ARTICLE

Silver linings for e-Commerce

Opportunities amidst the pandemic and the associated business risks

The COVID-19 pandemic has had a significant impact on both global and local economies. The Indian economy shrank 23.9 percent year-on-year in the second quarter of 2020, the biggest contraction on record. While most Indian industries grapple with the aftereffects of the economic standstill, e-commerce and digital payment systems look towards new economies of scale in the pandemic hit economy as well as in the post pandemic economy. As one of the few sectors that continued to operate throughout lockdowns, e-commerce and digital payments have expanded and are in the process of efficiently scaling their operations into various new business segments, product categories, portfolios and regions.

Preceding the pandemic, in FY 2019, total retail digital payments in India were INR 1,638 lakh[1] crore. While total payments made in India reduced during the lockdown, digital payments, as a percentage, has seen a gradual increase, especially in online delivery of essentials including food and pharmaceuticals. Over-the-top (OTT) platforms, educational technology, utility/bill payments among others.

Traditionally, Indian consumers prefer brick-and-mortar stores, where they may see the actual product before making a purchase. However, the extended country-wide lockdown and social-distancing measures have necessitated an increase in consumers' acceptance of e-commerce.

The present crisis has created an opportunity for e-commerce companies to 'tap' into a wider customer base. As such, the e-commerce market is estimated to grow at a compound annual growth rate (CAGR) of 19.6 percent between 2019 and 2023, and it is predicted to reach INR 7 lakh crore by 2023.[2]

Opportunities for growth and the subsequent risks

Drastic changes in consumer behaviour and product preference, as well as the impact of the pandemic on internal and external factors affecting the e-commerce industry present the following opportunities to scale operations and diversify, using advanced technology and delivery models.

[1] RBI assessment of the progress of digitization from cash to electronic; https://rbidocs.rbi.org.in/rdocs/Publications/PDFs/CASHB74203395BD64E2ABC1BD5F68D8AEF13.PDF.

[2] Global Data Banking and Payment Intelligence Center; https://www.globaldata.com/covid-19-to-further-drive-e-commerce-payments-in-india-says-globaldata.

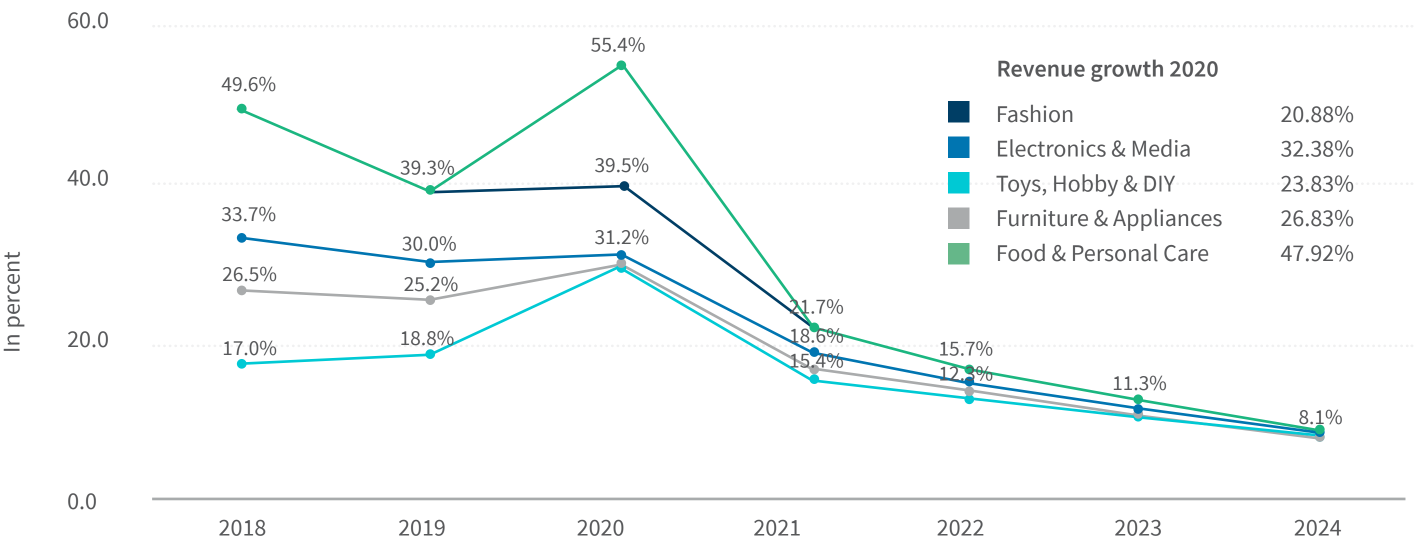
Diversification of product lines and validation of marketing schemes

The most promising opportunity for growth lies in diversification of product lines. Traditional product categories need to be realigned based on the shift in preferences and consumer spending habits. For example, work-from-home and a reduction in social visits have had an adverse impact in the demand for fashion apparel. Given the decline in household incomes for many individuals, the emphasis has shifted from preference-based to value-based products. Purchases of essentials, utilities and household convenience products have risen, and fashion purchases have fallen. (Figure 1).

In a recent survey conducted by FTI Consulting for the apparel sector[3], 42 percent of the 1,000 US consumer respondents to the survey stated that they plan on only buying clothing they absolutely need and ~31 percent said that price, more than brand names, influences purchases.

As companies attempt to diversify their products and merchant portfolio, they face an increased risk of fraud, including:

- Fictitious, blacklisted or unauthorised merchants;
- Collusion between employees and merchants to exploit cashbacks and promotional schemes;
- Self-ordering by merchants to receive cash backs;
- Employees providing higher visibility, product listing and discounts to their preferred merchants for kickbacks; and
- Reverse logistics (customer returns, overstock, expired items or redistribution) manipulation for personal gain of employees and delivery partners.



Source: Statista (Forecast adjusted for expected impact of COVID-19), August 2020

Figure 1: E-commerce product preference trends in India

[3] The Apparel Industry: Tailored for a New Era; https://www.fticonsulting.com/~/media/Files/us-files/insights/articles/2020/jun/consumer-reactions-covid-19-longer-term-implications-apparel-sector.pdf.

Hyperlocal delivery and regional expansions

Many e-commerce companies are trying to build the 'hyperlocal' model of delivery. The pandemic has reignited the focus of e-commerce and logistics companies on strategies to fulfil consumer demand through local 'kiranas' or neighbourhood stores rather than relying on inter-city deliveries. Another strategy would be to capture the underserved online ordering market in tier-3 Indian cities, where consumers still prefer to assess products in brick and mortar stores, placing a high level of trust in local family-owned shops, rather than online platforms.

Companies need to address some of the following key challenges to make the 'hyperlocal' model successful:

- Building technological capability
- Educating local merchants to list products as well as training to efficiently use the portal
- Addressing consumer data privacy concerns
- Identifying fake merchants or suspicious transaction patterns

Omni-channel and offline to online (O2O)

A severe impact on the offline retail sector's supply chain and logistics has already caused a loss of INR 5.50 lakh crore during the lockdown in India.[4] Many retail units are thus attempting to transition to O2O and omni-channel retail model to ensure business continuity. Several large retail outlets have either launched their own online platforms or have existing tie-ups with major e-commerce platforms.

The O2O and omni-channel model presents the perfect mix for brands, where the consumer trusts the retailer, and has the choice of picking up/ordering the product from the store and the convenience of returning/exchanging the product in case there are issues. For instance, one international cell phone manufacturer is bringing 20,000 of its Indian offline stores and brand ambassadors online through a click-to-mortar initiative that will allow the company to ensure business continuity and provide customers the convenience of ordering from their preferred stores from the comfort of their homes.

However, to achieve larger market penetration and success, companies should focus on:

- Providing effective warranty, replacement and return policies
- Proper integration of systems, data and policies between retailers and e-commerce platforms
- Strengthening logistics and data privacy controls

Digital transactions providing impetus

The Indian Government and the Reserve Bank of India have been the driving force behind the increase in digital payments in the recent years. Additionally, the pandemic led to the decision of e-commerce companies to discontinue cash on delivery (COD) payments, thereby increasing digital payments further.

However, the increase in digital payments has its own share of risks. Companies are increasingly facing large-scale phishing attacks, denial-of-service, defacement, data streaming (bulk theft of data or groups hacking into specific system), data takeovers, malware, ransomware and many other types of cyber-attacks.

It is essential to mitigate against cyber risks as falling victim to cyber-attacks causes severe reputational damage, financial losses and depletion of customer base for affected organisations.

Managing supply chain disruptions

The extended lockdown tested the fulfilment centres and warehouse capacities of most of the e-commerce companies and merchants. Companies had to quickly adapt to new ways of deliveries that also challenged their back-end technological systems and capabilities. The balance between order fulfilment and inventory management along-with seasonal demand and pandemic, is extremely difficult and most of the businesses are still trying to understand the ideal supply-chain diversification.

Further, the pandemic has severely impacted order fulfilment with many merchants running out of inventory, leading to delayed deliveries and cancellations and, subsequently, unavoidable refunds. Fraud schemes that have surfaced in this area include:

- Delayed deliveries or lost consignments
- Unauthorised and fraudulent refunds processed by call centres or requested by customers; and
- Round-tripping by merchants

[4] Economic Times – Retail sector losses

Although, most of the companies have reduced and, in many cases, eliminated cashbacks and discounts to minimise losses, demand for essential goods has increased, leading to a shift towards the need for maintaining demand-based inventory levels and reducing excess stock buffers.

What can e-commerce companies do?

While new opportunities pose new risks, there are several ways through which companies can navigate through these risks and drive more efficiency in operations, adding value to their stakeholders. A few of such measures that companies can take are:

— Enhance the effectiveness of merchant and seller onboarding due diligence processes;

— Focus on marketing leads, completion of KYC requirements, etc. by ‘fleet-on-feet’ or ‘field sales officers’ or marketing executives, which in most cases is outsourced to off-roll manpower agencies;

— Enhance usage of artificial intelligence (AI) and machine learning tools to monitor customer and merchant behaviour and botnet activities;

— Strengthen velocity checks with increased monitoring of transaction risks;

— Build checks to authenticate digital/synthetic identities;

— Implement warehouse management systems and supply chain automation tools with inbuilt fraud detection analytics;

— Re-evaluate access and controls to in-built system algorithm logic;

— Monitor marketing fees, cashback and incentive schemes for merchants through data analytics;

— Re-evaluate processes and controls around call-centre operations;

— Efficient management of fulfilment centres and expansion of merchant database;

— Integrate merchants’ inventory management system and e-commerce platforms to ensure order allocation and reduced cancellations; and

— Build smart logistics and delivery platforms with technology driven fulfilment centres.

With the advent of the ‘new normal’, there has been, and will continue to be, a significant shift in consumer behaviour. Amidst the gloom, there are a few silver linings that will enable the e-commerce industry to emerge stronger from the crisis. The key to success lies in how well companies prepare themselves to respond to the situation with processes and advancement in technology.

Our team of experts have worked with global, as well as Indian e-commerce giants to ascertain and mitigate risks associated with online retailing. FTI Consulting provides a combination of financial, technical, business and industry experience and helps its e-commerce clients infuse technological risk mitigators in their processes, existing supply chain and digital technology.

The views expressed herein are those of the author(s) and not necessarily the views of FTI Consulting, Inc., its management, its subsidiaries, its affiliates, or its other professionals. FTI Consulting, Inc., including its subsidiaries and affiliates, is a consulting firm and is not a certified public accounting firm or a law firm.

ROHIT DHINGRA
Managing Director
Risk Advisory & Investigations
rohit.dhingra@fticonsulting.com

ALEYA RAY
Consultant
Risk Advisory & Investigations
aleya.ray@fticonsulting.com