ANALYSYS MASON

INDIA INTERNET MONTHLY

Consulting specialists in telecoms, media and digital (internet)

AUGUST 2019

Featured in this issue

Online grocery shopping and success factors in this space

The growth in fintech market and the entry of CRED IndiaMART

InterMESH's IPO and an outlook on B2B ecommerce

Contents

FOREWORD

Welcome to the third (August 2019) edition of Analysys Mason's monthly newsletter on the internet and digital markets in India.

Dear all

I am pleased to share our third monthly newsletter with this group. We have had some great follow-up conversations about some of the thought pieces in the earlier editions of this newsletter; please keep them coming!

The internet/digital market in India has been busy with activity from start-ups and investors alike. In this edition for August 2019, we assess the recent developments in three sub-sectors within the digital/start-up space and draw upon insights from our analysis and discussions with investors.

Specifically, this month's articles consider:

1. the **online grocery space**, with an emphasis on the key success factors that players in the market need to focus on
2. the **fintech market** in India, particularly **CRED's** offering in this space and the recent attention that it has received from investors
3. the **B2B e-commerce** sector, IndiaMART InterMESH's successful IPO and the prevalent business models in this sector.

Revenue in the **online grocery market** is growing rapidly in India, driven by increasing broadband penetration and changing consumer behaviour. Revenue in the market is expected to grow at a CAGR of 41% over the next few years and will reach USD4.5 billion by 2023. Most players in the market have adopted an inventory-led business model to build customer loyalty and increase operating margins, but there are five critical factors that can help online grocers to differentiate themselves and gain market share.

The **fintech market** in India has grown significantly thanks to rising internet penetration, favourable government regulations and improving digital infrastructure. Investors continue to fund payment start-ups in the fintech market. **CRED** is one such start-up that has gained significant attention from investors recently. It is a rewards-based platform that enables credit card users to pay their bills and earn rewards in the form of cashback, discount coupons and free gifts. However, it will need to explore other monetisation strategies soon in order to build a sustainable business model, just like some of the other leading start-ups in the payments space.

The successful initial public offering (IPO) of IndiaMART InterMESH in July 2019 is testimony to the increasing prominence of the **B2B e-commerce sector** in India. B2B e-commerce sales in India are expected to grow at a CAGR of 24% over the next few years and will reach USD1458 billion by 2023. This article discusses recent investment trends and the business models that are being adopted by key players in this sector in India.

I hope you enjoy reading this month's edition of our newsletter.

Rohan Dhamija
Partner, Head – India (South Asia), & Middle East

Grocery shopping in India is moving online but success for retailers will depend on five critical factors

The online grocery market is experiencing rapid growth in India, driven by increasing broadband penetration and changing consumer behaviour. Revenue in the market is expected to grow at a CAGR of 41% over the next few years to reach USD4.5 billion by 2023. This article discusses the business models used by leading players and the critical factors for success in this market.

The online grocery market in India is gaining traction

The food and grocery market in India was worth approximately USD506 billion in 2018. It is expected to grow at a CAGR of 9% over the next 5 years to reach USD776 billion by 2023. This growth will be driven by increasing disposable income per household and a growing number of households in the country.

Unorganised retailing dominates the market – the country has around 12 million 'mom-and-pop' stores and a network of street vendors that serve the daily needs of households. Organised retailing accounts for around 3% of the total grocery market and is mostly concentrated in Tier 1 and Tier 2 cities, but it is expected to grow at a faster rate than the unorganised sector in the coming years. Various external and internal market factors are moving consumers of organised retailing towards online shopping. External market factors include increasing internet penetration, more modes of cashless transactions and a higher number of working women, while internal market factors include the convenience of online shopping, discounts and promotions offered by online grocers and the ease of ordering anytime. In a consumer survey conducted by Analysys Mason, cashbacks/discounts emerged as the top motivation for consumers to start/continue purchasing grocery online while delivery-related incentives were seen to be next most lucrative motivator (see Figure 1).

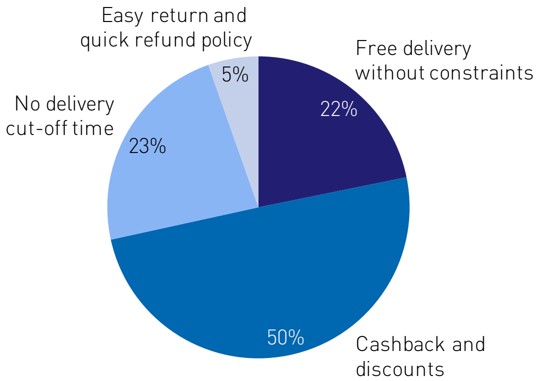

FIGURE 1: REASONS FOR PURCHASING GROCERIES ONLINE, INDIA[1] [SOURCE: ANALYSYS MASON, 2019]

The online grocery market is expected to grow at a CAGR of 41% from USD0.8 billion in 2018 to reach USD4.5 billion by 2023 (see Figure 2).

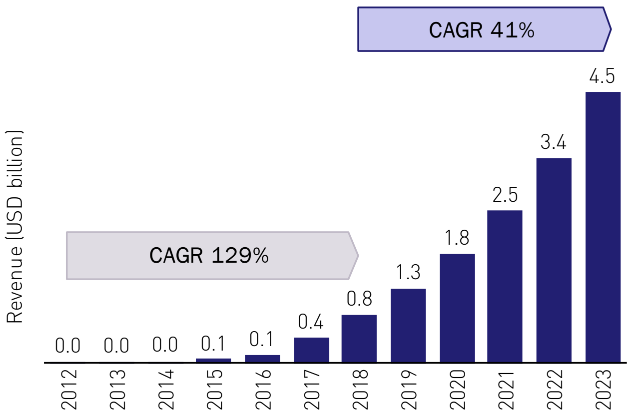

FIGURE 2: ONLINE GROCERY MARKET IN INDIA [SOURCE: ANALYSYS MASON, 2019]

[1] Analysys Mason conducted a survey of around 400 respondents in four metropolitan cities in December 2018.

At present, 96% of India's online grocery market is based in metropolitan areas. These large cities are expected to continue to dominate the market, but as internet penetration increases in non-metropolitan urban areas and online grocers expand their reach, the contribution of non-metropolitan areas is expected to increase to 19% by 2023 (see Figure 3). However, supply-side constraints are expected to restrict the growth of online grocery shopping outside urban areas.

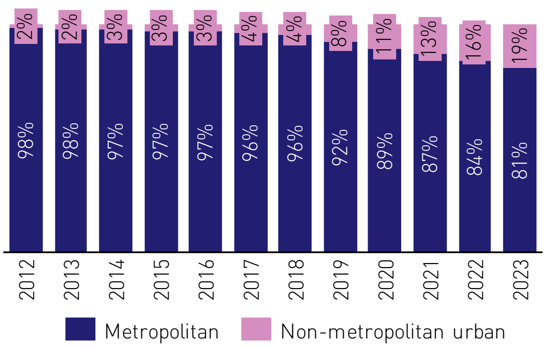

FIGURE 3: ONLINE GROCERY MARKET SPLIT BY TYPE OF AREA, INDIA, 2023 [SOURCE: ANALYSYS MASON, 2019]

Online grocery market players in India have adopted an inventory-led model to build customer loyalty and increase operating margins

Big Basket, dominates the online grocery market in India in terms of gross sales (see Figure 4). Amazon and Grofers are the next big players in this space. Flipkart Supermart entered the market in the middle of 2018 and has made a small impact in terms of gross sales, while new entrant Swiggy launched its services in early 2019 and delivers groceries to houses in Gurgaon via a mobile app.

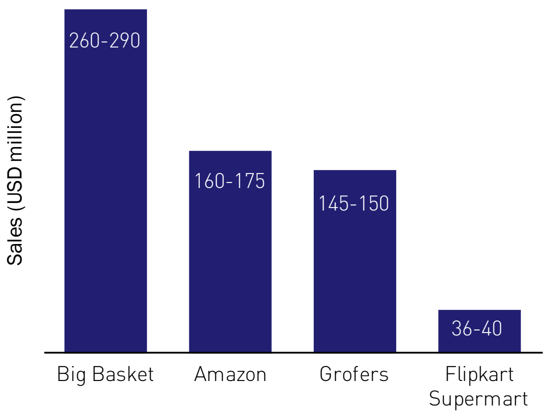

FIGURE 4: GROSS SALES ESTIMATES BY ONLINE GROCERY RETAILERS, INDIA, FY 2018 [SOURCE: ANALYSYS MASON, 2019]

The major players in this sector are mainly present in metropolitan, Tier 1 and Tier 2 cities. Amazon Pantry serves the largest number of cities, followed by Big Basket.

Online grocers in the market are operating one of two business models, namely marketplace and inventory-led. The key difference between the marketplace and inventory-led models is based on whether the inventory of products is held by the online grocer or not.

The **marketplace model** is a zero-inventory model where the online retailer provides logistical support and acts as an intermediary between buyers and sellers of grocery, and therefore does not incur high inventory and warehousing costs. However, this model makes it difficult for online grocers to maintain the trust of the customers due to a lack of control on product quality, despite the availability of a large product portfolio. This model also suffers from low margins and faces challenges in servicing large or multiple orders at the same time.

On the other hand, the **inventory-led model** is based on stocking up units after buying them from sellers. The online retailer becomes a single seller of a variety of products and has complete control over the availability of stock. This model enables the retailer to control the product quality and thereby build a trusting relationship with customers. The drawback of this model is the high fixed cost associated with maintaining the inventory. However, this model enables the retailer to service large or multiple orders at the same time, thereby achieving economies of scale and having higher margins than the marketplace model.

Big Basket, the largest player in the market, operates on the inventory-led model, which allows it to have greater control over its supply chain. It has been expanding the number of warehouses across different cities to increase its reach.

Amazon offers two online grocery platforms: Amazon Pantry, which is available on the Amazon app/website and is serviced via the warehouse model of Amazon; and Amazon Now, which is pre-dominantly a marketplace model available only via a mobile app in four metro cities, supported by a few fulfilment centres.

Grofers launched services based on a marketplace model. However, it faced operational issues such as unfulfilled orders and high operational costs along with low margins and therefore shifted to an inventory-led model in 2016.

Flipkart expanded its e-commerce portfolio to offer groceries using an inventory-led model in 2018 with a limited reach and number of product categories compared to other players.

Swiggy is relying on tie-ups with stores across Gurgaon to service the orders. It is using a marketplace model.

Five factors can help online grocers to differentiate themselves and gain market share

Five key factors can help online grocers differentiate themselves and gain market share (see Figure 5).

- **Scale and first-mover advantage:** First movers in the market have an edge over competitors in terms of improved brand recognition and customer loyalty. The large customer base captured by first movers also helps to achieve economies of scale, leading to higher margins and improved unit economics of the business in the medium term.
- **Integrated supply chain:** Enhancing the backward supply from suppliers such as vendors and farmers (for example, increasing the number of partnerships, establishing on-the-ground support teams and building a trusting relationship) and forward supply to customers via an omni-channel retail strategy (for example, offering services via mobile apps, website, physical kiosks, etc.) could improve the efficiency of supply-chain operations.
- **Private label strategy:** For product categories (such as milk, fruits and vegetables, etc.) that are commoditised/standard, have low product differentiation and a high frequency of purchase, offering private labels could be a viable alternative to branded products. This could improve overall margins because private label products offer better margins than their branded counterparts. The price difference between brands and private labels drives customers to purchase lower-priced private label products thereby generating recognition for the online grocer's private label.
- **Strength of customer relationships:** Customer loyalty helps to maintain a steady stream of revenue. Having low customer acquisition and retention costs is important for improving the customer lifetime value, which can be achieved by offering high-quality products across product categories, ensuring on-time delivery and locking-in customers by increasing switching costs.
- **Resources:** Online grocery is a capital-intensive business due to high warehousing and inventory costs and high customer acquisition and retention costs. Therefore, having access to a constant supply of funds from investors is a critical factor in having a competitive edge for online grocery retailers.

FIGURE 5: CRITICAL SUCCESS FACTORS FOR ONLINE RETAILERS TO DIFFERENTIATE THEMSELVES IN THE ONLINE GROCERY MARKET [SOURCE: ANALYSYS MASON, 2019]

The fintech market in India is flourishing; CRED has received particular attention from investors

The fintech market in India has grown significantly thanks to rising internet penetration, favourable regulation and improving digital infrastructure. Investors continue to fund payment start-ups in the fintech market. This article discusses one such start-up in the payments space, CRED, and explores its potential revenue streams.

The fintech market in India is expected to grow during the next 5 years

The disruption in the financial services sector is having a marked effect on the global fintech market. Over the last few years, this effect has been significant in the financial services industry in India: the number of fintech start-ups in the country increased three-fold during 2015–2018 to reach 2050 in 2018.[1]

The increasing popularity of fintech in India has been driven by several factors including:

- the rising internet and smartphone penetration
- favourable government policies such as financial inclusion, improvement in digital literacy and a focus on the formalisation of the economy through the introduction of Goods and Services Tax
- an improvement in digital infrastructure through the introduction of the Unified Payments Interface (UPI).

As a result, we estimate that the fintech market in India will grow at a CAGR of 26% over the next 5 years to reach USD63 billion by 2023, as shown in Figure 1.

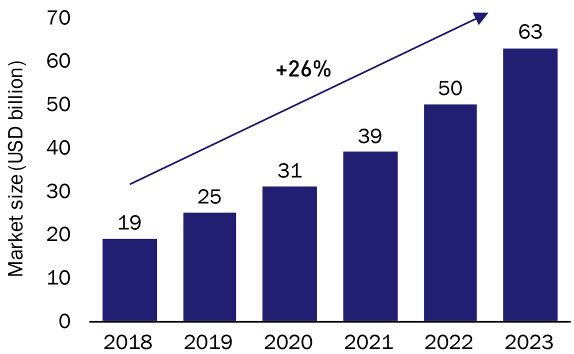

FIGURE 1: FINTECH MARKET SIZE, INDIA, 2018–2023 [SOURCE: ANALYSYS MASON, 2019]

Start-ups in the fintech sector in India have received considerable attention from investors due to the exponential growth in the market, along with the increased potential for returns. The investment in these start-ups reached a total of USD5.9 billion during 2014–2018, as shown in Figure 2. Within fintech, the

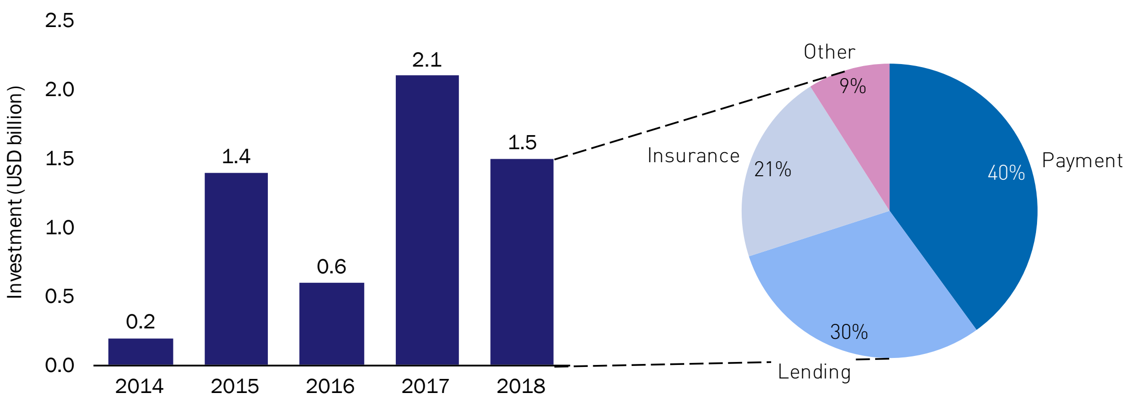

FIGURE 2: INVESTMENT IN FINTECH START-UPS (BY SECTOR FOR 2018 ONLY), INDIA, 2014–2018 [SOURCE: MEDICI]

[1] MEDICI (March 2019), India Fintech Report 2019.

payments segment accounted for the majority (40%) of the investments in 2018, followed by lending (30%) and insurance (21%).

These trends have persisted in the first half of 2019, and fintech companies in the payment sector have continued to receive the majority of investments. Payments start-up CRED has received particular attention from investors in 2019.

New fintech start-up CRED is gaining a lot of traction with investors

CRED was founded in 2018 by Kunal Shah (co-founder of FreeCharge) and is a rewards-based platform that enables credit card users to pay their bills and earn rewards in the form of cashback, discount coupons and free gifts. In its seed round, CRED raised USD30 million from marquee investors including Sequoia Capital, Ribbit Capital and RPT Global, and was valued at approximately USD75 million. Recently, CRED has been in the news again for its ongoing discussions with investors regarding a Series B round that is expected to result in investments in excess of USD100 million. News reports suggest that new investors such as Hillhouse Capital will participate in this round in addition to those that have already invested. CRED's valuation is expected to jump to between USD400 million and USD500 million as a result of the Series B funding round.

CRED has created a niche for itself by targeting a user base of upper-middle class Indians with high credit scores

Most start-ups in the digital payments space in India aim to target the vast majority of the population (that is, those in the lower-to-middle class bracket that do not have access to financial systems), but CRED has instead targeted upper-middle class Indians that have at least one credit card. It has thus created a niche for itself by establishing a user base of Indians with high credit scores. CRED attracts customers by giving them rewards in return for paying credit card bills through the platform. These rewards are in the form of cashback and discount coupons or free gifts from partner brands such as Amazon, Cleartrip, Cure.Fit, Flipkart and Uber. It also helps users to manage their credit card bills, make timely payments and spot hidden charges in their statements. CRED's mobile platform aims to differentiate itself by offering a world-class user experience when it comes to paying credit card bills. To make the user experience even better, CRED is planning to launch a UPI-based option for paying credit card bills.

CRED will have to explore other monetisation strategies in order to build a sustainable business model

Currently, CRED offers benefits to both customers and partner merchants. Customers get rewards/discounts and merchants get access to a rich pool of credit-worthy customers. Monetising merchant partnerships is one way to generate revenue, but this business model is unlikely to be sustainable on its own. Charging a significant fee per user for partner merchants would be challenging because these merchants are also incurring subscriber acquisition costs in the form of discounts/free gifts.

In the long term, CRED will need to move towards a sustainable business model by creating more revenue streams, much like other digital payments platforms are doing. CRED has access to an elite user base, and can obtain data regarding their credit-worthiness and spending by accessing their credit card statements and observing their behaviour on the platform (paying bills and claiming offers/discounts). CRED can make use of its user base and rich data to create new revenue streams. It could offer financial services such as lending, insurance, credit scoring and wealth management, and could also delve into targeted advertising. Exploring and adapting these high potential products/services could help CRED to drive business sustainability as shown in Figure 3.

Financial services	Lending	▪ Offer small personal loans and revolving credits to the user base based on their spending patterns and ability to repay ▪ Processing fees and net interest on the credit could be the key sources of revenue
Financial services	Insurance	▪ Either partner with insurance companies or become an insurance product vendor ▪ Insurance premiums/commission as an aggregator could be the source of revenue
Financial services	Wealth management	▪ Offer wealth management services such as financial advice and a platform for accessing investment tools ▪ Fees from financial advice and brokerage/commission could be the key sources of revenue
Financial services	Credit scoring	▪ Develop user credit scores based on user activity on the platform ▪ Selling the credit scores to banks and credit card companies could be the key sources of revenue
Advertising	Targeted advertisement and analytics	▪ Use the data generated from user interactions to understand consumer behaviour and run targeted advertisements on their platform based on usage patterns ▪ Monetise data by targeted advertising and selling data and consumer insights

FIGURE 3: POTENTIAL REVENUE STREAMS FOR CRED [SOURCE: ANALYSYS MASON, 2019]

B2B ecommerce is an emerging sector in India that is being driven by increasing digitisation in the country

The successful initial public offering (IPO) of IndiaMART InterMESH is testimony to the increasing prominence of B2B ecommerce in India. B2B ecommerce sales are expected to grow at a CAGR of 24% to reach USD1458 billion by 2023. This article discusses recent trends in investment and business models that are being adopted by key players in India.

IndiaMART's successful IPO highlights the value of the B2B ecommerce opportunity in India

IndiaMART made a strong market debut when it had its IPO on 4 July 2019, ending the first day of trading with a 34% increase on its issue price. The IPO was subscribed 36 times and helped to raise USD69 million from the market.

IndiaMART's IPO got subscribed to the retail investor portion of the issue 13 times, the institutional investor portion 31 times, while the high net-worth investor portion was subscribed to 62 times. Existing investors Amadeus Capital Partners, Intel Capital and Quona Capital sold shares through the IPO.

The success of IndiaMART's IPO comes at a time when the digital economy in India is benefitting from several policy changes introduced by the government, including

those that permit 100% foreign direct investment (FDI) in B2B ecommerce, making it easier for foreign players to invest in India. This significant policy change is intended to harness the potential of B2B ecommerce in India.

The market for B2B ecommerce in India is expected to be substantial: B2B ecommerce sales here are expected to grow at a CAGR of 24% from 2018 to 2023 to reach sales of USD1458 billion by 2023 (see Figure 1). This rate of growth is estimated to be higher than the past 4 years.[1] The Digital India campaign is also expected to be a key growth driver of B2B ecommerce sales in India, with its aims to increase internet penetration and launch digital supply chain management initiatives, thereby enhancing market size and operational efficiencies for B2B ecommerce players.

A surge in funding from local and international investors is driving growth in the B2B ecommerce sector in India

The new policy allowing 100% FDI in India has created the opportunity for large private equity (PE) and venture capital (VC) firms worldwide to invest in B2B ecommerce companies in India. Investment in B2B ecommerce in

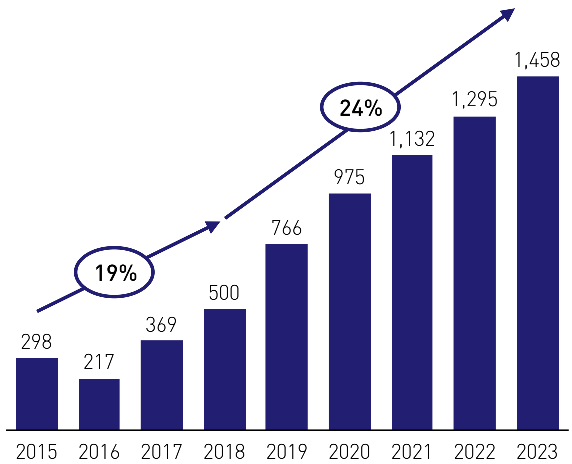

FIGURE 1: GROWTH OF B2B SALES IN INDIA, USD BILLION, 2015–2023
[SOURCE: ANALYSYS MASON, UNCTAD, MEDIA REPORTS 2019]

[1] 19% CAGR from 2015 to 2018, see Figure 1

India has been growing steadily and has reached more than USD500 million over the last 5 years.

For example, Moglix (an ecommerce company for B2B orders of industrial tools and supplies) recently received Series D funding amounting to USD60 million. Key investors in this round included Tiger Global Management, Sequoia Capital and Ratan Tata among others. Features of its B2B ecommerce platform include facilitating the supply of goods within and outside the country, GST technology that enables partners to file indirect taxes via the platform, and partnerships with over 200 000 SMEs and over 5000 suppliers for a client base of more than 300 large manufacturing firms. Moglix caters to major sectors including automotive, metals and mining and fast-moving consumer durables (FMCDs).

The positive trend for increasing investments in B2B ecommerce during 2019 suggests that growth will continue at least in the near term.

The subscription-based model enables B2B ecommerce players to maintain a reliable and recurring revenue stream and higher profit margins. This mode is not capital intensive because there is no need to store goods in warehouses or manage delivery of products. Furthermore, this model allows the businesses to predict orders more accurately. However, customer retention is a challenge when adopting this business model.

In contrast, some of the B2B ecommerce players in India that have adopted the transaction fee-based model also manage the logistics involved with transactions. For example, they are responsible for collecting the goods from sellers, storing them in warehouses and delivering them to the buyers. This makes it easier to retain customers compared with the subscription-based model. However, significant investment is required to manage the entire supply chain, making this model asset-heavy.

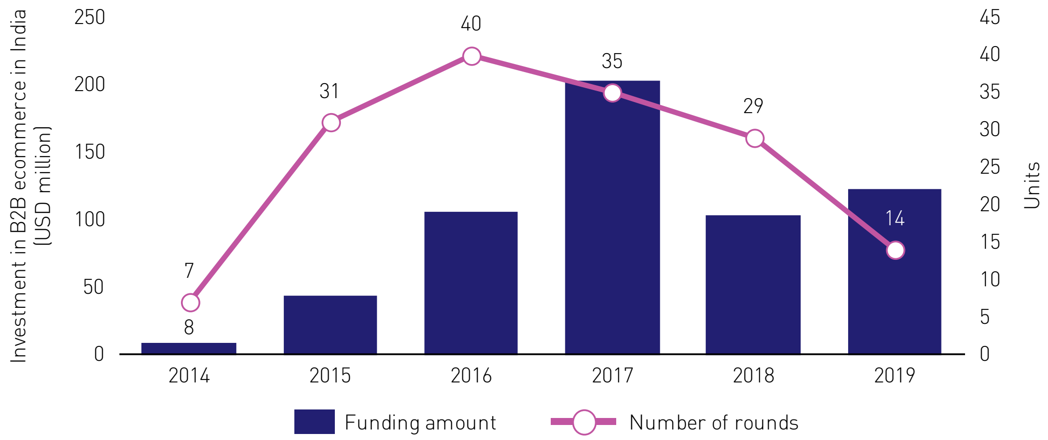

FIGURE 2: : INVESTMENTS IN B2B ECOMMERCE SECTOR IN INDIA[2] [SOURCE: TRACXN, 2019]

Indian B2B ecommerce players typically adopt either subscription-based or transaction fee-based business models

B2B ecommerce businesses have adopting either subscription-based or transaction fee-based business models. The subscription-based model enables B2B ecommerce players to charge subscription fees from buyers and sellers that want to be listed on the platform, which is a similar business model to an online classified platform. In contrast, the transaction fee-based model is driven by the fees that B2B ecommerce players charges for executing the transaction on the platform.

IndiaMART, JustDial and AlibabaIndia follow a subscription-based model, while Jumbotail, NinjaCart and Udaan, follow a transaction fee-based model. Amazon Business also operates in a limited number of cities in India and follows a mix of transaction fee-based and subscription-based business models. JustDial is also about to transition to a hybrid model.

Players in this space have traditionally used a pure subscription or transaction fee-based model, but an increasing variability in demand for online B2B goods and services means that players may adopt a hybrid model in the future.

[2] The 2019 investments appears rereported on 02 August 2019.

About Analysys Mason (including a view in to our internet transaction advisory experience)

Analysys Mason is a global specialist adviser on telecoms, media and digital (consumer internet). Through our worldwide presence, we have delivered strategy advice, operations support and market intelligence to leading commercial and public-sector organisations in over 110 countries.

We have successfully completed around 775 strategy and operations advisory engagements for TMT clients in over 60 countries in the last 3 years alone.

Offices worldwide

For more than 30 years, our intellectual rigour, operational experience and insight have helped our clients resolve issues ranging from development of operator strategy, evolution of national sector regulation and execution of major financial transactions, to the deployment of public and private network infrastructure. Analysys Mason consistently delivers significant and sustainable business benefits.

We are respected worldwide for the exceptional quality of our work, our independence and the flexibility of our teams in responding to client needs. We are passionate about what we do and are committed to delivering excellence to our clients. The company has around 260 staff worldwide, with headquarters in London and offices in Cambridge, Dubai, Dublin, Hong Kong, Kolkata, Lund, Madrid, Manchester, Milan, New Delhi,

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Key highlights of our Internet experience

1. 150+ due-diligences of **Internet assets** in South Asia, South East Asia, Middle East, Africa, and Europe over the last couple years
2. **75+** commercial diligences and market assessment in India/South Asia alone
3. **First port of call** for diligence of Internet assets for marquee investors globally
4. Provided advice on investments worth over **USD15 bn** over last 5 years

Diligence experience in Consumer Internet verticals

Ecommerce

- We have conducted **10+** full commercial diligences of **horizontal ecommerce majors** in India and South East Asia region
- In more recent years (post the market changes on horizontal ecommerce), we have also conducted **5+ diligences** as well as market scan of **vertical focussed ecommerce** players

Hyperlocal delivery

- We have been advisors to marquee PE funds and financial institutions on **5+ commercial diligences** of leading hyperlocal delivery players in the **grocery and food delivery market**
- We have diligenced the leading players in grocery and food delivery twice in the recent past

Payments and mobile wallets

- We have supported **10+** commercial diligences of leading **digital wallet** providers in India, South East Asia and Middle East regions including the full commercial diligence of a leading wallet provider in India
- We have also assisted **telecom operators** in developing their commercial and technical digital wallet strategy

Cab aggregation

- We have conducted commercial due-diligence of the **leading cab aggregator** in India **4 times** for different marquee hedge funds and financial institutions in the last 7 years
- We have also provided diligence support on the **self-drive commercial car market** and leading player in India

Content including OTT

- We have conducted full commercial and technical diligence of multiple players across the video and music content value chain (from producers to distributors/streaming assets
- We have also supported **leading mobile operators** in the region in developing their **Content and OTT strategy**

Others

- Over 15 diligences in the **classifieds** and **online travel** space
- Multiple diligences of **mobile advertising, cloud computing, SaaS, and AI** firms in various geographies
- Full commercial diligence of multiple **ed-tech** firms in India
- Assessment of the **fintech (online mutual funds, trading, and insurance)** in India, with a focus on two emerging companies

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