Policy Recommendations (I)
on Customer Centric E-commerce in India


# Foreign Direct Investments (FDI) for E-commerce

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## Executive Summary

The retail sector opened for foreign investment in 1997 with wholesale cash-and-carry with government approvals, and then saw the emergence of local and foreign backed e-commerce companies emerge during 2000s, experiencing massive growth during the decade. The policies around FDI in e-commerce and retail sector have gone through several changes over the last two decades with new changes surfacing every few years from different government entities. Some of the policies aim to protect the large number of small retailers in India and often seem restrictive in nature.

This report studies the retail and in particular, the electronic commerce landscape in India, by exploring the various factors that drive the customer to make purchase decisions like choice, convenience, price and quality. The report analyses the current policies in the e-commerce sector and provide recommendations around improving the same.

The Bharti Institute of Public Policy (BIPP), Indian School of Business (ISB) is working on this domain and have conducted a couple of roundtable discussions to confer on these policies with experts, government officials, sellers, e-commerce companies, etc. Based on the research and discussions, policy recommendations have been made in four broad areas:

**Policy Simplification and Clarity:** Recommends the government comes up with simple policies on broad norms for foreign companies or receiving foreign investments in India and do not interfere in minute aspects of the e-commerce business. A single ministry or government body should make FDI related decisions and its business implications in consultation with other ministries or government bodies. The government may further provide some easy understanding of the policies to avoid interpretation challenges.

**Online-Offline Parity:** Common norms can be set by the government for conducting retail business in India, irrespective of the mode of transaction, i.e., online or offline. Matters related to the conduct of business, like discounts, procurement of goods, etc. should also be similar across different modes.

**Small Indian Retailers:** Large number of policy decisions are made to protect the small Indian retailers who are primarily operating through traditional offline methods. Capacity building of the smaller retailers and sellers in digital technologies to function their store operations, distributor management, product marketing along with onboarding an e-commerce platform will make them at par with mainstream retailers and help them take advantage of the digital economy.

**Alternative Platforms:** Government may explore alternate e-commerce platforms with similar norms for conducting business which would increase competition and benefit both small sellers and end customers. Open Network Digital Commerce (ONDC) and Government e Marketplace (GeM) are proposed as those alternatives.

# Introduction

Retail sector has its own prominence in a populous country like India that has a population of close to 1.4 billion people, who require various products and services for their life needs, varying from must-have daily essentials to nice-to-have luxury products. The Oxford English dictionary defines retail as "the sale of goods to the public in relatively small quantities for use or consumption rather than for resale". India's socio-economic diversity and varying infrastructure facilities require a variety of models to fulfill the country's retail needs, which range from kirana shops (small mom-and-pop stores) to supermarkets to online retail like e-commerce. The huge retail market opportunity lures individuals, small Indian enterprises, large Indian enterprises and even foreign players to this ecosystem.

With the advent of internet, we saw innovations in retail/commerce through online medium started in India in the late 1990s to start with business only transactions and further expanding to other businesses like online travel (MakeMyTrip 2000; Cleartrip 2006), online shopping (Fabmart 2001; Flipkart 2007), etc. in the new millennium. In 2012, Amazon, an established player in the USA market entered the Indian e-commerce ecosystem through Junglee.com and later established itself as an independent entity in India.

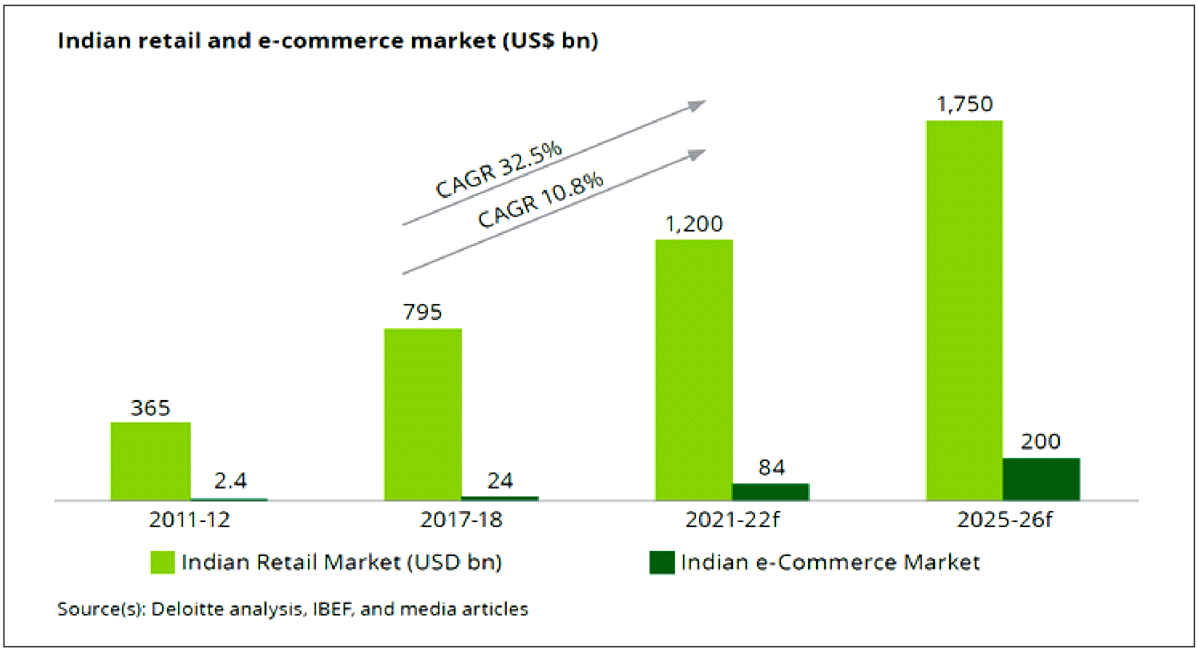


**Figure 1 : Indian Retail Market Growth (Source: Retail FDI in India, 2020 by Deloitte)**

The vibrancy of the Indian retail sector is evident from the phenomenal growth as seen in the analysis done by Deloitte[1] and India Brand Equity Foundation (IBEF). It is interesting to note that the complete retail sector has seen a Compounded Annual Growth Rate (CAGR) of 10.8% whereas a small section of the same, i.e., e-commerce has experienced a growth of over 30%. Now, let us explore the factors which are driving the growth in this sector in India.

[1] Deloitte Retail FDI in India, Jan 2020; Retrieved from: https://www2.deloitte.com/content/dam/Deloitte/in/Documents/consumer-business/in-conumser-retail-trade-pov-noexp.pdf

India's strong economic growth, supplemented by higher per capita earning of its citizens, has led to increase in disposable income of the citizens. The Ministry of Statistics (MOSPI), Government of India, carries our consumer expenditure surveys which forms the basis of such analysis. The analysis done by Deloitte[2] based on the data from MOSPI and NITI Aayog shows an increase in disposable income from 29% in 2007-08 to 35% in 2015-16, which is expected to further increase to 45% in 2025-26.

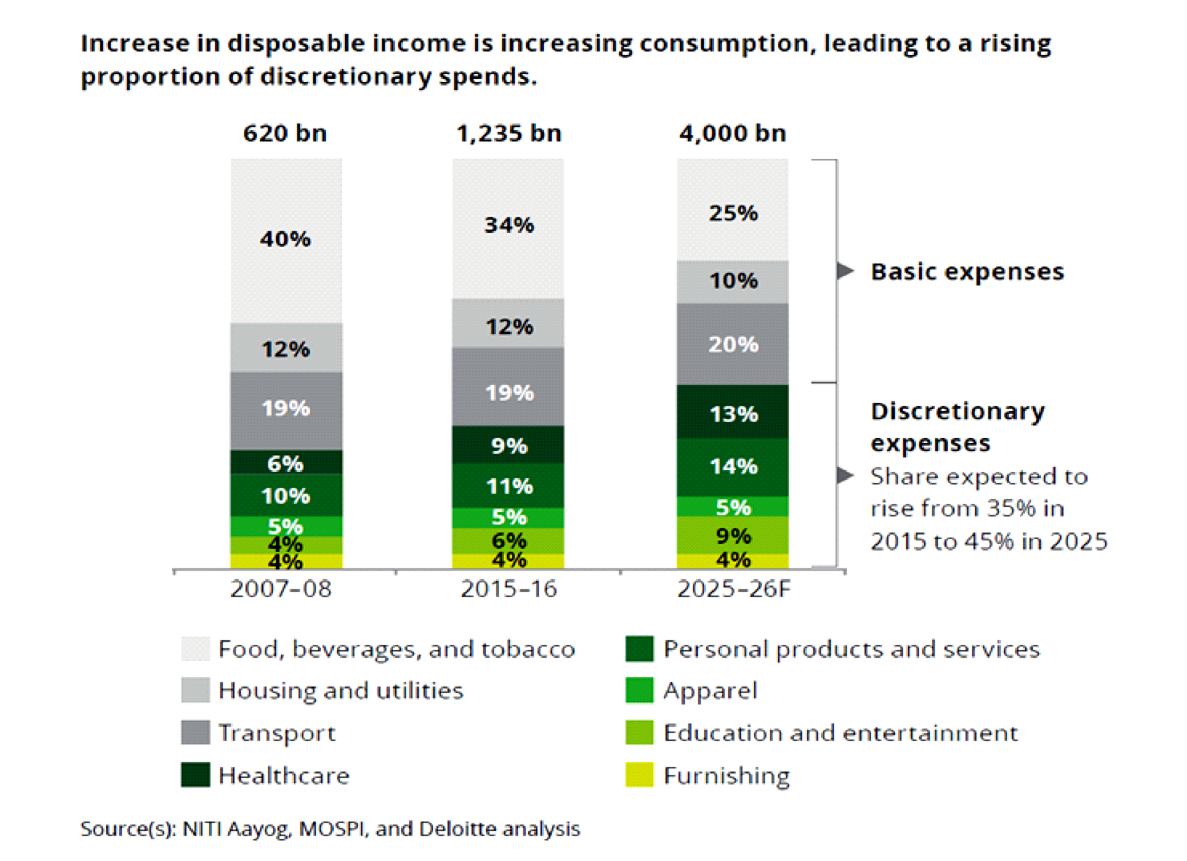


**Figure 2 : Consumption Patterns (Source: Retail FDI in India, 2020 by Deloitte)**

Internet penetration and smartphone usage has increased significantly over the years. The chart below based on research[3] by KANTAR-AIMAI shows the number of Active Internet Users (AIU) in Millions across urban and rural India along with the percentage of internet penetration. This has enabled more Indians to access online retail through mobile applications or websites.

[2] Retail FDI in India, Jan 2020 by Deloitte; Retrieved from: https://www2.deloitte.com/content/dam/Deloitte/in/Documents/consumer-business/in-conumser-retail-trade-pov-noexp.pdf

[3] Internet Adoption in India, June 2021 by KANTAR

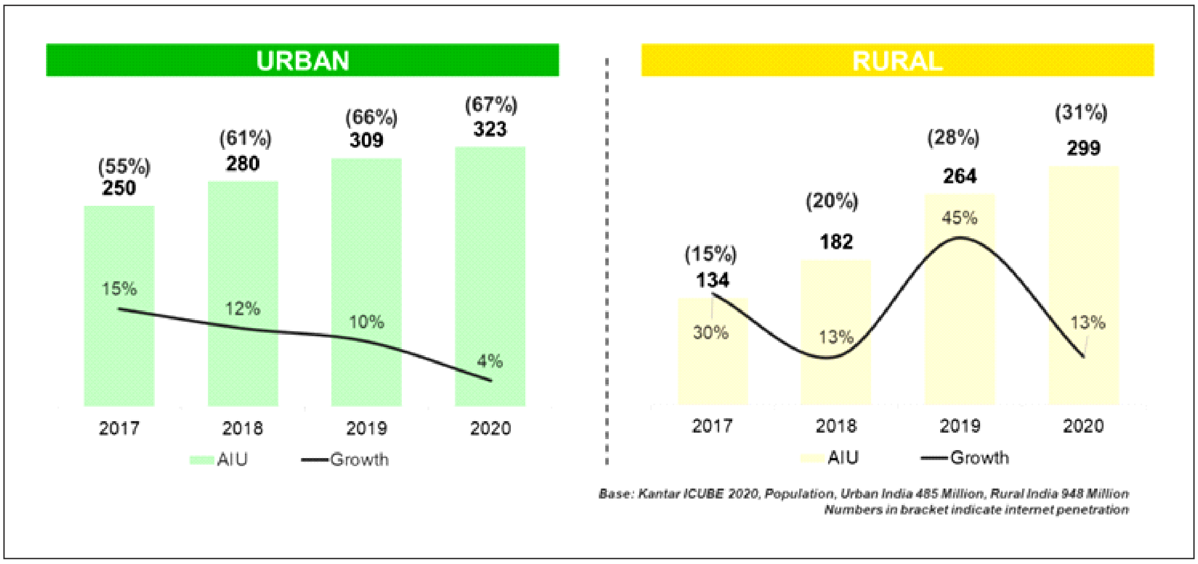


**Figure 3 : Urban & Rural Internet Growth 2017 – 2020 (Source: Internet Adoption in India by KANTAR)**

Rise in internet connections is one of the key factors driving growth in India's Digital Economy. The other two factors are: Jan Dhan bank accounts and Aadhar unique identification number which together creates the popular JAM Trinity (Jan Dhan Aadhar and Mobile). The JAM trinity has enabled online digital transactions for large number of Indians where were previously not connected to formal banking channels. Other factors driving the retail growth are diverse choices for customers, combined with convenience provided by technology advancement and retail channel options. Constant flow of Foreign Direct Investments (FDI) to India in the physical retail sector (single brand retail, multi brand retail, supermarket, etc.) and in the online e-commerce industry, has been a strong enabler of this growth. These investments have led to the development of physical stores, warehouse infrastructure and strong technology development for e-commerce.

The ongoing Covid-19 pandemic has proved to be another strong factor driving the adoption of online e-commerce in India as several physical retail outlets were closed for months. The pandemic saw an increase in the use of technology by first-time users driving the rise in e-commerce sales[4]. The increase in first-time online users was observed in tier II and tier III cities of India. This was a good opportunity for several start-ups to innovate in this space and small merchants across cities to adopt the digital platforms to drive sales and customer requests.

The rapidly changing nature of retail businesses in India implies that the policies related to funding, conducting business, relationship with customers, cut across multiple ministries in the Government of India. The interdisciplinarity of the e-commerce arises due to multiple reasons like – international companies invest in e-commerce companies in India which come under the purview of Foreign Direct Investment (FDI) for businesses managed by

[4] RedSeer NewsLetters, 'How did COVID-19 impact India Internet and what's the way forward' June 2020 Retrieved from:
https://redseer.com/newsletters/how-did-covid-19-impact-india-internet-and-whats-the-way-forward/

the Department of Industrial Policy & Promotion (DPIIT), that also determines the norms for running e-commerce business in India. There are multiple e-commerce players in India, so the Competition Commission of India (CCI) ensures fair business competition and deters any monopolistic behavior. The e-commerce ecosystem should aim at better choices and options for the customers, which is the responsibility of the Ministry of Consumer Affairs, which comes out with the Consumer Protection Act. These e-commerce platforms function as digital marketplace which come under the purview of the Information Technology Act and these platforms also generate huge volumes of data which should not be misused, as per the draft Personal Data Protection (PDP) Bill – both these come under the purview of Ministry of Electronics and Information Technology (MEITY). The aspects related to taxation of digital transactions is dealt by the Ministry of Finance. This aspect of interdisciplinarity in conducting business is not limited to retail sector only, several other sectors face similar challenges and multiple ministries should collaborate to deal with similar scenarios.

Given the interdisciplinary nature of retail and e-commerce, the sector requires clear direction and policy recommendations that considers the interests of the customers, retailers, technology platforms and small traders in the ecosystem. The Bharti Institute of Public Policy (BIPP), Indian School of Business (ISB) is working on policy recommendations for the retail and e-commerce sector in India. The research involves various aspects of the retail and e-commerce ecosystem in India starting with the norms for Foreign Direct Investment (current report) and would be followed by reports on other aspects like business models for retail; data ownership in e-commerce; algorithmic bias impacting the product search ranking; tackling the issue of counterfeit products and support for small sellers and retailers.

Towards the policy recommendations for Foreign Direct Investments (FDI), closed-door roundtable discussions and one-on-one interactions were conducted over the last few months with representatives from government, multinational technology companies, industry bodies, government, research institutions, trader associations, citizens and law firms. The authors of this report would like to thank the participants of those workshops for their time and valuable comments.

# Customer Centric Retail

Our policy recommendations are towards a customer-centric retail and e-commerce ecosystem in India. Customers like to have a **choice** of options during the purchase process that they can purchase at their own **convenience** at the best possible **price** ensuring product **quality**. Here we focus on elaborating upon these core elements that drive customer-centric retail.

## Choice

Consumers are always attracted to the idea of choice as they have more influence over what they buy, given a larger number of options. Consumers also value the promise of choice: the more possibilities available, the more likely they are to find something that is ideal for them. In other words, they believe that having more choices provides them with more power and satisfaction.

In early days, consumers used to visit the local kirana stores and buy essentials that were available at the store. Later, with the arrival of department stores and supermarkets, consumers were exposed to a wider variety of product choices. The supermarket has multiple products on display that the customer can discover, experience and choose, which contrasts with traditional kirana stores where very few items are on display and other items were provided upon request. Now with the advent of online e-commerce, the aspects of discovery and choices have increased several times for both domestic and international products.


**Figure 4: Retail Evolution (Source: T. Fishburne, 'Evolution of retail' [5])**

Consumers now expect to have choice in a market that offers a variety of products and services and choose in accordance with their lifestyle needs or conditions. They will consider a

[5] T. Fishburne, 'Evolution of retail' 22 February 2009, marketoonist.com, Available at: https://marketoonist.com/2009/02/evolution-of-retail.html

product or service as a best deal for them if its marketing demonstrates that it understands the unique needs or wants of a consumer as an individual and is offering a solution that is customized or tailored to their specific situation. This puts the consumer once again at the center of the purchasing experience. In today's time, with both in-store shopping and e-commerce options at hand, consumers are now more aware about the products and wisely research their options before buying anything. So, retailers are now focusing on providing consumers with customized solutions, ensuring quality and optimum prices.

Nowadays, important aspects of the purchase process for consumers are product comparison while shopping, availability of multiple brands at one stop and user-friendly services that ease the shopping processes e-commerce provides many of choices to the customers. Customer service after the product purchase plays a very important role. Managing customer queries, product replacement, tracking the movement of goods ordered and ensuring timely delivery in the online industry are important aspects in e-commerce business. Providing excellent customer service allows businesses to achieve elevated levels of customer satisfaction, thereby ensuring customer loyalty and positive outreach.

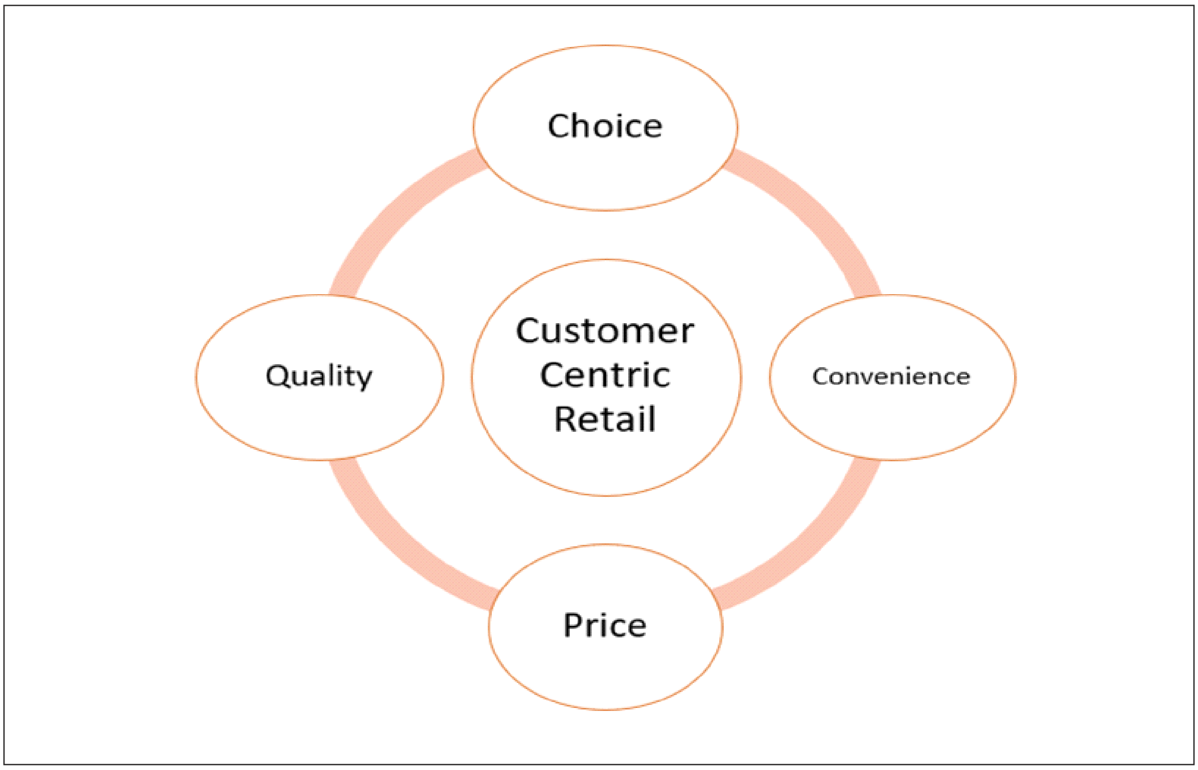


**Figure 5: Customer Centric Retail**

## Convenience

The retailing environment is evolving with technology and innovations. These innovations are driven by consumer demand and advancement in technology. Along with the retail industry, consumers too have undergone significant changes in their lifestyles, spending and shopping habits, along with usage of technology. From the perspective of a consumer, the ease of availing goods and services is a major deciding factor before buying. The idea of what constitutes convenience differs for every consumer depending on how they are shopping, what they are buying, or where they are in their purchase process and what they prefer personally.

For example, a supermarket offers the convenience of purchasing a variety of items under a single roof. A supermarket or a department store also allows the convenience to explore multiple leading brands without the hassle of travelling to multiple places. A store that is open all 24 hours provides the convenience of shopping at any time like the online e-commerce portals. With the advent of mobile applications, shopping online has now become an anytime activity with no bars with respect to location and time further increasing the convenience of the customers.

Especially during the pandemic, people wanted to shop ensuring safety and having the products delivered at their doorstep. Here, convenience of purchasing is incredibly significant. Convenience comes in many forms; it can be free or fast shipping, time flexibility, online buying with in-store pickup, local delivery, or location-based incentives etc. and it depends upon what consumers consider most convenient for them.

E-commerce delivery ecosystem constantly keeps updating to keep up with consumer needs, with the convenience to shop anytime, anywhere or on the move. Consumers now often enjoy product deliveries on the same day of order placement and delivery at the convenience of their place and time. Traceability of their ordered products in logistics is also a benefit that attracts consumers to online shopping. The ease of returns on the products which are not satisfactory is also one the most appealing aspects.

# Price

Customers like to purchase products from stores that offer the best prices. It is common for supermarkets in India and across the globe to provide lower prices than smaller retail sellers which is often possible due to the preferential rates they receive from suppliers or manufacturers due to bulk orders, or due to large warehouses which help in bringing down the storage costs.

With the emergence of e-commerce, the retail market has become more competitive as many of the consumers are purchasing products online due to more choice and better convenience. Thus, to attract and retain a loyal consumer base, retail businesses (both online and offline) provide numerous incentives like festive sales, discounts, coupons, cashback, credit points etc. to make products and services available to consumer at the best price. Among all the product choices being offered, it is important for the consumers to understand the differences between competing products, as to believe that they have a best deal. They choose the best approach to leverage their purchasing power to achieve maximum satisfaction at a reduced price. When customers are aware of the features, perks, guarantees, upgrades, and other aspects that give them advantages, they will regard products or services as best compared to others. E-commerce platforms using technology and dealing in bulk procurement can minimize several costs related to logistics, warehousing, etc. which are further passed on as benefits to the customers.

## Quality

The quality of a product or service can be defined based on consumers' satisfaction with it. A good quality product for a consumer comprises various characteristics such as, need fulfilment (whether the product or service quality meets the consumer's required needs or is tailored to their requirements); durability (how long the product will last); efficiency and the ease of use also matters the most.

Quality is often more important than price to many consumers and they frequently find quality aspects in brands. Consumers pay high prices for brands because they have gained a reputation for quality, consistency, and trust over time. In the era of choices, branding helps identify what makes a product different and more appealing than comparable products, as it provides safety and minimum risk of disappointment. A high-quality product inspires unwavering consumer loyalty which makes them return to make repeat purchases.

Quality of a product can be evaluated only after use of the product by some customer. This information about the feedback on the product is not available to a new customer during the time of purchase either in a small retail store or in a large supermarket – here the customer has to rely solely on the words of the seller or agents selling the product. In contrast, feedback on the quality and durability of a product by past customers are available in most e-commerce platforms through which new customers can easily read the feedback while making the purchase decisions. There are several standalone portals and user groups providing reviews or feedback on products which the user may research while making the purchase decisions, but an e-commerce platform offers transparency to the user by integrating the feedback and making them available to the customer at the point of decision making.

# The Retail Ecosystem

As a customer, one either visits a physical store to buy the product or orders the product online on an e-commerce platform which gets delivered at the doorstep and other players in the ecosystem are not visible to the customer. Before we delve into the recommendations of the retail ecosystem it will be good to have a common understanding of the various core components and players of the retail ecosystem.

## Manufacturer

A manufacturer is a person or a registered company which makes finished products from raw materials in a bid to make a profit[6]. The goods are later distributed to wholesalers and retailers who then sell to customers, but the manufacturer hardly interacts with the customer during the process. A manufacturing business optimizes the procurement of raw materials for manufacturing the product or parts for the assembly of the final product. The manufacturing business focuses on maintaining low production cost ensuring a good product quality. The manufacturer markets the product and has tie-ups with distributor networks for further sale of the product. Manufacturing or assembling products in India is the focus of India's "Make in India" program, which would reduce the import of goods, possibly bringing down the prices and providing delight to the end consumer.

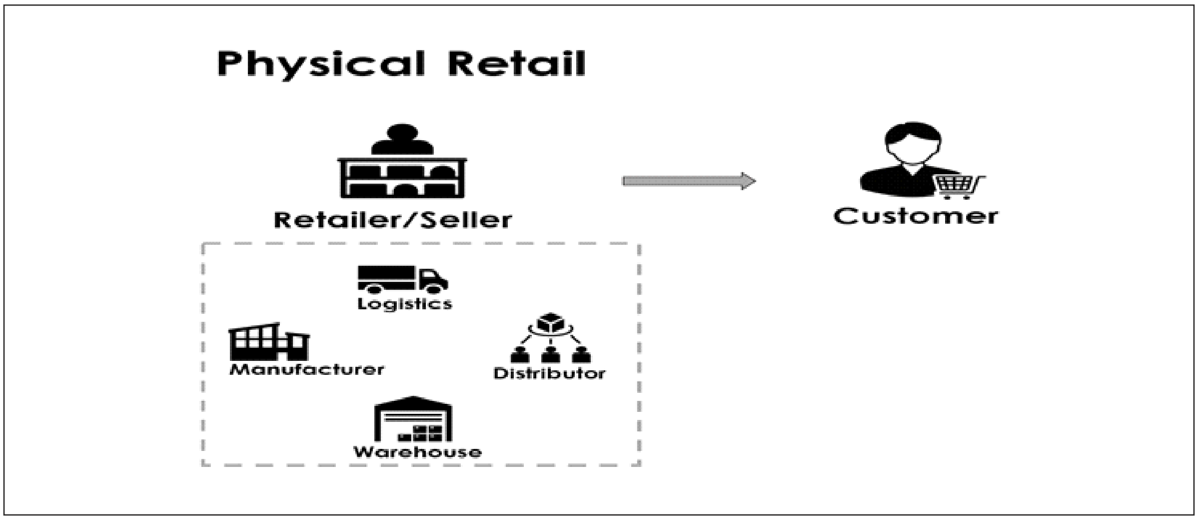


**Figure 6: Physical Retail**

## Distributor

A distributor is an entity that buys (or procures on credit) noncompeting products or product lines and makes them available to the retailers/sellers to be sold to the end users or customers[7]. Distributors are essential in helping manufacturers access the markets which they could not otherwise target. Distributors know the local culture and business practices, therefore, they become a direct point of contact for the manufacturer to reach prospective buyers.

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[6] Derived from Cambridge Dictionary. Available at: https://dictionary.cambridge.org/dictionary/english/manufacturer

[7] Derived from Cambridge Dictionary. Available at: https://dictionary.cambridge.org/dictionary/english/distributor

A wholesaler[8] is an intermediary between the retailer and distributor. In an ideal scenario, the distributor works with the manufacturer. A wholesaler deals in bulk-buying of the goods, which are sold to the distributor who is purchasing the large quantities of goods for a single retailer or multiple retailers.

## Logistics

As seen above, the goods or products are not consumed in the close vicinity of the area where they are produced, so logistics in terms of transport of the goods and products, become an important component. 'Logistics'[9] often refers to how resources are obtained, stored and then shipped to the destination. Therefore, logistics is also responsible for the safety, safe delivery and security of the product. In large organizations, the logistics' team also take on the added measure of insuring the products.

Aspects of material handling, warehousing, transportations, packaging of goods, inventory of goods and control of inventory also comes under logistics. At times, it also deals with finished and unfinished goods. Therefore, management of logistics deals with the right quantity of resource/s, at the appropriate time, to the right location in perfect condition and delivering the product to the correct person. A robust logistics network would enable quicker delivery of goods even beyond tier III cities and into the rural areas of India.

## Warehouse

Warehousing[10] involves storing products or goods to be distributed later. Any large spacious place which is used to store or accumulate goods, products or items is called a warehouse. While it simply means storing goods, a warehouse plays an extremely important role in a logistics system. It has a fundamental role in the supply chain management. Since consumption and production do not take place at the same time, there is a gap. Warehousing or a warehouse helps to bridge this gap by storing goods, products etc. Each warehouse would have its own catchment area for delivering products to nearby cities or adjoining areas. Building a warehouse involves high expenses, so deciding on the optimal number and location of warehouses to deliver goods in reasonable time is a continuous challenge.

## Retailer or Seller

A retailer, or merchant, is an entity that sells goods such as clothing, groceries, or cars directly to consumers through various distribution channels with the goal of earning a profit. Retailers typically buy goods from a manufacturer, wholesaler, or distributor and then resell them to the public. Large retailers such as Walmart and Target in USA and Big Bazar in India often purchase goods in huge volumes from manufacturers or wholesalers, thus receiving preferential discount rates for the products. The difference between retailers and wholesalers is that while retailers sell directly to consumers, wholesalers sell their goods to other businesses (including retailers).

[8] Derived from Cambridge Dictionary. Available at: https://dictionary.cambridge.org/dictionary/english/wholesaler

[9] Derived from Cambridge Dictionary. Available at: https://dictionary.cambridge.org/dictionary/english/logistics

[10] Derived from Cambridge Dictionary. Available at: https://dictionary.cambridge.org/dictionary/english/warehousing

Retailers are the direct entities which interact with customers and based on the choice and convenience aspects of the customer, a range of retailers have evolved over time which involves small kirana stores, Single Brand Retail Stores (SBRT), Multi Brand Retail Stores (MBRT) focusing on single items (mobile phones) or vertical (sports or electronics) to supermarkets catering to multiple products, multiple brands and multiple product lines.

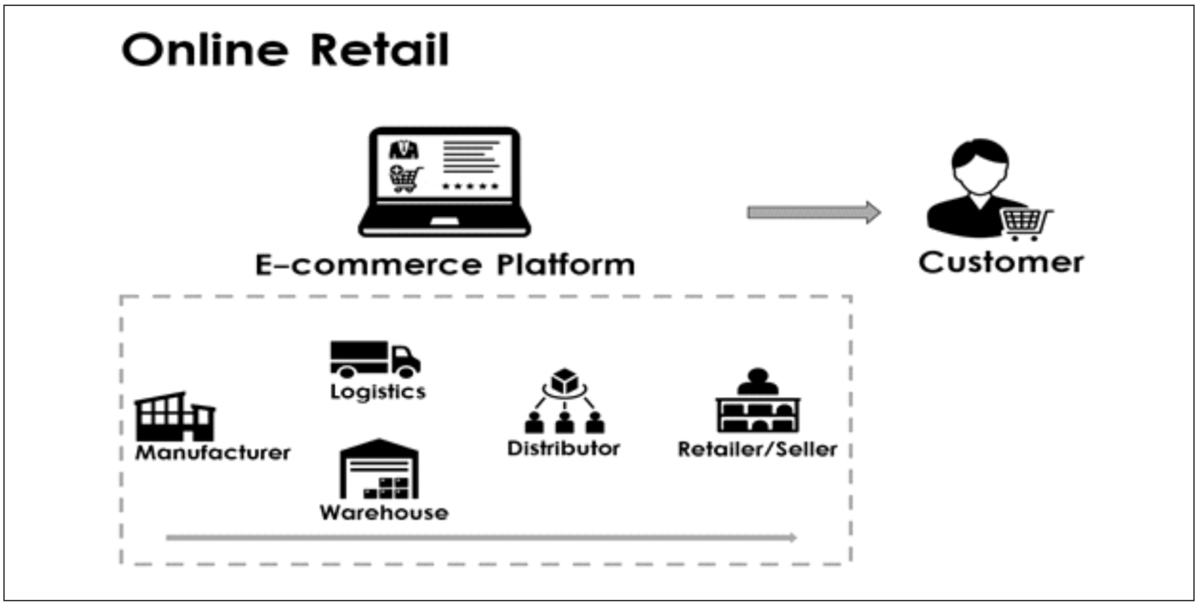


**Figure 7: Online Retail**

## Physical vs. Online Retail

In physical retail, the customer visits the retail outlet to buy the product and it is the responsibility of the retailer to store the product once received from the distributor. Retailers must maintain a physical store to display and store the products along with the operational expenses of running the store in the locality of the customer. Large retailers have the flexibility and space for storing large amounts of goods. The retailer must continuously keep track of the stock of products in the store and must order fresh stock from the distributor when the existing stocks are about to replenish. The retailer and/or the distributor also manages the delivery of the stock from warehouses through their logistics partners. Various aspects like upkeep of the store, warehousing of the products and logistics, all add up to the product cost, ranging between 15–30% of the actual product price paid by the customer.

With the advent of technology, online electronic commerce has evolved which allows customers to directly choose and order products online. The ordered products are delivered directly by the logistics partner from the seller or distributor to the customer's doorstep within a reasonable agreed time frame. In online delivery, as the product is not delivered instantaneously (unlike food delivery), it provides the flexibility of warehousing the product outside the city limits that has less price overheads. The expenses incurred from upkeep of physical stores and its employees can thus be avoided in the online e-commerce route which is often passed on to customers in terms of discounts.

# E-commerce fulfilment models

In online e-commerce, the customer always places the order online through the website or mobile application but the way the order is fulfilled by the e-commerce platform might vary. There are primarily two prominent fulfillment models which are considered.

# Marketplace Model

A marketplace model connects and facilitates buyers (customers) and sellers (retailers, distributors who fulfil the orders) on e-commerce platforms. The sellers can list their products on the marketplace platform providing details of the product, its features, specifications, manufacturing details, price and delivery details. Prospective buyers can view these details of products listed by multiple sellers in the single marketplace interface, i.e., the portal or mobile application of the e-commerce platform. The marketplace provides an interface for payments and transactions between sellers and buyers, in return for the services the marketplace platform provides. The platform charges a commission for facilitating the successful transaction - the commission charged by the platform can range from 5% to 30% depending on class and category of the seller.

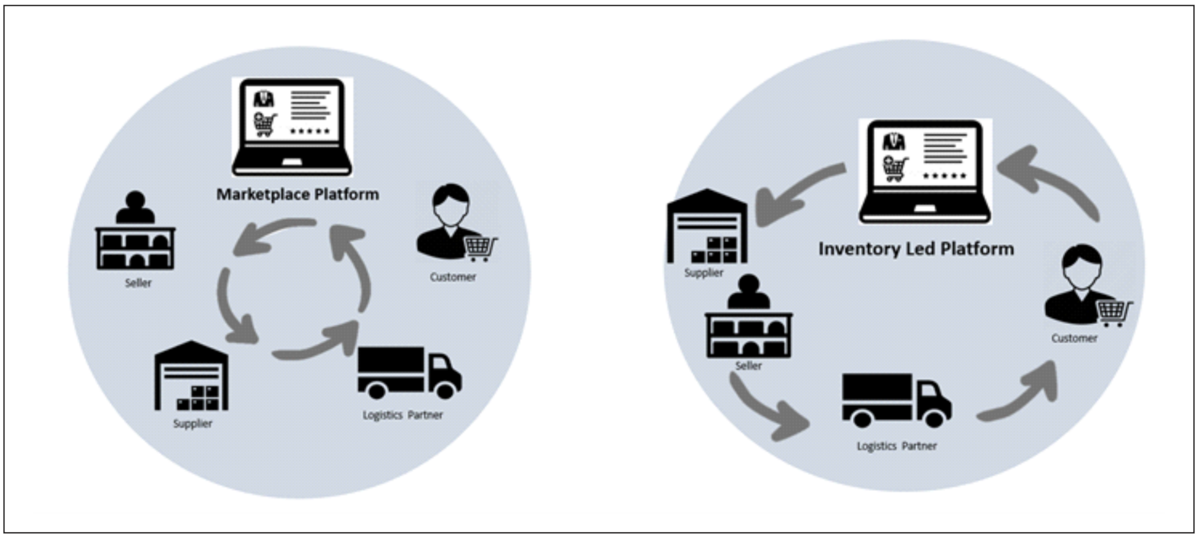


**Figure 8: E-commerce fulfilment models**

In this model, the inventory rests with various sellers who advertise the products on the platform. In this model, the ownership and management of the inventory is the responsibility of the various sellers who list and advertise their products on the e-commerce platform and are the ultimate sellers of goods or services. The "Market Place", thus, works as a facilitator of e-commerce. The platform does not aid the seller in any sort of retail functions on the type of items to be sold, pricing of those items, etc.

The advantages of the marketplace model are that it is highly scalable as it can cater to a wide product portfolio and many sellers. Since the e-commerce platform does not have direct ownership of the products, it is difficult to conduct quality checks. Items might be delivered from different locations leading to higher logistics costs and it takes a longer time to build customer trust and loyalty. After sales aspects of the product are not handled by the marketplace platform which are very crucial aspects related to the usage of the product like product returns, warranty, after sales services, etc.

## Inventory Model

In Inventory Model, the ownership of goods and services rests with the e-commerce platform. Here, the platform is directly engaged in e-commerce activities ranging from listing the products to the post-ordering processes of procuring the product from manufacturer, warehousing and dispatching the product for final delivery to the customer.

If the e-commerce entity maintains a distribution center to stock-and-store inventory and dispatch customer orders, it is called 'warehousing model' or 'inventory-led fulfillment model'. At times the organization ends up partnering with third-party providers for logistics and warehousing activities.

This third-party collaboration ensures a speedier delivery and control over quality which helps to enhance the shopping experience of the customer and helps in improving customer trust. Given the high, fixed capital costs involved, the inventory-led model can be difficult to scale as it requires high amounts of investments.

# Foreign Direct Investment (FDI)

A Foreign Direct Investment (FDI) indicates a purchase of interest in a company or individual investor in a different country. The Indian economy is on a constant growth, and this entices foreign businesses to operate in the Indian market based on the FDI norms and regulations of the country. FDI can take on many forms – opening an Indian subsidiary, a joint venture with an Indian and foreign entity or company or even acquiring a controlling interest in an Indian company by a merger.

With FDI, foreign companies get directly involved in the regular business operations of Indian entity/entities. The companies coming with FDI bring with them the global expertise of retail and e-commerce operations, in terms of managing the distributor network, managing the supply chain, technology expertise in developing the e-commerce platform and customer management aspects. These global players have operated similar businesses in different ecosystems and hence have an additional advantage which is a major reason for the rapid technological enhancement and growth of the sector in India.

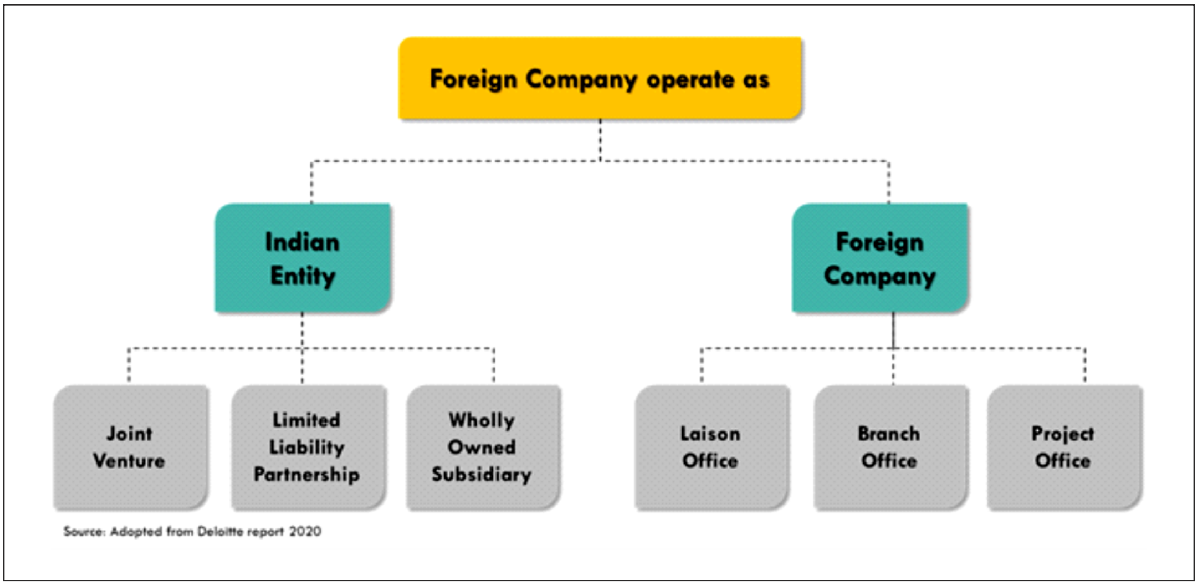


**Figure 9: Foreign company Operating models**

Foreign direct investment in India is sector specific, where the FDI in some sectors can be made through automatic route without specific approvals from the government or Indian central bank. Some of these sectors are agriculture, petroleum and natural gas exploration, and telecom. In some other sectors, FDI is permitted through approval route and the foreign entity needs to take prior government approval for making the investment. Some example sectors are broadcasting content services, print media, satellite operations, etc. FDI in the retail sector in India first started in wholesale cash-and-carry through the approval route in 1997 and then changed to the automated route in 2006. FDI is completely prohibited in few select sectors like atomic energy, chit funds, gambling, lotteries, etc. The route of FDI has implications on the ease of entry of foreign companies into specific sectors.

# FDI Norms in Retail & E-commerce

The FDI norms related to the retail sector and e-commerce sector in India have undergone a series of changes over the last couple of decades. Summary of FDI Policy Recommendations is listed below.

| YEAR | MINISTRY | INTERVENTION |
|---|---|---|
| 1997 | DPIIT | • 100% FDI in cash-and-carry wholesale trading with prior government approvals |
| 2000-2010 | DPIIT | • Automated 100% FDI approval in wholesale cash-and-carry<br>• 51% FDI in Single Brand Retail Trade with prior government approvals |
| 2010-2015 | DPIIT | • Allowed 100% FDI in SBRT through the automated route<br>• Business to customer (B2C) ban irrespective of Single Brand Retail Trading [SBRT] or Multi Brand Retail Trading [MBRT] (2012)<br>• FDI permits SBRT for e-commerce which have physical stores (2015)<br>• SBRT allowed to sell online if 30% goods value sourced from Indian cos. |
| 2016-2017 | DPIIT | • 100% FDI in marketplace e-commerce model<br>• Defined marketplace & inventory models<br>• FDI in inventory model not allowed |
| 2018-2019 | DPIIT & Consumer Affairs | The policy can be summarized as:<br>• **Marketplace** restriction extended to both 'ownership' & 'control' of goods and inventory<br>• Sellers listing on the e-commerce platform cannot have **equity or investment** from the platform or their group companies. No threshold on equity and silent on indirect equity participation<br>• No **Exclusivity** arrangement of the platform with the seller/brand allowed<br>• **Impartiality** to be maintained for all sellers and level playing field while offering any discounts.<br>• E-commerce platform to provide evidence of **compliance** |
| 2020-2021 | Consumer Affairs | • Prevent foreign marketplaces from selling products through sellers in which they have indirect equity stakes<br>• Restrict a marketplace's relationship with its associated parties[11] |

From the above changes in the FDI policy regulations, it is difficult to interpret the objectives that lead to each of these new norms every few years. In 1997, India first opened its doors for FDI in the bulk cash-and-carry retail sector with a very **cautious** approach, ensuring that deals went through government's approvals and scrutiny. Such investments led to the development of the warehouse and logistics backbone for higher retail penetration.

During the next decade between 2000 – 2010, the government allowed 100% FDI in business only (B2B) transactions, with a focus on **national interest--** with the company receiving the investment had to divest at least 26% of their equity to be invested in India within 5 years. The government continued its focus on using foreign investment in infrastructure development both in terms of warehouse and logistics supply chain and in terms of technology. Complying with such policies seemed quite challenging for the e-commerce companies and by 2005, several of them approached the Foreign Investment Promotion Board (FIPB) to seek exemption[12] leading to the relaxation of these rules.

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[11] S. Chengappa, ' Draft e-commerce policy could add to compliance burden of stakeholders' The Hindu Business Line, 16 March, 2021, Available at: https://www.thehindubusinessline.com/news/draft-e-commerce-policy-could-add-to-compliance-burden-of-stakeholders/article34085913.ece

[12] Gaurav Malani, FDI in B2B e-comm, petro marketing, tea to get a boost, Economic Times, Nov. 14, 2005. Available at: https://economictimes.indiatimes.com/fdi-in-b2b-e-comm-petro-marketing-tea-to-get-a-boost/articleshow/1294024.cms

The FDI policies for Single Brand Retail Trade (SBRT) also demonstrated a swift policy change – the government allowed 51% FDI investment in SBRT through approval route in 2006, and then in just six years in 2012, the government allowed 100% FDI in SBRT through automated route. There was an additional policy requirement for those SBRT having more than 51% FDI of sourcing minimum 30% of the goods from the Indian artisan and cottage industry. Around the same time, the government also allowed 51% FDI investments in Multi Brand Retail Trade (MBRT) with prior approval from the states, along with the policy of sourcing 30% of products from the local produce. The intention for such policies is not quite clear, ranging from a sense of **national interest** focusing on Indian enterprises, and **restrictions** for e-commerce entities. The government on this front possibly intended at capturing various aspects like the focus on the manufacturing sector by ensuring most of the manufactured goods are utilized in India. This would also enable the development of the physical infrastructure and technology backbone for enabling electronic commerce in India.

As e-commerce by foreign platforms was allowed in India, accelerated technology development took place leading to large number of e-commerce players in the country. The government allowed 100% FDI in only the marketplace model, making clear definitions of the marketplace and inventory models. The Indian FDI policies allow e-commerce companies to operate through the marketplace model, but by creating tie-ups with group companies, the e-commerce companies were practicing the inventory model in practice, but the marketplace model on paper. Many e-commerce companies used similar complex business structures to circumvent the FDI restrictions on B2C e-commerce. Such business practices would be considered as a violation of the FDI policies of the countries and involved judicial intervention[13]. Putting conditions on the source of procurement for goods by a retailer means interfering with core business decisions which would in turn impact the quality or price for customers. This was seen as a **protectionist** approach targeted towards smaller retailers and kirana stores who have not embarked yet on the digital economy.

There was a fear amongst smaller retailers that the e-commerce platforms would come up with their own products or enter exclusive arrangements with some traders which would affect their businesses and hence lead to the collapse of smaller retailers in the ecosystem. Similar apprehensions were observed when supermarkets entered India and customers were attracted towards them as they offered multiple choices, convenience to compare products along with attractive price discounts. A study by ICRIER commissioned by DIPP[14] around 2008 showed that the closure of small retailers was hardly attributed to the opening of supermarkets in the vicinity and rather on other external factors. To counter these aspects, the government came up with regulations that e-commerce platform companies must operate in marketplace models only and cannot have ownership of products sold and further cannot have equity participation in linked companies – sellers or logistics partners. Several prominent e-commerce platforms worldwide operate as inventory model which allows them better control and optimization of the supply chain leading to cost savings which

[13] Mihir Dalal & Shrutika Verma, Amazon's stake in seller may come under scrutiny, Livemint, 06 Oct. 2014, https://www.livemint.com/Companies/5rcMyyEJgbQzZUnkJ9dRjJ/Amazon-stake-in-seller-may-come-under-scrutiny.html

[14] ICRIER, 'Impact of Organized Retailing on Unorganized Sector' May 2008, Available at: https://dpiit.gov.in/sites/default/files/icrier_report_27052008_0.pdf

can be passed on to customers in the form of discounts. This is quite a challenging requirement for the e-commerce platforms and ensuring compliance of the same is a larger challenge, which again is the liability of the e-commerce platform. Here, instead of going deeper into the root cause of the issue, the government came up with some **superficial policies** which would in turn impact both platform companies, retailers and customers. To circumvent these policies, the large e-commerce platforms in India created multiple foreign firms with their subsidiaries in India, leading to an increase in **corrupt practices**, increase in **business expenses** and moving away from the **ease of doing business** in India's retail sector.

Continuing along similar lines, on the so-called complaints by smaller retailers, the Ministry of Consumer Affairs and DPIIT banned flash sales on online e-commerce platforms and the e-commerce platform cannot have "related parties and associated enterprises" listed as sellers on their shopping websites. While the government's concern for this matter and intention for such measures are rightly justified, such regulations would make it **difficult for business entities** to operate in India. The innovative e-commerce model that leads to cost savings by managing the supply chain and deterring the platforms to pass on those discounts to the customer, is not in the best interest of the customers. The ministry dealing with consumer affairs is possibly not the appropriate body to make decisions that overlap with the nature of investment of the firms and calls for **greater co-ordination** between the ministries. Further, there needs to be common rules for the entire retail ecosystem irrespective of the mode of transaction (online or physical ).

# Policy Recommendations

Based on the discussion on the policies governing the e-commerce ecosystem in India, we recommend some policy interventions to promote better customer centric retail in India. The recommendations are grouped into five broad areas – the first two revolve around simplification of policies and bringing in policies into areas where these are required. Policy directives at every step of the process will reduce the ease of doing business in this sector. The next section talks about the relationship between online and offline retail and recommendations for bringing parity between the two forms of retail. The third section provides recommendations with a focus on the smaller retailers and sellers. Options for providing alternate e-commerce platforms are discussed and recommended in the final section.

## Policy Simplification

The objective of any business entity is to cater to the needs of customers by identification of the market need, offer the appropriate product based on that market need and gain profit in the process. The policies around e-commerce in the country cover a large gamut of elements, including the nature of business transactions (B2B vs. B2C), brands on offer (single brand vs. multi brand), relationship with the sellers on the platform (independent vs. allied), etc. E-commerce as nascent sector will experience several innovation and changes over the years and over-regulation might hamper the growth of the sector.

The organizations which are a part of the e-commerce business process, would often need to explore options within the broad business rules in India. Broad policies and rules would give the entities a clear direction for conducting business and the rest of the intrinsic matters can be left to the market dynamics. The Central government believes in the notion of "Minimum government and maximum governance" which suggest reduction in the government intervention leading to better governance and welfare of the citizens and business entities – this can be achieved by the process of policy simplification. Borrowing on the same philosophy, we recommend that policy interventions in the booming sector of retail and e-commerce be minimized such that more players (both Indian and foreign) can enter the ecosystem and innovate for ease of conducting business leading to customer centric retail.

**Recommendation:** There are many policies released by the government over the last two decades which cover various areas and are often found confusing and overlapping. It would be recommended that the **government comes up with broad policies to promote the e-commerce and retail ecosystem in the country** – this would provide a clear direction for companies working in this space.

The government needs to have adequate trust in the market forces that are the main players in the e-commerce ecosystem, be it sellers, platform owners, logistics or warehouse partners. Businesses work towards providing the best product/service, minimizing their operational costs, so they can maximize the profit. Extending to the retail sector, the retailer aims to procure best quality goods from the one producing at the lowest costs. The government, as part of FDI policy, dictate criteria for local product procurement, which might not be the one of best quality or lowest price and in some cases local producers might not have adequate know-how or technology to develop the product. These would not be in-line with the aims of the business and in turn the customer (Indian citizens) would have to compromise on lower quality product or pay higher price for the product. Such decisions on type of products, means of sourcing should not be part of an FDI policy. As a market opportunity for sourcing local products emerge, the retailers or e-commerce platforms would be the first to identify the opportunity and source more products from them. As the government is not involved in day-to-day functioning of these various entities, it is best left to the market entities to innovate, based on the market opportunities.to-day functioning of these various entities, it is best left to the market entities to innovate, based on the market opportunities.

**Recommendation: Simplification of norms for conducting business in the retail and e-commerce sector should be formed by a single ministry in consultation with other related government and non-government bodies.** It would be good to articulate broad business norms at the time of starting the business (Indian companies) or while entering India (foreign companies) along with a **reasonable time duration for the validity of these business norms** so the companies can focus on the core business aspects rather get tied in multiple policies. The companies would continue to operate under the other norms for doing business in India.

The policies related to FDI in the e-commerce sector in India have changed multiple times over the last two decades creating a lack of clarity and confusion, which impacts future planning activities for the e-commerce business and other business entities. A company might have entered India adhering to policies at that time, which constantly keep changing every few years, leading to constant challenges for the company for coping up to these changing norms. Frequent changes to the regulations impacts the business environment and development of the industry, is not a step in the right direction and would adversely impact investor sentiment. There is need for a stable policy. There is no requirement for any additional policy or changes to the existing policies, the existing policy is comprehensive, clear and robust, and is appropriate for the regulation of e-commerce marketplaces.

Although it is understandable that this an evolving sector and policies will be required with growing complexities, but the need is of far sightedness and simplification of policies. Companies would need to spend a significant amount of their time and resources towards the understanding of these changes and aligning the businesses to the new norms. All these aspects would make it complex and difficult for entities to operate and carry out business in India. Such constantly changing policy norms, in the long run, can lead to many foreign investors leaving India and would hurt the customer's interest at large. Given the complex nature of e-commerce business, multiple ministries and government bodies get involved in aspects of the policy making which makes it complicated for businesses to interpret and operate. It would be recommended that a Central ministry, DPIIT, holds consultation with other government entities and comes up with policies, rather than multiple government bodies like the Department of Consumer Affairs, Competition Commission of India, etc. coming up with overlapping policies. For the ease of businesses operating in this space, the government can provide easy interpretation of the policies to avoid any issues related to interpretation of the same.

## Online-Offline Parity

In India, people believe in guided buying as they rely on recommendations by and trust on the seller they are buying from, making it a very social experience. In addition, reasons that are unique to in-store shopping is the ability to see, touch and try the product and being sure about the fit or suitability of the product. Also, consumers can immediately avail themselves of the product when shopping offline. To attract customers, offline retailers spend on the look and feel of their stores and shops and do one-to-one customer engagement to ensure they shop from them. They also provide deals and offers as a value-added service[15].

In the retail industry, to attract customers and boost sales, discounts and offers play a significant role. In India, discounts and sales are an integral part of festive seasons and consumers spend on luxury items, apart from necessities during this time. Adopting to this strategy, both online and offline retail players offer discounts and sales to retain a large customer base. There are several domestic sellers with significant foreign capital, that engage in MBRT including through online e-commerce. Such entities (being recipients of monies invested by foreign investors) also offer discounts. There is no justification for these industry players to benefit from foreign capital and give discounts to customers, whereas FDI funded marketplaces are prohibited from allowing sellers despite minimal economic participation by entities related to the marketplaces. If any kind of foreign participation is not permitted, the position should be consistent for offline / physical retail businesses, without any sort of preferential treatment to domestically funded marketplaces.

**Recommendation: Common policies and rules for the entire retail sector both online and offline retail are recommended** which would allow customers to choose from any means for purchase based on their current needs. The customer often has multiple touchpoints as they move through the retail journey, like choice of the product, product comparison, needs assessment, and finding the best price to make the final purchase. Hence, business practices for the retail sector should not be based on the mode of the final transaction, i.e., online vs. offline.

Presence of multiple players in e-commerce and supermarkets has given rise to a competitive environment. Both online platforms and supermarkets have been doling out high levels of discounts, flash sales and creative advertisements to bring in customers. The discounts and sales are not limited to festive seasons, but have become common all-round the year, like during month-ends and holidays. With more consumers preferring online purchasing to in-store shopping, many sellers have started forming exclusive selling arrangements with online retailers across all product categories.

Through these exclusive arrangements, both Indian and international brands have started leveraging the reach of e-commerce, which has made consumers shop frequently and get attractive price deals on niche brands/products. Under FDI laws, the pricing of products is under exclusive control of the seller and a marketplace is prohibited from exercising any influence on pricing. In view of the above condition, the offer or discount on products is a seller's discretion. The marketplace only advertises the offers or discounts offered by the seller on its products. Hence, there is no reason for introducing restriction on discounts on the marketplace.

[15] Total Retail 2015: Retailers and the age of disruption, available at:
https://www.pwc.in/assets/pdfs/publications/2015/retailers-and-the-age-disruption.pdf

> **Recommendation:** Sales and discounts are used as a marketing tool across all sectors even in offline stores. Discounts & flash sales are one of the major reasons that attract consumers to e-commerce platforms and enable them to buy exclusive and high-priced products at the best price. A prohibition on such sales events will stifle competition and deprive consumers of the best price which may impact consumer behavior in a negative way. **Thus, banning of discounts and flash sales should be reconsidered.**

Offline traders have complained that e-commerce platforms give deep discounts and offer sales to customers which they cannot match, and that affects their business negatively. It is difficult for offline stores to offer sales and discounts throughout the year to compete with online platforms, since they have additional expenses like store rent and maintenance which is not an issue for online platforms. Emphasizing that the tactic of sales and discounts is discriminatory towards offline sellers, the government have put a ban on flash sales, and discounts on online platforms as a measure to create a level playing field for offline sellers.

## Small Indian Retailers

E-commerce companies through their marketplace platforms have helped create opportunities for craftsmen, micro-entrepreneurs, and other small businesses. They have digitally enabled them to attract customers from all over the country and sustain their businesses as well as contribute to the economy. Many offline stores are adopting e-commerce to leverage these opportunities. This has helped both e-commerce companies and sellers in attracting a larger customer base and sales. The well-established e-commerce players in India have already started capacity building initiatives for smaller retailers and kirana stores with the sole objective of onboarding them onto the seller network of the large platform players. Small retailers who have embarked on these digital platforms benefit from the multiple outlets for selling their products and have also formalized their businesses, leading to transparency and improved government revenue collection. Small number of sellers have benefited from these efforts and many more are yet to embark on that journey which will enable these small sellers to reap the benefits of digital technology and e-commerce platforms. Interventions from the government would be a great help for the smaller retailers, in this regard.

With the current pandemic situation, buyers and sellers have adopted digital channels more quickly, in both metro and non-metro cities. Consumer preferences have shifted to online shopping due to safety concerns. This has largely affected the small-scale offline businesses and stores. With little to no sales it is difficult for them to sustain on their own. This pushes offline stores to evolve with the changing market and shift to online channels. Even if offline sellers are ready to transit to the online channel there are many aspects that they struggle with, like branding and marketing of products, packaging, logistics and delivery to customers, and customer service. This understanding and adoption of online channel poses a challenge which discourages small scale offline sellers to easily adopt to e-commerce.

**Recommendation:** The government should start a dedicated program for capacity building of small retailers and sellers for onboarding them to online channels and help them transforming their businesses into digital formats. **Provide training and build capacity of small retailers and sellers in product packaging, marketing, logistics and delivery aspects, and slowly ease them into leveraging online business.** The Ministry of Commerce in collaboration with Ministry of Micro, Small and Medium Enterprises and National Skills Development Corporation (NSDC) can develop self-paced learning courses on technology, marketing, branding, taxation, etc.

In the current scenario, the offline small retailers operate in a different business model and are not taking full advantage of the digital economy that is driving massive growth in the ecosystem. These small traders need to embark on the digital ecosystem which involves digitizing their entire supply chain – ordering of products, keeping track of in-store stocks, warehousing, display, to the final product sale. Once this is established, the smaller retailers can operate digitally on their own terms – either independently via platforms like Facebook, WhatsApp, independent mobile application or website, or by tying up with large retail platforms in India. The small retailers do not have the adequate skills or resources to embark on this journey.

**Recommendation:** Ministry of Commerce in collaboration with the National Informatics Center (NIC) can develop an **open-source software** that can be used by **small retailers for managing various aspects of their retail operations.**

Provision of **financial aid or loans** at very low interest rates to small businesses and retailers, to cover operational costs related to digitization of the business, can prove beneficial. Such financial aid from the government would also encourage businesses to embark upon the digital economy and reap rewards for the same in the long run.

Digitization of the entire supply chain can often be time-consuming and requires investment of time and resources. The retailer store would need to transform all elements of the supply chain in a process flow software or application which would involve costs related to the procurement of such a software application and then entering details related to every product into the system, which might require several man hours of work depending on the size of the business. These transformations will lead to several benefits in terms of efficiency in tax compliance and financial auditing, the flexibility to operate as online business through tie-ups or independently. But several retailers might be deterred by the prospect of additional investment incurred for such activities and some sort of financial aid from the government would be a great step in this direction.

## Alternative Platforms

Large number of online e-commerce players operating in India have some foreign entity as the majority fund supplier or as majority stake. Hence the initiatives of these large e-commerce players often seem anti-national as per the general narrative. It would be good to have more e-commerce platforms backed by Indian promoters or Indian government which will lead to enhanced competition providing multiple options for both sellers and customers.

Over the last decade, venture capital-backed aggregators have dangled online demand as bait in front of traders. These online aggregators offer lucrative commission to the sellers during the initial acquisition phase, but then during the growth phase the sellers find their commissions eroding with very few alternative options. So, a seller-first platform focused on consumer choice could redraw the rules around competition, capital, and scale in India.

**Recommendation: Promote and launch the Open Network for Digital Commerce (ONDC) on priority basis as a Mission Mode project under the government's Digital India program.** ONDC would be focused on the interest of sellers and ensure fair trade and competition in the ecosystem. Customers will have another choice to reach out to multiple small retailers and sellers through the ONDC platform.

Sensing the growth of the online commerce, Department for Promotion of Industry and Internal Trade (DPIIT) has taken an initiative to create an Open Network for Digital Commerce (ONDC), where buyers can access products of sellers across platforms without having to switch between multiple platforms creating an open network model from a platform-centric model. Having an interoperable system will help streamline the onboarding of retailers and establish a cataloguing, vendor and price discovery method – thereby making the customer shopping journey fuss free. The idea is that this will be a new digital infrastructure on which all e-commerce will be built, connecting sellers and buyers, like creating a Unified Payment Interface (UPI) of commerce.

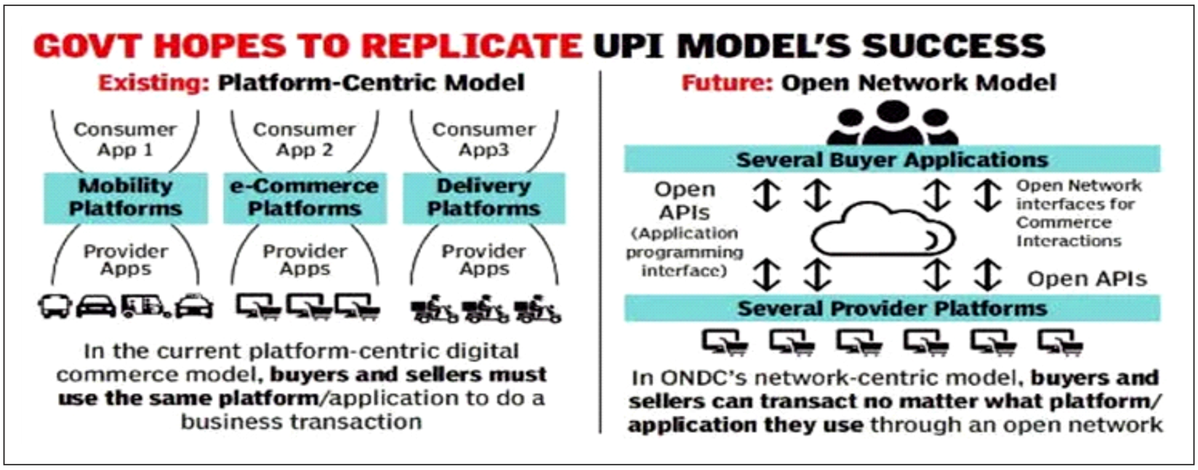


**Figure 10: Open Network Digital Commerce**
**(Image Source: The Times of India - How will open network for e-commerce work? Jul 12, 2021)**

Open-source software will ensure that the small retailers and sellers do not have to spend additional costs for procuring the software licenses. Also, the aspects related to onboarding of sellers, product listing on the catalogue, searching of products, etc. can be monitored by citizens on an open-source platform ensuring complete transparency of the process, and no bias can be introduced by the platform owner. Further, engagement of government back platforms and promoters will help the government understand the nuances of operating profitable business and will thus lead to simplification of the business norms for the e-commerce sector bringing delight to the e-commerce platforms, sellers and customers.

**Recommendation:** The government through a Special Purpose Vehicle (SPV) has successfully managed the Government e Marketplace (GeM) aimed at public procurement for state and central government. It is **recommended that GeM be made available for the Indian citizens and customers to take advantage of this excellent initiative.**

More options available to the customers are good for both the sellers and the customers. Government of India through a Special Purpose vehicle (SPV) had launched an online platform for public procurement of goods and services in India, named the Government e Marketplace (GeM) since 2016. This has provided an open and transparent procurement platform for state and central government buyers. Since August 2021, the GeM platform has onboarded 25,98,510 Sellers & Service Providers out of which 718,365 are MSE sellers & service providers. Further, it has more than 52 lakh products, in about 16,409 product categories, and has 193 service categories. The number of sellers on the platform are in no way less than any of the large e-commerce platforms in India and GeM has adequate experience in handling large number of sellers and buyers simultaneously. The government-backed GeM platform would also provide an additional layer of assurance to the onboarded sellers about fair competition and transparency. The customers would get an additional option for their shopping journey with multiple options from both private and government players.

# Concluding Remarks

The growth of e-commerce in recent years has been triggered by the technology revolution along with the growing internet connectivity and higher amount of disposable income for citizens – this growth trend in the e-commerce sector is likely to continue for the next decade and possibly even more. The tier II and tier III cities register higher growth rate in e-commerce spending compared to the Indian metro cities. As the sector becomes vibrant, more e-commerce players would emerge, and many more sellers would join the bandwagon. Foreign Direct Investment is expected to play a significant role in India's future growth story. The current policies around foreign funding backed e-commerce players would make it restrictive for new players to enter.

This report suggests some policy recommendations starting with the simplifications of the FDI norms in India's e-commerce sector. This simplification would mean that the policies chalk out some broad rules for conducting e-commerce business in India and leave the minute details to the business entities and market dynamics. The government should see the entire retail sector and its various business models through the same lens and recommend similar rules on all companies operating in the sector, irrespective of their mode of transaction-- online or offline. Several policies related to the retail sector in India are made stringent in favor of the smaller retailers and sellers in the expectation that they cannot cope up with the dynamic technological changes. This report recommends strengthening of the small Indian retailers through capacity building programs to equip them with digital technologies to facilitate their store operations, distributor management, and product marketing along with onboarding an e-commerce platform. Further, to bring in competition alternatives, e-commerce platforms may be promoted from the government end like the work-in-progress Open Network for Digital Commerce (ONDC) or opening Government e Marketplace (GeM) for transactions by citizens.

Foreign Direct Investment is just the beginning of the e-commerce journey in India which is likely to grow over the next one or two decades, and many more issues related to e-commerce needs further research and deliberations. The current research by the Bharti Institute of Public Policy (BIPP) investigates various aspects of the retail and e-commerce ecosystem in India, starting with the norms for Foreign Direct Investment (covered in the current report) and would be followed other aspects, like business models for retail, data ownership in e-commerce, algorithmic bias impacting the product search ranking, tackling the issue of counterfeit products and support for small seller and retailers. These recommendations are made towards making the retail and e-commerce ecosystem in India more customer centric over the years.

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