Business Standard

E-retail vs. organised retail: an uncertain battle

The underlying fight is between supply chains. But as long as consumer benefits, who wins does not matter.

Prashant K Singh October 14, 2015 Last Updated at 08:45 IST

A decade and a half ago, the antagonism between organised retail and unorganised retail came to fore in India, including political polarization on the issue. Barely had the schism begun to harden, it reached a cul-de-sac by the end of previous decade. All this while, e-retail, the business-to-consumer (B2C) segment of e-commerce—the new darling of the investors—made a surreptitious entry. After all, Flipkart started in 2007, Snapdeal in 2010 and Jabong as late as 2012. Amazon entered India only two years ago in 2013.

Suddenly the debate is no longer about organised retail versus unorganised retail but between traditional retail and e-retail. E-retail has grown at an exponential rate; for instance, Amazon registered 500% growth in India. Almost mirroring "Veni, vidi, vici",("I came; I saw; I conquered"), online retail proclaims its triumph citing phenomenal increase in revenues and how the present $5 billion market of Indian online retail is set to jump ten times to $50 billion by 2020 .

Yet these victory proclamations may turn out to be premature bragging. No doubt, the older, traditional retail perched in its high citadel underestimated the threat from e-retail and is now alarmed as the fortifications are breached. Outwardly, the traditional organised retailers are still putting up a brave front, even as mergers and consolidations take place among them. Mr. Biyani, for instance, in an interview during the recent merger of Future retail with Bharti retail did not foresee any threat from online retail.

None of the major e-retailers in India has shown profits to this day. The revenues of pure e-retailers may be growing but for earning every rupee, they are spending between two to three rupees. Mr. Bansal of Flipkart justifies the losses by saying that it was a conscious strategy on their part to grow market share while sacrificing profits. The e-retailers can continue bleeding in this war of attrition as long as the private equity (PE) finances them. This is an indication that the PE values these companies very highly. But the assumptions, timelines for positive cash flow on which the high valuations are based are not known. In fact, a company is truly valued when it lists in the market, though that seems unlikely for e-retailers, unless the government stops FDI in e-commerce. If it happens, this may be the last hurrah for e-retailers.

Many analysts and organised retailers say that it may not be before 2020 that these e-retailers show even a glimmer of profit. But it seems more a case of pot calling the kettle black as the big organised retailers, for example, Future group, are also mired in huge debt, let alone huge blocked inventory. Going by valuations, online retail dwarfs offline retail by orders of magnitude.

Reaping economies of scale, scope along with increasing efficiencies is the continual quest of retail, offline or online. In a few years hence, when the war between the online retailers draws to an end, maybe only those with deep pockets and achieve scale will survive as the market becomes oligopolistic. Then we might see deep discounting and free shipping done away with as focus shifts on improving the balance sheets.

The fundamental reason why customers buy online is low prices as compared to a brick-and-mortar store, apart from convenience. Offline retail could have reduced the gap between the prices but their supply chains are too inefficient, the resulting costs borne by the consumer—a stark reality highlighted since the advent of online retail. For a few products like books, e-retail dealt a deathblow to the brick-and-mortar store model. In recent years, new online alternatives have mushroomed to every existing offline model. But many of these niche online retailers will meet a similar fate, if they are unable to turn profitable by increasing volumes and supply chain efficiencies. The underlying fight is between supply chains: the more efficient chain wins.

Indian e-retailers collaborated with enemies of organised retail—small, unorganised retailers, the like of mom-and–pop stores—by having a market place model, which allows small retailers to sell their products, a model followed by profit making Chinese e-retailer Alibaba. This helps e-retailers to pocket net profits without any hassles, offsetting their own loss-making sales. More importantly, by turning their potential foes into allies they do not face the political opposition that the organised retail faced, especially over entry of foreign retailers in India. The flip side is that this makes online retailers responsible for the quality of items sold by third-party sellers, while having no direct control over them, as the Chinese giant Alibaba realised after other companies sued it over the sale of fake products.

The proponents of e-retail point to favourable demographics, growing internet penetration, in particular m-commerce and a huge market beyond the urban areas that remains untapped. The opponents point to this irrational exuberance despite negative cash flows as evidence of another bubble. It might be so, but it is still ballooning up; Mr.Tata, Mr.Aziz Premji and other business bigwigs continue to invest in a number of e-commerce companies.

It may be too early to predict the outcome of the on-line vs off-line war as the decisive battles are yet to be fought. For now, the e-retailers have checked the growth of organised retailers but only time will tell, if they can declare checkmate. Meanwhile, as long as the customer benefits, the outcome does not matter.

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