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DE-STRESS TO DELIVER

Overcoming the Threat of E-tailers

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These days, e-tailers, in India, have been making headlines with their mind-boggling valuation figures. One of the most established firms in this space, Amazon has a valuation of more than 500 times its earnings. Amazon's sales growth is near exponential with 40% CAGR over last one decade. However, even after decades of existence, it makes a meager net profit of around USD 270 million on sales of over USD 74 billion. Economist reported that Amazon's core retail business does little better than break-even; most of its meager profits come from the independent vendors who sell through Amazon's marketplace.

Back home, Flipkart declared that it wants to become the first Indian company to touch 100 billion USD – not in revenues or profits but in valuation. Indian newspaper reports are full of valuation and funding stories of different e-tailers. However what is lost in the hysteria is the debate on business viability or bottom line numbers. Analysis of the balance sheets filed by the top e-retailer companies with the Ministry of Corporate Affairs, shows that most of them are making massive and consistent cash losses. Yet valuations are ever increasing. The argument that scale will ultimately bring desired profits does not seem a strong one, looking at profitability of Amazon after decades of existence.

Clearly, these e-retailers, unlike traditional retailers, prioritise valuation over profits. While for a "brick and mortar" company, these two factors should have a strong positive correlation; the game seems to be different for e-retailers.

The tactics for higher valuation is simple – get more and more customers to buy from the website – more the customers more is the valuation. The way to do it is massive variety (Amazon offers 30 times more variety than Wal-Mart) and massive discounts. As customers, we would have no complains at all. But what about the brand companies supplying to these firms?

Brand companies feel it is important to be there in the e-retailer channel or suffer from market share loss, as more and more customers are moving on-line to buy across different consumer goods category. But Brand companies have to offer massive discounts to stay relevant in this channel. With high discounts on one channel and normal prices in the traditional wholesale channel, channel conflicts are inevitable. Recently Samsung faced a rebellion from all its traditional dealers. Hundreds of Samsung dealers across the country have threatened to boycott the company's products over pricing concerns. The dealers said that they would stop stocking Samsung phones unless the South Korean tech giant takes steps to narrow the wide gap in pricing between its phones sold at various physical outlets and on e-commerce sites.

On one hand brand companies want to be present in the e-retail channel to retain market share but on the other hand, this action may ultimately destroy the traditional channel where brand companies have significant volumes sold with good prices. It is like being caught between the rock and the hard place.

One can have two arguments against the proposed threat of e-retailers.

- The size of e-retail market for any consumer product category is too small to even worry.
- If modern retail could not create a significant dent in traditional channel in India, why should we be worried about the e-retail challenge

With pressures of profitability, modern retail in India has not been expanding at a pace where it can be a threat to the traditional channel in a big way, other than few urban market hubs. Even after a decade of birth of modern retail in India, vast percentage of sales of every brand company (80% to 90%) comes from traditional channel rather than modern retail. This is because entire modern retail industry is struggling to make profits and this is coming in the way of expanding rapidly. However e-retail has the potential to disrupt the traditional channel because on one hand they seem to be having a different business objective – need of meeting valuation numbers over profits and on the other hand they have two major advantages.

Range Amplification: E-retailer can carry a massive variety and reach out to customers, with much less inventory carrying costs than the traditional or the modern retailer.

Reach Amplification: With Internet connections increasing at an exponential pace, a good enough logistics support will provide reach much faster and cheaper for an e-retailer company.

Brands, these days, are working with two different types of competing organizations – one willing to make losses to gain valuation (e-commerce) while the other wanting to run as a normal economic enterprise with profits as the prime motive (brick and mortar retail).
The combined effect is a real threat to the traditional channel. We can make the typical Darwinian argument of survival of the fitter enterprise; But one should not forget that we are clearly looking at two different types of competing organizations– one willing to make losses to gain valuation while the other wanting to run as a normal economic enterprise with profits as the prime motive.

If companies do not react to the threat, one may eventually see the traditional wholesale/distribution marginalized and the profitability of brand companies will take a huge hit when sales from multi-brand e-retailers overcome traditional channel sales. The rapid sales growth (much beyond industry average) of these e-retailer companies is clearly telling us that they have started eating into the share of traditional channels.

As traditional channels die out and e-retailers become mega buyers from the brand companies, the power equation will totally shift towards e-retailers. Selling to few large buyers (read e-retailers) as opposed to numerous small distributors will bring the brand companies under perennial margin pressures. The pressure can eventually get passed on the manufacturing sector of the country. The relentless pressure on margins can drive out manufacturing from the country to lower cost destinations. While there is need to look at rules of fair competition at an overall economic level, but brand companies have to take steps to protect themselves against this threat.

Way out for the brand companies

Instead of falling for the short-term lure of "buying" sales from the e-retailers by offering massive discounts, brand companies need to think long term to overcome the threat.

The traditional distributer channel with sales from a retail counter still has two major advantages over the e-retailers.

- Ability to look/feel the product before buying (other than books and music where there is no such advantage between two channels
- Get an instant delivery – rather than wait for days.

However, comparatively, they suffer from two major disadvantages

- Reach potential of e-retailers can be potentially higher than the retail footprint of a brand company
- Extent of variety visible to the end customer

If brand companies are able to nullify the disadvantages, they stand to beat the e-retailers. The two disadvantages can be overcome, by creating a distribution reach, where one is present in nearly every relevant retail outlet in the country with a good enough range.

Customers do not always stay in the house and browse the net; they also go out to office and run daily errands. If brand companies are able to place products wherever a customer is likely to be around, the reach objective is achieved. 7-Eleven stores in Japan have achieved this level of reach. The stores are available wherever the consumer is likely to be around. It is nearly impossible not to come across a 7-Eleven store, while one is doing his daily chores outside of his house, in many places in Japan.

Brand companies in India selling through multi-brand outlets should strive for this form of reach – to be there wherever a customer is likely to go! Current "mom and pop" store retail foot footprint set up by many small traders across the country has been done with the same objective – be present wherever a customer is likely to move around. So one can ride on this vast retail footprint available in the country. However the problem with this footprint is the long tail problem. Vast majority of retailers are small but cumulative they can give large volumes. Most brand companies typically neglect the tail, assuming it is inefficient to deal with this "tail". Brand companies depend on a wholesale network to deal with the long "tail "of small retailers. The wholesale network is not effective to ensure good reach and range availability for a brand company.

If brand companies make it efficient to even serve the tail directly through distributers without resorting to wholesalers in the channel, the game of reach can be won easily.

This calls for a different distribution strategy than what most companies do – forecast and push. Forecast and push locks a significant amount of working capital in inventory at the distributor. This limits their ability of distributors to service many retail outlets and forces them to limit range, which is considerably lower than that of the supplying company. The range at the retailer is even smaller for the same reasons.

The objectives of range expansion at point of sale and reach depth (increase selling points) can be achieved, if one moves over to pull distribution at lower inventory. A pull distribution model can allow any distributer in almost any category of consumer product to operate with just 7 to 10 days inventory (the maximum distance between a distributer from nearest depot of brand company). This pull distribution will help release capital locked in inventory of few SKUs, which can be used to add many SKUs to its range and increase reach.

Bajaj Electricals Ltd, Appliances Business and Godrej & Boyce, Interio are using these principles to increase depth of distribution to many small retail points in the country, which was previously left to the mercy of wholesalers and few large dealers. Similarly, Fleetguard Filters (part of the Cummins group) has been able to remove all wholesalers in the channel and is directly servicing about 60,000 auto retail points for spare parts, using a distributor model. It is perhaps the only auto spare parts company to have achieved status of zero wholesaling in the network, a benchmark which even the best of FMCG companies have been unable to achieve in India.

Once a company gets the desired reach coupled with very good availability at many geographical points in the country – it can beat the e-retailer at its own game.

While e-retailers try to move towards faster deliveries to counter the challenge of physical retailers, they will open multiple local warehouses. They will lose out on aggregation benefits of a large central warehouses. If they follow the traditional techniques of forecast or reorder point systems to move inventory between locations, they will be afflicted with the same mismatched high inventory woes as a traditional network, leading to delivery unreliability.

Despite having a large physical reach in the country, brand companies need to also cater to community who would prefer to buy from the net. They can have their own dedicated e-stores. The capability built to have very high availability in its many stocking points (warehouses and distributors) across the country, the brand e-stores can offer same day delivery with unmatched reliability – a feat very difficult to copy. The e-store will allow the brand company to show even a larger variety (as with the distributer) than the nearest local retailer.

With this combination strategy (of dedicated e-store and traditional distribution) brand companies can then decide to be present in the multi-brand e-retailers, with their own terms – without resorting to discounting (i.e. same price as that of its retailers).

With reach and range same as that of the e-retailers, they can retain the brand strength by selling on advantage of the features in own channels, rather than just using price as a selling tool and commoditizing the brand in the multi-brand e-channel.