to accept the product upon delivery. Other deterrents include poor last mile connectivity which delay quick delivery, regulatory issues etc. Positive signs are in the form of growing number of smartphone users, the youngest population in the world, and growing disposable incomes. Apart from this, collaboration and integration of different departments which are geographically isolated with different time zones was another challenge. E-commerce industry needs greater deployment of resource for managing supply chain and logistics. However, experts opined that, e-commerce industry still in its early developing stage and there is so much for improvement. According to Paul Fu, senior director of Alibaba Group, China, says e-commerce in future will be more personalized and would become consumer to business.

With clear possibility of growth, the e-commerce cumulatively will spend US \$0.95-\$1.9 billion by 2017-2020 on infrastructure, logistics, and warehousing according to a joint study by PricewaterhouseCoopers (PwC) and Associated Chambers of Commerce and Industry of India (ASSOCHAM).

LITERATURE STUDY

Companies do acquisitions for various needs. Preventing your competitor from not doing it one of the reasons as can be seen in Flipkart-Walmart and Nestle-Starbucks deal (Braun, n.d.). Consumers prefer online retailers for better experience and to get information beyond what is provided by the advertising of the same products and services by the brick and mortar companies (Popli & Gaurav, 2016). Studies show that consumers are having a positive behaviour, perception and attitude towards offline shift of online brands as a whole (Subash & Mangeshprasad, 2018). An e-retailer can be studied based on basic business model and its key components (Value proposition, Revenue model, Competitive advantage, Market strategy, Organizational development and Management team) (Kaila, 2015). While online companies try to enter into offline segments and vice-versa, the correct strategy would be somewhere at the middle (Sims, 2018).

ABOUT WALMART

Walmart Inc was started by Sam Walton in 1962 in Bentonville, Arkansas, US and got incorporated on October 31, 1969. The company stated as chain of hypermarkets, discount department stores, and grocery stores around the globe. The company works under three reportable segments – Walmart U.S., Walmart International and Sam's Club.

Walmart has been a best example of a successful retailer that has well survived in the international markets through expansion. It proved that there can be retail growth in domestic markets when appropriate marketing strategies and entry modes are used. This had given Walmart, a competitive advantage over other retailers in which ever geography it worked. "Every Day Low Price", which had been successfully applied strategy throughout the world.

WALMART ENTRY INTO NEW MARKETS

Walmart used different strategies for its global expansion (Lee Yee Mun & Rashad, 2012). It entered the Mexican market in 1991 as a JV with a domestic player - CIFRA. CIFRA provided critical market intelligence including supplier connections, local market culture and about dealing with local officials. This helped in the development and expansion into new cities and thereby increase customer base. A 2005 bribery scandal broke out alleging that the company used favour from Mexican government officials to win market dominance thereby tarnishing its image.

Walmart entered Canada in 1994 acquiring 122 Woolco stores and further expanded by buying 220 former Zellers stores in 2011. Its supply chain and logistics focus helped its low pricing strategies to sustain in the Canadian market. It entered the Chinese market in 1996 where it tried localization strategies in terms of local procurement and stores management apart from focusing on distribution centres. However, its supply chain operations are weak compared to domestic market players. Huge competition from local retailers and failure to understand the Chinese operational and cultural environment has become a dent for the company. A series of legal actions from China's local and national laws for professed product violations and inability to make profits lead to a poor show in the Chinese market.

The Indonesia entry was in 1996 with a partnership with Multipolar, a subsidiary of Lippo. However, it failed again in to understanding the Asian supply chain and even face legal action from Lippo only to exit the country in 1998. Another failed marketing strategy was with Germany, where Walmart entered in December 1997 by acquiring 21 Wertkauf hypermarket chain stores. Walmart's aggressive pricing strategies resulted in a loss of US \$200 million in 1999. Germany's highly regulated and unionized market because of strikes and fines followed by public relation challenges forced it to exit Germany in 2006 at a US \$1 billion cost.

Walmart purchased 6.1% stake in Seiyu in 2002 to enter in Japan market. In 2008, it raised 100% stake in Seiyu with US \$875 million making Seiyu to be a full-fledged subsidiary. Walmart struggled to understand the tastes and preferences of Japanese customers. Continuous losses forced it to close almost 20 outlets and cut in workforce by 6% so as to trim losses in 2008.

In 2006, Walmart's international arm was established to become the world's 4th largest retailer. In 2007, Walmart entered a joint venture with Bharti Enterprises in India for a cash-and-carry business. As many as 50 stores were opened in a span of 5 years. The JV made a loss of Rs. 2.77 billion in 2011 and by 2013, the JV was dissolved after Walmart purchased Bharti's 50% stake. The company also decided to stop expansion plan in China, Mexico, Brazil, India and other countries to fulfil the requirement of US anti-graft law as US authorities launched investigation in probable violations of Foreign Corrupt Practices Act. In 2015, the company opened a store in Agra resuming its Indian expansion drive.

The 2018 Walmart Annual Report says it has 11,700 stores in 28 countries has 2.3 million employees on its rolls. As many as 270 million customers are served every week at its stores and on various websites under 65 banners. As per 2018 Fortune 500 list, Walmart is 'The world's largest company by revenue' (with revenue of \$500.3 billion for the fiscal year ended on January 31, 2018).

WALMART ENTRY IN ECOMMERCE BUSINESS

Walmart entered into ecommerce space mainly to counter Amazon which is already challenging it in the US. Though a leader in wholesale and cash-and-carry segments, Walmart remained a laggard in the online space. Global increase in internet users by 82% since 2012 to 2017 and an addition of 1 million users each day means a lot of potential customers. As many as 1.3 billion new users started using social media between 2012 to 2015. Mobile connections grew by 2.2 billion from 2012 to 2017. Companies like Walmart cannot afford to lose the opportunity! Walmart acquired Jet.com, a US-based e-commerce firm for \$3.3 billion in 2016. This followed with several small acquisitions such as Shoebuy, Moosejaw, Modcloth, Bonobos and Flipkart.

FLIPKART: LEADING E-TAILER IN INDIA

Flipkart.com (Flipkart), often referred to as the 'Amazon of India', was started by two ex-Amazon employees, Sachin Bansal (Sachin) and Binny Bansal (Binny), (not related) in October 2007 with an investment of Rs. 0.4 million. The company started as an online book seller with 50,000 book titles and got its first order about four months after its launch. By December 2009, it has become the largest online bookstore in India. Having picked momentum, Flipkart started expanding its products under various categories. In 2010, it began selling DVDs/VCDs, mobile phones etc. In March 2011, the company was doing business with a Gross Merchandise Value (GMV) of around US \$10 million. It finally started selling cameras, laptops, home appliances, e-learning, healthcare and personal products, and clothing.

In February 2012, it launched an MP3 download service called the Flyte Digital Music Store (Flyte) offering a wide range of music collections across several genres. It entered the men's clothing category (Oct 2012) and women's clothing segment (Feb 2013). The company changed its business model from the inventory-based model to the marketplace model. To adhere to FEMA guidelines, the company transferred its front-end business to a separate legal entity, WS Retail Services Private Limited, and sold it to a group of High Net-worth Individuals (HNIs) led by Rajiv Kuchhal. In March 2014, Flipkart's GMV reached US \$1 billion, a year earlier to its plan. Since inception, Flipkart continuously searched for better ways in every aspect. This made it to be No.1 in ecommerce industry. Constant innovation, experimentation and the ability to look each obstacle as an opportunity was the successful feature of Flipkart. Flipkart developed its own logistics centres and delivery fleets. It used an array of digital and online marketing strategies to succeed (Priti, 2015). Innovation in payment mode was initiated such as cash-on-delivery, credit/debit card payment at doorstep and even monthly instalment facilities. Reverse logistics support also worked out well for it gaining customers trust. This became an added advantage for their business experts opined.

VALUATIONS & MERGER CHALLENGES

A US \$210 million fund raising in May 2014 has put Flipkart valuations at US \$2 billion. Valuation further rose to US \$2.6 billion when it acquired Myntra, an online fashion and lifestyle store. Industry experts felt the deal triggered the consolidation phase in

Indian online retail space. By the end of July 2014, it was hosting 3,000 merchants offering more than 15 million products under 70+ categories serving 22 million registered users, 4 million daily visitors and making 5 million shipments per months with the help of 14,000 employees. As much as 50% of its income is from mobile internet users. Industry experts feel the success mantra of Indian e-tailers is the discounts and offers. The entry of deep pocket player likes Amazon in the Indian market has increased competition and has hurt Indian loss-making e-tailers despite having high valuation. Speaking on profitability, Sachin said that the company would focus on profitability when it had 100 million users. A 2016 Telecom Regulatory Authority of India (TRAI) report says that 50% of the Flipkart's traffic comes from non-metros and has the fastest customer growth from Tier 2 and Tier 3 towns. Flipkart has a reach of 60% of wireless and wireline internet connections in India!

Flipkart merged with e-Bay in August 2017 amidst intense competition from rivals such as Amazon and Snapdeal. e-Bay made a US \$500 million cash investment into Flipkart in exchange of equity stake. The merger helped Flipkart get a stronger customer base and access to a global platform. Flipkart CEO Kalyan Krishnamurthy termed 2017 as the year of "revival of confidence in the Indian consumer internet industry". During the year, it got funding from Soft Bank, Tencent and e-Bay and Microsoft Corporation.

Flipkart welcomed Walmart acquisition offer in May 2018. The deal is believed to help all stakeholders involved. Flipkart will no longer be a start-up company but dons a global giant tag. It can enter into newer markets, particularly in developed economies. Walmart has immense retail experience and know-how and this will immensely help Flipkart. Walmart is deep pocketed and has committed to make an investment of US \$2 billion as new equity to accelerate growth pace of the company which can be used to improve logistic and supply chain services. It promised to create new jobs and even promote Indian national initiatives.

No merger can go through without facing challenges. This deal, for example, got subjected to certain legal conditions. Walmart is technically free to pick up to 100% stake under the FDI route and can even open offline stores under Flipkart brand but only in platform model and not under inventory model. Similarly, pan-India multi-brand retail under FDI comes under the ambit of Central Government but foreign entities have to take State approvals as well. Some traders, under the umbrella of Confederation of All India Traders (CAIT) opposed the deal and petitioned the Competition Commission of India (CCI) claiming the deal creates unfair competition and impacts small traders on offline platform. CCI cleared the deal in August 2018 citing Flipkart discounting practises are to be dealt separately and that FDI issues have to be dealt in the policy space. As of September 7, 2018, the last date for depositing of withholding tax by Walmart, tax of only 10 funds and entities (out of the 44 involved) are paid. Withholding tax or retention tax is an income tax that is to be paid to the Government by the payer of the income (as opposite to the recipient of the income). Tax experts feel Walmart might have not deducted withholding tax from small foreign investors whose holding is less than 5%. Certain ambiguity in regard to Explanation 5 to 7 of Income Tax Act's Section 9 (1)(i) is the reason for the possible tax dispute.

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