9B14N018

FLIPKART: VALUING A VENTURE CAPITAL-FUNDED STARTUP[1]

The latest round of venture capital funding, in October 2013, had valued Flipkart, an online retailer, at US$1.6 billion,[2] nearly eight times sales. In less than two years, the firm had attracted nearly $550 million in VC funds and its sales turnover had grown nearly thirty-fold.

Was Flipkart growing too big too soon? Were these valuations justified? The market was divided on opinion.[3]

FLIPKART INDIA PVT.LTD.

Flipkart was founded by two friends, Sachin Bansal and Binny Bansal, with an initial capital of INR400 thousand[4] in 2007, as an online book retailer. By 2012, the firm had added electronics, mobile phones, apparel, footwear, toys, accessories, etc. to its repertoire. In early 2013, the company had embraced the "marketplace model" for online retail.

Between fiscal year FY2010 and FY2013 the firm saw its revenues multiply over 100 times. Flipkart was valued at US$1.5 billion at its sixth venture capital fund raising round in October 2013 (see Exhibit 1). At the time, the firm had more than 10 million registered users and shipped 130,000 items a day. Funding such growth was not easy. But the owners of Flipkart were some of the lucky few who managed to raise the required capital in a lacklustre business environment (see Exhibits 2 to 5).

As a result, Flipkart was probably the most celebrated story in India for entrepreneurship, superlative growth and online success. However, there were murmurs in industry and analyst circles that Flipkart was probably overvalued.[5]

INTERNET PENETRATION AND USAGE IN INDIA AND COMPARABLE MARKETS[6]

The Asia-Pacific region saw its online population increase by approximately 40 million in one year to reach 644 million by March 2013. Between March 2012 and March 2013, India's share increased from

9.3 per cent to 11.5 per cent, bringing the country up to second place and tipping Japan to third. India's extended online universe was estimated in excess of 145 million. China continued to dominate with a huge margin; its share of the online population in the Asia-Pacific region stood at 54 per cent as of March 2013. The 2.2 per cent increase in India's share came about through an addition of 17.6 million users during 2012-13.

As compared to other emerging market nations and the average worldwide trend, 75 per cent of the online population of India was under 35 years of age in 2013.[7] Another interesting trend was that as against other regions, India's female population was far less participative on the Internet both as a percentage of total participants as well as time spent online. Females comprised only 39 per cent of the total population active online in India as against 52 per cent, 49 per cent, 45 per cent and 47 per cent for Russia, Brazil, China and the worldwide average, respectively. Even the time spent by women was far lower at 10.8 hours on average as against 32.5 for Brazil and 22.6 hours on average worldwide.[8] The number of working women in India was estimated to grow at 1.7 per cent per annum between 2010 and 2020, while their earnings were set to grow at an annual rate of 12.4 per cent to US$900 billion.[9] Of the female Internet users, the heaviest users were in the 35 to 44 age group, while male Internet users in India were mainly in the 25 to 34 age group.

INTERNET RETAIL MARKET IN INDIA

Forrester Inc. estimated India's e-commerce market at US$1.6 billion in 2012. It was poised to grow at a compound annual growth rate (CAGR) of 57 per cent during 2012 to 2016. China's online retail market was almost as big as that of the United States at $169.4 billion, poised to grow to $356 billion by 2016.[10] At the time, "e-tailing" was estimated to contribute just over 2percent to the nearly $400 billion overall retail market in India.[11]

India's Internet retailing market had seen quick traction in a short time with a few known players and plenty of other small and struggling start-ups. The competition among the players was close and intense. Each of the leading retailers had seen remarkable growth in unique visitors over the previous year (see Exhibit 6).

Revenues made by an online retailing platform were a function of the number of visitors to its site — both unique as well as repeat visits — as well as of the rate of conversion of such visitors to customers. The latter was again a function of the amount of time they spent on the site and, more importantly, what they spent their time on.

Apparel was seen to be the most popular category in online shopping with a 21 per cent reach, followed by computer software at 16 per cent. Comparison shopping emerged as the third most popular 'category' at 15 per cent.

EMERGENCE OF INTERNET RETAILING IN INDIA

Unlike developed economies, India had always seen skewed regional development. This resulted in high rent differentials for real estate between developed areas and the less developed areas. This coupled with poor and unevenly distributed infrastructure and logistics proved quite challenging for the traditional retail industry and limited the reach of brick-and-mortar retailers to only a few pockets of the population. Retail industry required proximity to potential customers at reasonable cost in order for the business model to lead to sustainable and profitable growth. Paradoxically in India, the market for large retailers existed mostly in large cities and towns where real estate costs were prohibitive. Smaller towns and cities might have provided cheaper real estate but had a clientele type that did not support scale. Logistical and infrastructural bottlenecks were also immense.

These challenges to traditional retail proved a potent opportunity for online retail, also known as e-tailing – a blend of retail and information technology (see Exhibit 7). Online retailing could reach practically anyone who was electronically connected and willing to transact online. Willingness to transact online was seen to be low for the conservative and cautious Indian consumer who took time to start trusting an impersonal medium. This challenge gave rise to an innovation in the Indian e-tailing market called cash-on-delivery (COD). This mode of payment became so popular that by 2012, 40 per cent[12] of sales were being done on a COD basis.

Besides hesitation to transact online, Internet quality in India left much to be desired. Only in the third quarter of 2012 did average speed of Internet connections in India exceed 1Mbps, as against 14.7Mbps for South Korea and 10.5Mbps for Japan. China was only slightly better off at 1.6Mbps. Only 2.8 per cent of India's online population used speeds of greater than 4Mbps against corresponding figures of 5.4 per cent and 86 per cent for China and South Korea respectively. Nonetheless, the speed at which adoption of high-speed Internet was increasing was commendable.[13]

FUNDRAISING BY INDIAN E-COMMERCE PLAYERS

As per reports,[14] of the 53 e-commerce companies that together raised $853 million in venture capital funds since 2010, only 11 managed further rounds of funding, with Flipkart topping the list (see Exhibit 1).

The promoters of Flipkart were clear that the funds raised would be used to build scale; profitability was not an immediate goal (see Exhibit 8).[15] This was the Amazon model,[16] wherein building scale, creating and expanding the market and grabbing market share superseded profitability.

Competition was fierce as entry barriers were low; all that was needed was a retailing platform. Little scope existed for product differentiation as the same products were being sold over all platforms. Customers were at a significant advantage with all product and price information at their finger tips; no wonder comparison shopping was the third most popular product category on these websites. The first casualty in such situations was always price. Companies started offering larger discounts and more attractive deals to woo customers. The COD model, initially offered as a differentiator, soon became mainstream. The already wafer-thin margins collapsed under the onslaught with as many as 136 e-commerce start-ups shutting down between November 2012 and April 2013.[17] Flipkart's deep pockets created through rounds of venture capital funding helped them sustain development despite posting operating losses over the years (see Exhibit 8).

Realizing that any differentiation was possible only on the service front, Flipkart adopted customer service and satisfaction as its unique value proposition.[18] Besides attractive prices (all players, including Flipkart, offered products at substantial discount to brick-and-mortar outlets) and COD, Flipkart offered an excellent collection of items, high quality packaging and very prompt delivery. This was more than enough to convert and acquire many new customers who would first check Flipkart for any requirement ranging from books to television sets to laptops.