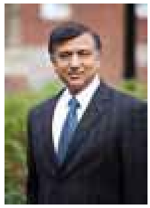
E-COMMERCE IN ASIA: CHALLENGES AND OPPORTUNITIES

By Sunil Gupta and Tanya Bijlani



Asia is a large and rapidly growing region with a rising middle class, accelerating internet access and a staggering penetration of mobile phones. As north Ameri- can and European markets mature, Asia is becoming increasingly attractive to businesses, especially to e-commerce firms that thrive on global and scalable business models. Yet, barring markets like Japan, most global e-commerce players like Amazon, eBay and Expedia have yet to find in Asia the kind of success that they have enjoyed in their home markets. While late entry and local regulations partly explain their low market share in the region, these firms also face unique challenges in Asia due to diverse cultures, multiple languages and poor infrastructure. And it's not only the big guns that are struggling to get a handle on Asia: local entrepreneurs who clone global e-commerce firms are facing similar challenges, and some have turned these into opportunities by innovating in unusual ways. So the real question is this: can e-commerce firms be profitable in emerging Asian markets, and what are the critical factors that determine their success?

Challenges and opportunities

There are five key challenges that e-commerce firms are encountering in emerging Asian markets. however, many of these same challenges, are also providing scope for innovation, thus driving the market forward.

1. Logistics: logistics is a key element in providing essential customer service, but remains a major challenge for all e-commerce players. As most emerging Asian markets are large and fragmented with poor logistics infrastructure, local logistics firms have only partial coverage in large countries like india and china and are generally viewed as unreliable.

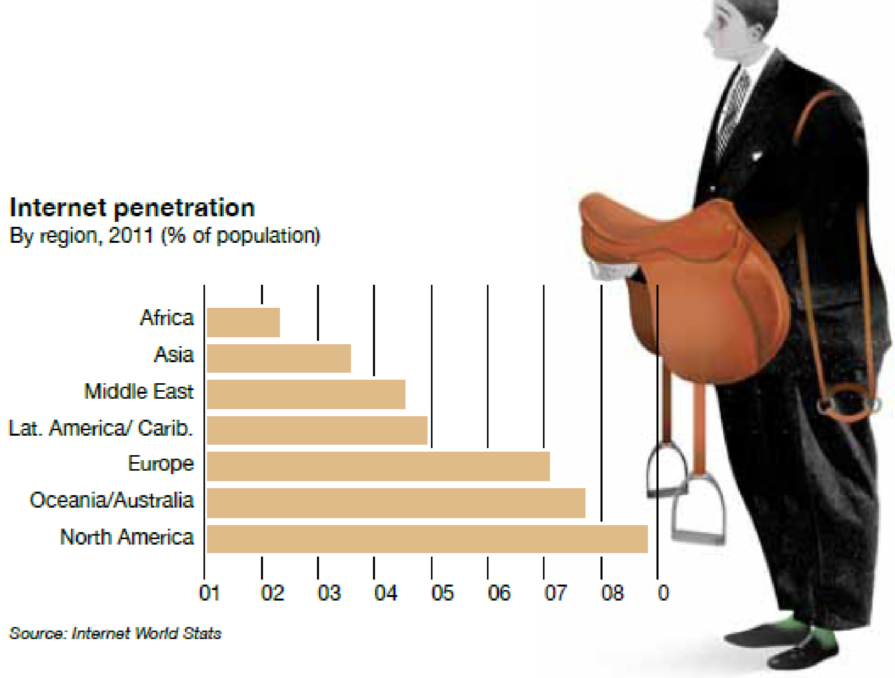
This has forced e-commerce firms to build their own logistics systems at enormous cost and time outlay. china's Alibaba, which owns taobao, china's largest consumer e-commerce firm, has invested in local logistics and delivery businesses. It announced in 2011 that it planned to invest $4.6 billion over five years to build a network of warehouses across the country. 360buy, china's second largest online retailer, established its

own express delivery operation in 2009 to offer same or next-day deliveries to its customers. Flipkart started an Amazon-like service in India, but soon realized that it would have to build its own logistics infrastructure in the country in order to survive.

Building these logistics systems from scratch involves enormous time and cost investment. Additionally, it has three important implications: first, it has a substantial impact on profits; second, it provides significant competitive advantage against new local and global entrants; third, it opens up a new business opportunity for these players by allowing competitors to use their delivery networks for a fee, much like Amazon encourages small firms to use its marketplace or cloud computing services. In Russia, for instance, more than 60 e-commerce firms already use online retailer Ozon.ru's 97-city strong courier network. In December 2010, Flipkart piloted a similar system in India, called Flipkart Logistics.

2. Digital Infrastructure: While logistics play a major role in establishing and sustaining e-commerce in emerging Asian markets, the challenge is not limited to physical infrastructure alone. Although Internet penetration in Asia is rapidly increasing, except for a few countries such as Malaysia and Singapore, less than a third of the population in most emerging Asian countries have internet access. Yet, this challenge is also being met: to counter low internet penetration in India, Redbus, a bus-ticketing site, offers an additional platform through which thousands of small travel agents across the country can book tickets for passengers. In Vietnam, where most consumers do not have printers, NhomMua, a Vietnamese Groupon-style discount site has a team of couriers with motorbikes, who deliver vouchers to customers in Hanoi and Ho Chi Minh City.

However, linking businesses to create centralized systems for e-commerce can bring its own challenges. When online travel services such as Cleartrip started in India, they soon discovered that many smaller airlines in the region were not part of the Global Distribu-

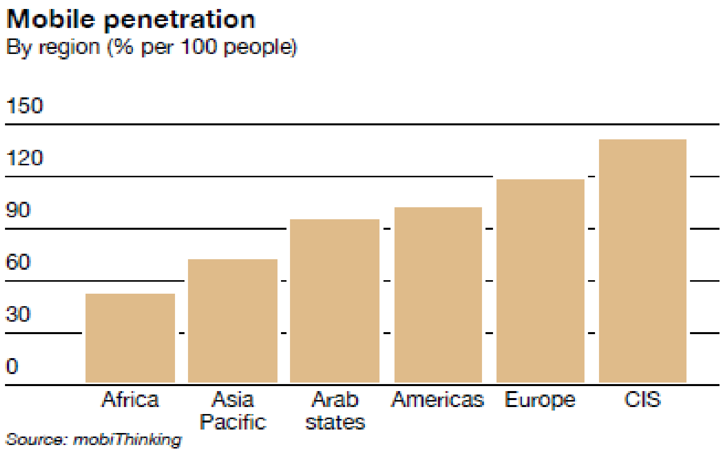


tion System (GDS) – a computerized reservation network used as a single point of access for reserving airline tickets worldwide. They undertook a long and laborious process of building software to link these smaller carriers to GDS so that their customers could access the inventories of all airlines.

BookMyShow, which started in India as a clone of Ticketmaster, also encountered a similar difficulty. The company wanted to provide Indian consumers with the ability to book movie tickets online; however, virtually none of the movie theatres in India had a computerized reservation system that could be linked to a centralized database. BookMyShow had to build a GDS-like system for movie theatres from scratch. It took several years of building software and convincing local theatres to allow access to their inventory before BookMyShow could sell its first ticket online. Today, having built this system, the company enjoys enormous competitive advantage in India, making it difficult for global players like Ticketmaster to gain traction in the market.

3. Payment: Many emerging markets in Asia continue to be cash-based societies due to limited banking and credit card penetration, and in certain cases, the existence of parallel cash economies. This, combined with a lack of consumer trust in online merchants, has prompted several leading e-commerce firms such as Flipkart in India, 360buy and Taobao Mall (Tmall) in China, and Rakuten in Indonesia, to offer cash collection on delivery (COD).

While COD solves these challenges, it imposes significant financial cost for firms in the form of labor, cash handling, and higher returns of purchased items. As a result, new payment gateways, such as Cherry Credits in Singapore, GudangVoucher in Indonesia, and Gash Plus in Taiwan, allow young consumers to buy pre-paid cards at retail outlets that can later be used to purchase online games. Such pre-paid cards are expanding in scope to include online payment for other online goods and services, thereby reducing the need



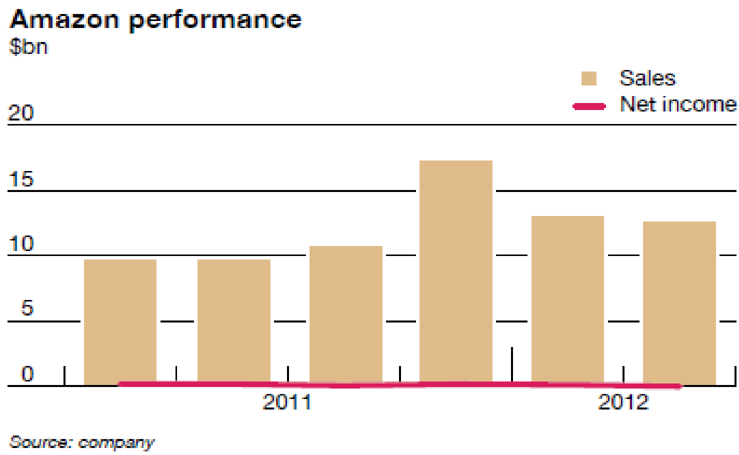
for COD. Similarly, to counter a lack of trust, payment gateways, such as China's Alipay, owned by the Alibaba Group, also provide escrow services that release payments to merchants only after customers confirm that they are satisfied with a purchase.

Another promising platform for payment is the mobile phone, due to high mobile phone penetration and poor banking infrastructure in parts of Asia. Using the innovative model of Kenya-based M-Pesa, Indian start up Eko enables migrant workers to open bank accounts and remit money via their mobile phones. These systems have the potential to expand to payment of goods and services bought at retail or online stores.

4. Cultural Differences: In June 2012, after four years of operation in India, Expedia announced plans to open physical retail stores across the country, thereby starting an offline business for the first time. Poor broadband penetration and challenges with online payments only partly explain this capital-intensive move. The experience of Indian online travel agents such as Yatra and MakeMyTrip shows that Indian consumers may be comfortable with online searches for travel, but they still want to talk to someone in person to discuss the details of their travel plans, and especially vacation packages, before booking their tickets. As a result both Yatra and MakeMyTrip decided to invest in offline stores a few years ago.

Indian matrimonial site Shaadi.com had a similar experience. Consumers lacked confidence in their ability to use the site effectively, and were looking for the human touch. As a result, the company opened over 70 "Shaadi Centers" that are staffed with "relationship advisors" who recommend potential profiles to families and help them find suitable matches.

On the whole, it appears that safety and security are generally greater causes for concern in Asia than in the West. While it is commonplace for FedEx to leave an Amazon package at a doorstep in the United States, a package similarly left unattended in most Asian countries would most likely disappear. Procedures therefore need to be put into place to resolve such problems.



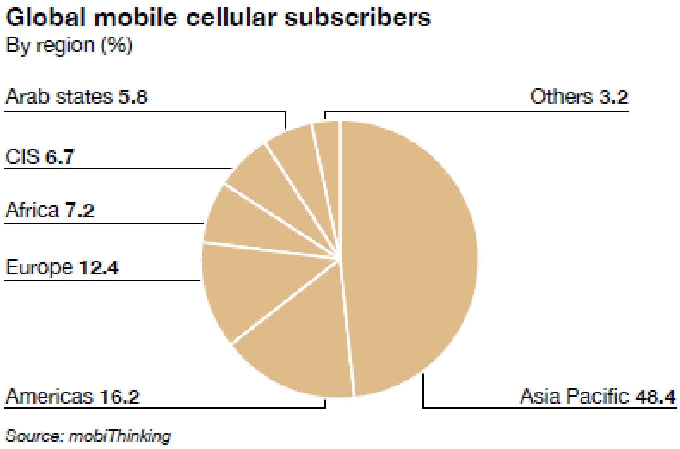
While COD solves both the concerns of payment and theft, it often involves several trips by the delivery person, thereby increasing costs substantially. Some e-commerce players such as Rakuten in Indonesia therefore allow customers to collect their packages at convenience stores across the city. Interestingly, Amazon recently announced that it would install delivery lockers in several grocery, drug and convenience stores to provide a similar service in the United States.

5. Price Sensitive Consumers: Even though average incomes in Asia are rising and the middle-income group is growing, the per capita income of most consumers in emerging Asian markets remains less than a tenth of those in developed countries like the United States and Singapore. Low incomes and a mindset of “every penny counts” make Asians among the most price sensitive consumers in the world. This mentality has been compounded by e-commerce offers price-sensitive shoppers the ease of being able to compare prices online.

Online retailers in Asia face price pressure not only from competing websites, but also from offline mom-and-pop stores. The latter run such highly efficient and low cost operations that even powerful corporate houses like India’s Reliance Group have found it challenging to make inroads in the local retail industry. To compete with local merchants, Indian e-commerce firms like Flipkart and Yebhi offer free shipping and flexible return policies in the hope of making their online services more palatable to the price conscious consumer base they wish to attract.

Profit potential

Despite the challenges, the promise of a rapidly growing market and potentially large valuations has given rise to scores of new venture-funded e-commerce players in Asia. But



what is the profit potential of such firms? Do startups like Flipkart deserve valuations as high as a billion dollars?

Retail in general and e-commerce in particular are thin-margin businesses. In 2011, even after 17 years of operation in the US, Amazon had a meager profit of $631 million from sales of over $48 billion – or an operating margin of less than 1.5 per cent. By the second quarter of 2012, its profit was down to $7 million as the company continues to invest in new products and logistics. Considering that 9-12 per cent of Amazon's annual revenue comes from its marketplace where it takes a cut of 6-15 per cent of revenue from third party retailers, the lack of profitability in Amazon's own e-commerce business looks even more startling.

E-commerce firms in emerging Asian markets are likely to have even thinner margins. They need to: invest heavily in logistics and infrastructure that substantially increases their fixed costs; overcome payment problems; build offline presence to earn consumer trust; manage highly price sensitive consumers; face both local and global competition; and compete against a highly efficient offline retail sector. It is therefore not surprising that Flipkart's founders had trouble convincing General Atlantic Partners to invest $150-200 million in their business despite their projected 2012 sales of nearly $500 million, a 400% year-over-year growth. Even Rocket Internet, known for successfully cloning US Internet companies, decided to shut down its Indian fashion shoe site Zalora, a Zappos-clone, after six months of operations. So while e-commerce firms in Asia seem to be engaged in a land grab, they are bound to face significant operational and financial challenges and only the most disciplined and efficient are likely to survive in the long run. ■

Sunil Gupta is the Edward W. Carter Professor of Business Administration and Head of the Marketing Department at Harvard Business School. Tanya Bijlani is from Mumbai, India and is currently a reseach associate at Harvard Business School.