e-tail eats into retail
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Online retail heat altering brick & mortar models

In the last five years, online retail -- both direct and through marketplaces -- has had a helluva ride, going from nascence to critical mass. So much so, today it has started to threaten the traditional brick-and-mortar retail. Recognising the danger, many physical retailers have started to establish or beef up their online presence. CRISIL Research believes some of them, who play to their strengths of physical reach and multi-location presence, will be able to build successful and, more importantly, complementary, business models – just as it happened in the US.

WHAT CONSTITUTES ONLINE RETAIL?
CRISIL Research’s definition includes standalone online retailers and marketplaces, but excludes segments such as online ticketing and online deals, which do not compete directly with traditional brick-and-mortar retailers. For details on various segments within India’s e-commerce industry, please refer to the annexure at the end of this report.

Becoming bigger by the day

Online retail market size and growth

Rs Billion

Source: CRISIL Research
India’s online retail industry has grown at a swift pace in the last 5 years from around Rs 15 billion revenues in 2007-08 to Rs 139 billion in 2012-13, translating into a compounded annual growth rate (CAGR) of over 56 per cent. The 9-fold growth came on the back of increasing internet penetration and changing lifestyles, and was primarily driven by books, electronics and apparel.

CRISIL Research expects the buoyant trend to sustain in the medium term, and estimates the market will grow at a healthy 50-55 per cent CAGR to Rs 504 billion by 2015-16. The entry of new players in niche segments such as grocery, jewellery and furniture, along with large investments by existing players in the apparel and electronics verticals, will be the drivers.

In terms of size, India’s online retail industry is very small compared with both organised and overall (organised + unorganised) retail in the country. This speaks volumes of its potential. We expect the industry’s revenues to more than double to around 18 per cent of organised retail by 2016 from around 8 per cent in 2013. Yet, its share of the overall retail (organised + unorganised) pie will be just over 1 per cent. That compares with 9-10% in the US and UK, and around 4-5% in China.

THE COMPARATIVE PICTURE (2012-13)

Source: CRISIL Research

Impact on business of traditional retailers evident

Over the past 4-5 years, competition from online retailers such as Flipkart (in books, music and electronics), Myntra and Jabong (in apparel) has eaten into the revenues of physical retailers. Specifically, competition in the last three years has been intense compelling many to go online even as their net store additions slowed.
Net store additions for traditional retailers

Note: Number of stores includes the Shoppers Stop Department stores and Speciality Stores (viz Home Stop, Mothercare, Crossword Bookstores, Arcelia, Mac, Clinique, Estee Lauder & Airport Business). It also includes stores of Trent and the ones operated by JV Inditex Trent Retail India Private Limited.

Source: Company reports, CRISIL Research

Impact maximum in books, music & electronics segment

The impact of online retail is most evident in segments where the product specifications are standard and differentiation low, such as books, music and electronics. Unable to match the huge discounts offered by online retailers, traditional booksellers and music stores are either shuttering outlets or folding up. For example, PlanetM, a part of Videocon-owned Next Retail, has been closing stores since 2012. Between 2011 and 2013, it shut over 100. As of March 2013, it had 85 open. As a part of this restructuring, PlanetM has adopted a kiosk-based model for expansion which saves lease rentals.

Even in segments such as apparel, e-commerce companies have become extremely aggressive offering discounts throughout the year, and conducting shopping festivals repeatedly to play the volume game. This is difficult for a physical retailer because of the added costs of lease rentals and higher inventory. If that were not enough, the exponential growth of online retailers has got them the attention of venture capitalists and private equity players, affording relatively easier access to capital.

Online retailing shadow over physical retailer financials

The rapid growth of online retail is, in a sense, reflected in the deteriorating financials of physical retailers over the past 3 years. At an aggregate level, operating and net margins of companies such as Shoppers Stop, Cantabil, Kewal Kiran, Provogue, and Trent have all shown a declining trend. Even operating
parameters such as same-store sales growth, conversion ratio and sales per square feet have been on a decline. For example, in the case of Shoppers Stop, sales per square feet have declined from Rs 8,518 in 2010-11 to Rs 7,837 in 2012-13, while the conversion ratio has come down from 24 per cent to 22 per cent over the same period.

Financial performance of traditional retailers

<table>
<thead>
<tr>
<th>Units</th>
<th>Mar-11</th>
<th>Mar-12</th>
<th>Mar-13</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating income Rs million</td>
<td>49,325</td>
<td>59,767</td>
<td>66,036</td>
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<tr>
<td>Growth Per cent</td>
<td>-</td>
<td>21.2</td>
<td>10.5</td>
</tr>
<tr>
<td>Operating profits Rs million</td>
<td>3,027</td>
<td>1,603</td>
<td>2,001</td>
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<tr>
<td>Operating margins Per cent</td>
<td>6.1</td>
<td>2.7</td>
<td>3.0</td>
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<tr>
<td>Net profits Rs million</td>
<td>92.7</td>
<td>(290.4)</td>
<td>(523.8)</td>
</tr>
<tr>
<td>Net margins Per cent</td>
<td>0.2</td>
<td>(0.5)</td>
<td>(0.8)</td>
</tr>
<tr>
<td>RoCE Per cent</td>
<td>7.1</td>
<td>4.7</td>
<td>4.8</td>
</tr>
<tr>
<td>Gearing Times</td>
<td>0.7</td>
<td>0.5</td>
<td>0.6</td>
</tr>
<tr>
<td>Net cash accruals to debt Times</td>
<td>0.05</td>
<td>0.04</td>
<td>0.02</td>
</tr>
<tr>
<td>Interest coverage Times</td>
<td>2.3</td>
<td>2.6</td>
<td>2.3</td>
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<tr>
<td>Current ratio Times</td>
<td>1.7</td>
<td>1.4</td>
<td>1.4</td>
</tr>
</tbody>
</table>

Note: Companies included in aggregate are Cantabil, Provogue, Kewal Kiran, Trent, and Shoppers Stop
Source: Company reports, CRISIL Research

To be sure, the surge in online retailing is not the only reason for the weak performance of traditional retailers. There are other factors such as economic slowdown and local competition, but what’s irrefutable is that the online upstarts are chomping away business.

Traditional retailers being forced to move online

To stay in the game, traditional retailers have been working on their internet strategy. For instance, Shoppers Stop, which started its online store in 2008, has boosted presence and improved features and user interface to bring its online visage on a par with leading e-commerce websites. The company is also trying to leverage its physical network by giving customers the option to return products at its stores. Apart from Shoppers Stop, Croma has an online store with options such as store pickup and cash on delivery. Even manufacturers of retail products such as Titan Industries (watches, jewellery, eyewear, etc) and Aditya Birla Nuvo (apparel - Allen Solly, Louis Philippe, Peter England, etc) have set up beachheads in cyberspace. Going ahead, we believe more and more traditional retailers will board the online bandwagon.

Ample proof traditional retailers can compete well online

What we are witnessing in India today played out in the US about a decade-and-a-half back. That was when today’s big daddies such as eBay and Amazon debuted. In the next 4-5 years, by the turn of the century, they had become big enough to pose a threat to traditional retailers such as Wal-Mart, forcing them to come up with online strategies of their own. Today, after nearly a decade since the seismic shift began, some traditional retailers boast of a large online presence.
Similarly, physical retailers in India will have to establish their presence online quickly. And, with the right strategies, they can even compete effectively. For instance, to tackle the queue problem at its stores, Wal-Mart allows customers to shop online and opt for either home delivery or store pick-up. Today, Wal-Mart is among the top 5 online retailers in the US with estimated revenues of USD 10 billion in 2013 from the online segment alone. There are other examples as well, such as BestBuy and Toys“R”Us, which have developed a significant online presence over the past decade and are now among the top online retailers in the US.
CRISIL Research defines e-commerce companies as those in the primary business of providing web platform(s) and website(s) through which individuals, using a computer or smartphone, can purchase a product or service. The definition excludes classifieds and information portals, online transactions between businesses, and websites offering online financial services.

For the purpose of this article, our definition includes retailing of products through both online and the marketplace business models. We have excluded online ticketing and online deals, which do not compete directly with the traditional brick-and-mortar retail.

(Please note that the views expressed here are those of CRISIL Research and not of CRISIL’s ratings division. CRISIL Research operates independently of, and does not have access to, information obtained by CRISIL Ratings)

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