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Flipkart-Myntra; From a Merger to an Acquisition

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Abstract

The Indian e-commerce market was worth ☐ 75,000 crore, in 2013, according to a joint report by KPMG and Internet and Mobile Association of India. India has the potential to double its economic contribution via Internet, from 1.6 percent GDP at present to 2.8 and 3.3 percent by 2015 [MCkensy'2012]. Indian E-commerce is most likely to generate employment for 1.45 million people in coming two years. Emergence of the new government and its innovative policies are developing hope to bring FDI in e-commerce for local market players. Marking the biggest consolidation in the e-commerce space in India, this report puts light on India's own Amazon; Flipkart and fashion e-tailer Myntra which jointly exposes their vision to capture more than 50% e-market share by strategic alliance. As Flipkart's annualized sales crossed over ☐ 6,100 crore a year ahead of target. It had estimated to reach the billion dollar mark for gross merchandise value by 2015; on the other hand Myntra's revenue was about ☐ 1,000 crore in the previous financial year. It aims to double its revenue in this financial year as it expands its seller base and adds products following China's biggest e-retail model Alibaba.com. Myntra has about 100 sellers on board and plans to increase this number to 1,000 by fiscal end. The strategy of Flipkart is to invest around ☐ 600 crore in its fashion business in coming years to combat with global rivals like Amazon and eBay Inc. Furthermore it reveals the philosophy behind this giant acquisition and how this will contribute to the progression of Indian economy which will lead it to become a global player in E-commerce.

Keywords: Strategic Alliance, Flipkart, Myntra, E-commerce, Globalization, Economic Development, Amazon.com.

1. Introduction

Mergers and Acquisitions represent the ultimate in change for a business. No other event is more difficult, challenging, or chaotic as a merger and acquisition. According to Oxford, the expression ‘Merger’ means “Combining of two commercial companies into one”. The term "Acquisition" refers to the acquisition of assets by one company from another company. In an acquisition, both companies may continue to exist. The acquiring company will remain in business and the acquired company will be integrated into the acquiring company and thus, the acquired company ceases to exist after the merger. Transfer of technology develop prospects with multiple challenges for any enterprise. The prospects include access to new markets that were previously closed due to cost, regulation, or indirect barriers, the ability to beat resources such as capital, knowledge and labor. Challenges come from foreign competitors entering firms’ domestic markets, and from domestic competitors reducing their costs through global sourcing, moving production offshore or gaining economies of scale by expanding into new markets. Globalization challenges firms to become more streamlined and efficient while simultaneously extending the geographic reach of their operations [Kraemer et al., 2002].

Moving over to the fastest growing and striking on the position of third largest economy, Indian e-commerce has evolved significantly in the last decade, and there are many aspects of e-commerce like Tele shopping, online shopping and mobile, which are all part of what is digital commerce followed by Flipkart.com, Snapdeal.com, Jabong.com and Myntra.com; major players on the ground. eBay entered India nine years ago through the acquisition of Baazee.com, and five years prior to that was the start of organized retail in India. So, it is about 15 years old. What is interesting though in India is that the entire evolution of e-commerce happened in over 15 years whereas in advanced markets like the U.S., it took over 50-60 years. Flipkart, often termed as Amazon of India acquires smaller e-commerce rival Myntra to combat threat of Amazon.com the world's biggest online retailer, last year in June slashed prices and rolled-out next-day delivery in a bid to win market share of e-commerce. The pillar of Indian e-commerce industry is its igniting internet user base as millions of new users gain access through smartphones. India has an internet user base of over 200 million users as of 2013.

2. Literature Review

An understanding of mergers and acquisitions as a discipline is increasingly important in modern business. A glance at any business newspaper or business news web page will indicate that mergers and acquisitions are big business and are taking place all the time [Roberts, Wallace, Moles 2003, 2010]. Competitive pressure has been identified through numerous studies as an important determinant of IT adoption, whether it is EDI diffusion [Banerjee & Golhar, 1993; Ramamurthy et al., 1999; Webster, 1995], adoption of IT innovations [Gatignon & Robertson, 1989; Grover, 1993], degree of computerization [Dasgupta et al., 1999] or e-business adoption [Zhu et al., 2002]. Outstanding planning and execution are essential for a successful strategic alliance. Integration is reached only after mapping the process and issues of the companies to be merged. Even then just 23% of all acquisitions earn their cost of capital. When M&A deals are announced, a company's stock price rises only 30% of the time. In acquired companies, 47% of executives leave within the first year, and 75% leave within the first three years. Synergies projected for M&A deals are not achieved 70% of the time. Productivity of merged companies can be affected by up to 50% in the first year and financial performance of newly merged companies is often lacking [Practical guide for Merger and Acquisition, 2009]. Using the Internet for transactions and coordination can save time and money on delivery of goods by using rich information flows to simplify and streamline the flows of physical goods in the supply chain [Dedrick & Kraemer, 2002; Sturgeon, 2002]. Finally, firms that buy and sell in international markets are under pressure from trading partners to adopt e-commerce (especially B2B) to improve coordination with other members of the value chain. Subsequently Indian e-commerce has grown at a swift pace in the last 5 years from around ☐ 15 billion revenues in 2007-2008 to ☐ 139 billion in 2012-2013, translating into a compound annual growth rate [CAGR] of over 56 percent [CRISIL, 2014].

One of the biggest names in the Online Retail Industry and a leading e-Commerce player in the Country; Founded by Sachin Bansal & Binny Bansal in Bangalore, Karnataka in 2007.Which was started with initial capital of ☐ 4 lakh contributed by the founders, warehouses, offices and delivery centers across India. With over 17.5 million book titles listed, 16 different categories, more than 4 million registered users and sale of 55000 items a day their operations are simply huge. Had 8600+ employees till December 2013. Had a massive revenue of around ☐ 6,100 Crores [Raman, 2014]. On the other hand India's largest fashion e-tailer Myntra is aiming for a valuation of ☐ 2,400 crore.

3. Objective of the Study

1. To understand the existing e-commerce system of India.
2. To study the philosophy behind the acquisition of Flipkart and Myntra.
3. To examine major challenges faced by Indian consumer while shopping online.
4. To study the future of Indian e-commerce industry.

4. Research Methodology

This research paper is descriptive in nature and is based on the secondary data attained from the various secondary resources such as old research papers various e-journals, books, websites, whitepapers, newspapers and some of the governmental data etc. The data is compared with the previous data of Indian e-commerce industry with respect to the world economy.

4.1 E-commerce ecosystem of India

The rapid growth of e-commerce in India is supported by an increasingly sophisticated ecosystem that speeds consumer products makers' goods to online shoppers. The sector is classified into four major types, based on the parties involved in the transactions – Business-to-business (B2B), business-to-customer (B2C), customer-to-business (C2B) and customer-to-customer (C2C). The emergence of well-designed user-friendly online trading, payment and delivery services (see Fig. 1).

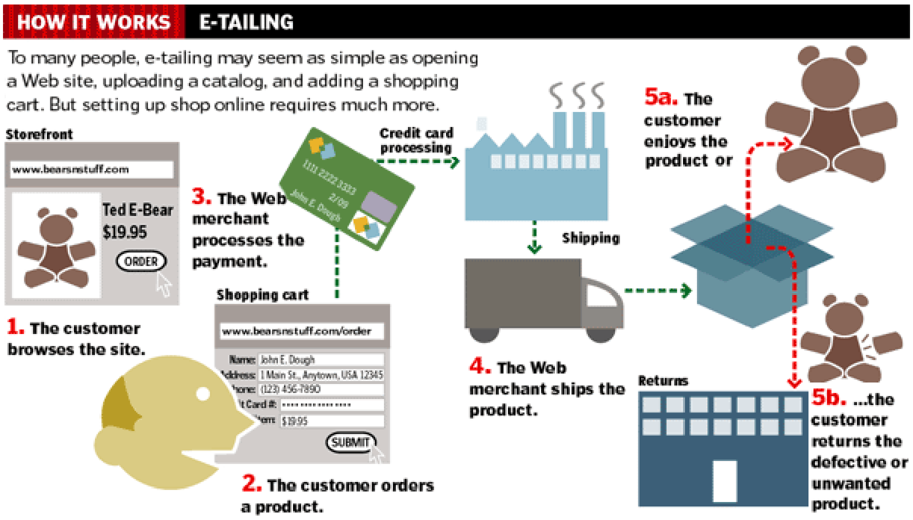

Fig. 1: Source Technopak 2013.

E-Commerce (B2C, C2C) revenues have been growing at a whopping ~50% year on year with USD 10billion in 2011. Technopak estimates that e-tailing in India will grow from the current USD 0.6 billion to USD 76 billion by 2021, i.e., more than hundredfold. The key reason for this disruptive growth lies in the fact that the market-enabling conditions and ecosystem creation for e-tailing will outpace the same for corporatized brick & mortar retail. This growth will offer many advantages to the Indian economy, besides bringing in immense benefits to consumers.

The growing need of consumer in various zones, travelling, jobs, entertainment and changing trends in fashion, has attracted customers to get comfortable ordering online. The companies has played a vital role in building a critical mass of Indian users – and they will continue to evolve. Key competitors of market Jabong, Flipkart, Yebhi and makemytrip has made a tremendous growth in case of turnovers (see Fig. 2).

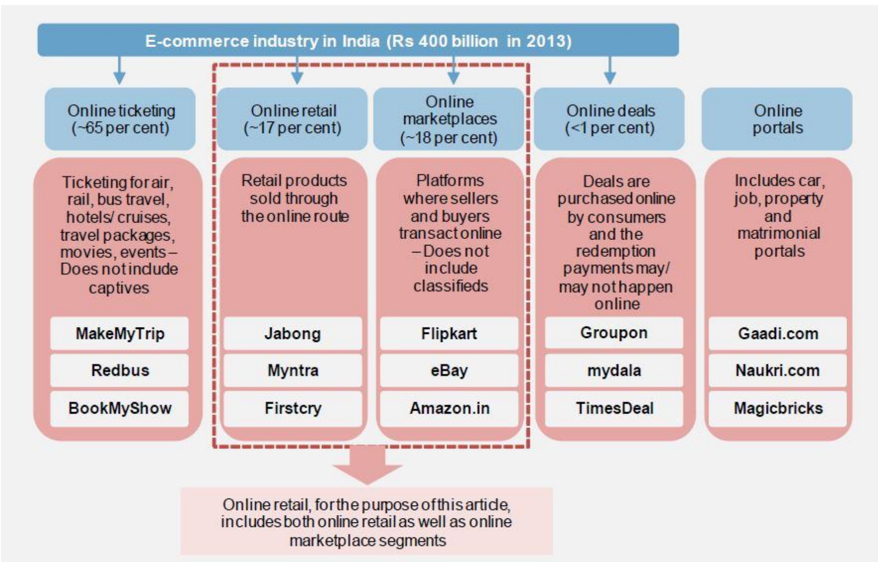

Fig. 2: Source CRISIL 2014.

Mobile phones are proving to be an important factor in the e-commerce ecosystem owing to its easy compatibility with the Internet. India has more than900.0 million mobile users, of which around 300.0 million use data services. This number is expected to touch 1200.0 million by 2015. Also, more than 100.0 million mobile users are expected to use 3G and 4G connectivity in the coming few years of the total 900.0 million mobile users, a meager 27.0 million are active on the Internet. Moreover, only 4.0 per cent of the active mobile internet users buy products through mobiles. However, mobile shopping is on upward trend and is expected to increase five–fold to 20.0 per cent in the medium term [IBEF 2013 also see Fig. 3 & 4]

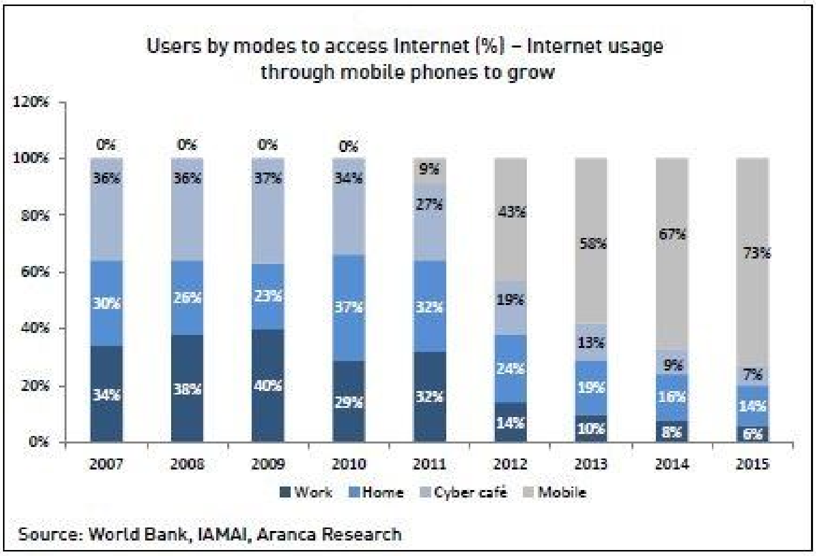

Fig. 3: Source World Bank, IAMAI, Aranca Research

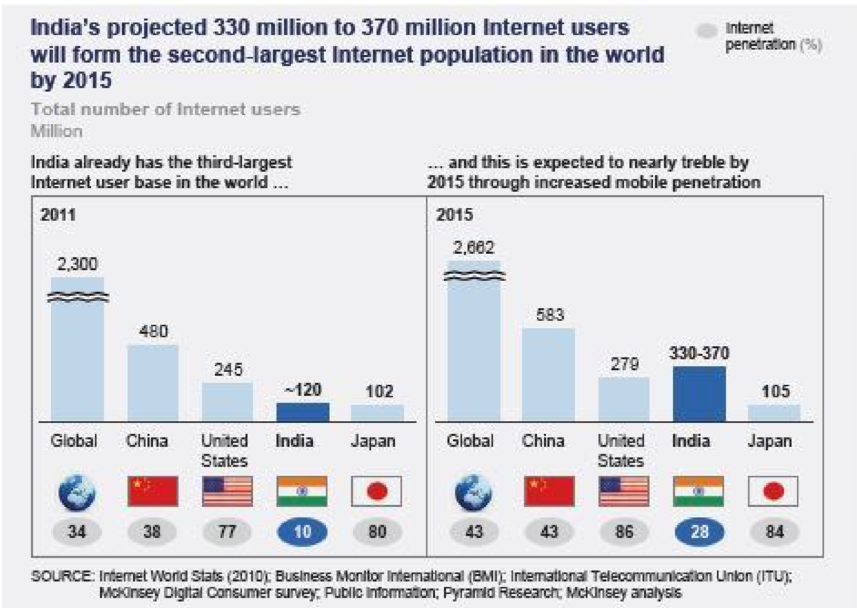

Fig. 4: Source IWS, 2010, BMI, ITU, Mckinsey

4.2 Philosophy behind the acquisition of Flipkart and Myntra.
As India’s community of online shoppers grows, so will the traditional and online players that make smart and strategic moves to enjoy the major share by optimizing operations for profit. The main idea behind any merger and acquisition is to gain competitive advantage in global market and accelerate company’s growth particularly when its growth is constrained due to paucity of resources. For entering in new product/markets, the company may lack technical skills and may require special marketing skills and a wide distribution network to access different segments of market. The joining or merging of the two companies creates additional value which we call "synergy" value.

Synergy value can take three forms:

4.2.1 Revenues: By combining the two companies, we will realize higher revenues then if the two companies operate separately.

4.2.2 Expenses: By combining the two companies, we will realize lower expenses then if the two companies operate separately.

4.2.3 Cost of Capital: By combining the two companies, we will experience a lower overall cost of capital.

The model below represents the process and map of merger and acquisition (see Fig. 5).

MAP OF M&A PROCESSES AND ISSUES

	Formulate	*Locate*	*Investigate*	*Negotiate*	*Integrate*
Key Activities	• Set business strategy • Set growth strategy • Define acquisition criteria • Begin strategy implementation	• Identify target markets and companies • Select target • Issue letter of Intent • Develop M&A Plan • Offer letter of confidentiality	• Due diligence analysis: 1. Financial 2. People/Culture 3. Legal 4. Environmental 5. Operational 6. Capitals • Finding summary • Set preliminary integration plans • Decide negotiation parameters	• Set deal terms: 1. Legal 2. Structural 3. Financial • Secure key talent and integration teams • Close deal	• Finalize and execute integration plans: 1. Organization 2. Process 3. People 4. Systems
Issues Risks	• Costs • Channels • Content • Competencies • Customers • Countries • Capital • Capacity	• ROI/ Value • Strategic Fit • Cultural Fit • Timing • Leadership Fit • Potential synergy • Viability	• Liabilities • Human Capital • retention/eliminate • Financial Viability • Integration Issues • Synergies • Economy of scale • ROI	• Price • Performance • People • Protection • Governance	• Speed • Disruption • Costs • Revenues • Results • Perception: 1. Shareholders 2. Public 3. Customers 4. Employees

Fig. 5: Watson Wyatt deal flow model (M&A)

Many mergers are driven by the need to cut costs. However, the best mergers seems to have strategic reasons for the business combinations. These include:

Positioning-Taking advantage of future opportunities that can be exploited when the two companies are combined. For example, a telecommunications company might improve its position for the future if it were to own a broad band service company. Companies need to position themselves to take advantage of emerging trends in the marketplace.

Gap Filling-One company may have a major weakness (such as poor distribution) whereas the other company has some significant strength. By combining the two companies, each company fills-in strategic gaps that are essential for long-term survival.

Bargain Purchase-It may be cheaper to acquire another company then to invest internally. For example, suppose a company is considering expansion of fabrication facilities. Another company has very similar facilities that are idle. It may be cheaper to just acquire the company with the unused facilities then to go out and build new facilities on your own.

Diversification-It may be necessary to smooth-out earnings and achieve more consistent long-term growth and profitability. This is particularly true for companies in very mature industries where future growth is unlikely. It should be noted that traditional financial management does not always support diversification through mergers and acquisitions. It is widely held that investors are in the best position to diversify, not the management of companies since managing a steel company is not the same as running a software company.

Short Term Growth-Management may be under pressure to turnaround sluggish growth and profitability. Consequently, a merger and acquisition is made to boost poor performance.

Undervalued Target-The Target Company may be undervalued and thus, it represents a good investment. Some mergers are executed for "financial" reasons and not strategic reasons [Evans, 2000].

Marking the above explanation Flipkart which started with online bookstore similar to Amazon and now sells products across categories, including fashion and electronics. It now also sells white goods and furniture. It hit the billion-dollar milestone in annual gross merchandise value last month.

Subsequently Fashion, which delivers over 35% in operating margin, is among the most contested categories in ecommerce and has seen the emergence of players like Jabong, Fashionara and Limeroad and even web-only brands like Yepme and Zovi. The number is growing every month and on track to grow between 100-150 per cent over next 3-4 years. The overall Lifestyle category in India is $45 billion, growing at 16% CAGR. The industry will cross $100 billion in 2015 with somewhere between 5-10% of this being online.

Flipkart moved to market place model in feb 2013 where third party merchants sell goods to shoppers through flipkart site. It allows e-commerce companies to scale up faster & save storage & other inventory related cost as the products are held by merchants. For Flipkart, setting up a huge fashion vertical means boosting margins, because fashion has the highest margins-35 to 40 per cent-among all products sold online. Myntra has big plans with its private brands like Anouk, Dress berry and Roadster, which promise margins as high 60 per cent. Myntra will continue to operate as a separate brand, and its founder Mukesh Bansal will occupy a seat on Flipkart's board, heading all fashion at the new entity. Flipkart will bring in its capabilities in customer service and technology. Both companies will also net customers that have shopped on both portals-about 80 per cent of the country's online shoppers have shopped on either Myntra or Flipkart. However, the companies will not integrate the back end. The two teams will also function separately.

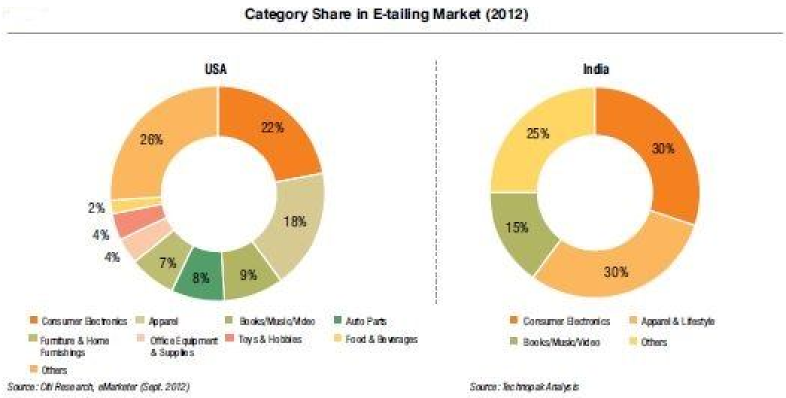

Fig. 6: Technopak Analysis.

To begin with Flipkart will invest \$100 million in fashion business. On the other hand Myntra’s goal is to generate ☐ 20,000 crore in gross sales by 2020 for which the site needs more than \$150-200 million fresh funds. Flipkart and Myntra deal will create the first Indian e-tailing powerhouse, and provide a big fillip to India's still nascent but very promising e-commerce industry. Myntra sells products from over 650 brands like Nike, HRX by Hrithik Roshan, Biba and Steve Madden and clocked revenue of about Rs 1,000 crore in the previous financial year (see Fig. 7)

HOW THEY STACK UP

	Flipkart	Myntra	Flipkart+Myntra
Registered users	18m	8m	26m*
Daily Visits	3.5m	1.7m	5.2m
Sellers on platform	3,000	100	3,100*
Team strength	10,000	2,000	12,000

Flipkart-Myntra annualized sales \$1.5bn

Myntra valued at approx \$350m

Fig. 7: Industry estimates.

As part of the acquisition, Myntra co-founder Mukesh Bansal will join Flipkart's board and will also oversee Flipkart's fashion business. Flipkart and Myntra will remain as two separate entities, but people holding stock options in Myntra will now hold the same in Flipkart. The current deal appears to be win-win for both companies, and could be the making of a giant company, better positioned to address India's growing demand for online retail-one that could put up strong competition against rivals Flipkart, which also operates under the marketplace model allowing retailers to offer products on its platform, has since its inception raised over \$500 million.

Common investors such as early-stage investor Accel Partners and investment fund Tiger Global are expected to remain invested in Myntra, as also recent investor Premji Invest, which participated in the ☐ 300 crore funding round in the fashion portal in February.

The two companies now have three common investors Accel, Tiger and Belgium-based family office Sofina. Myntra's other investors are IDG Ventures India and Kalaari Capital (see Fig. 8).

INVESTOR'S FAVOURITE	
Flipkart and Myntra have been among investors' favourite Indian e-commerce companies	
Myntra	**Flipkart:**
Funding so far: $125 million	Funding so far: Over $540 million
Feb 2014 - $50 million - Premji Invest, Tiger Global, Accel Partners and others	2013 - $360 million in two rounds - Led by Naspers, Dragoneer Investment Group, Morgan Stanley Investment Management, Sofina, Vulcan Capital and Tiger Global
Mid-2013 - $25 million - Tiger Global and Accel	2012 - $150 million - Naspers and ICONIQ Capital
Early 2012 - $21 million - Led by Tiger Global	2011 - $20 million - Tiger Global
March 2011 - $14 million - Tiger Global, IDG Ventures and Indo-US Venture Partners	2010 - $10 million - Tiger Global
November 2008 - $5 million - Series A funding from NEA-IndoUS Ventures, IDG Ventures and Accel Partners	2009 - $1 million - Accel Partners
October 2007 - Undisclosed seed funding from Accel Partners and Mumbai Angel's Sasha Mirchandani	

Fig. 8: Source industry estimates.

This giant deal will not only help to generate revenues for the companies but will also create opportunities for young talents of India. As industry grows it will require engineering teams, customer agents and logistic support to meet the demand. Flipkart will increase hiring from 13,000 to 25,000, and out of this 1,200 will be engineers. The e-commerce firm acquired fashion portal Myntra, according to source, the later too plans to double its headcounts this fiscal from a team of 500 employee (see Fig. 9).

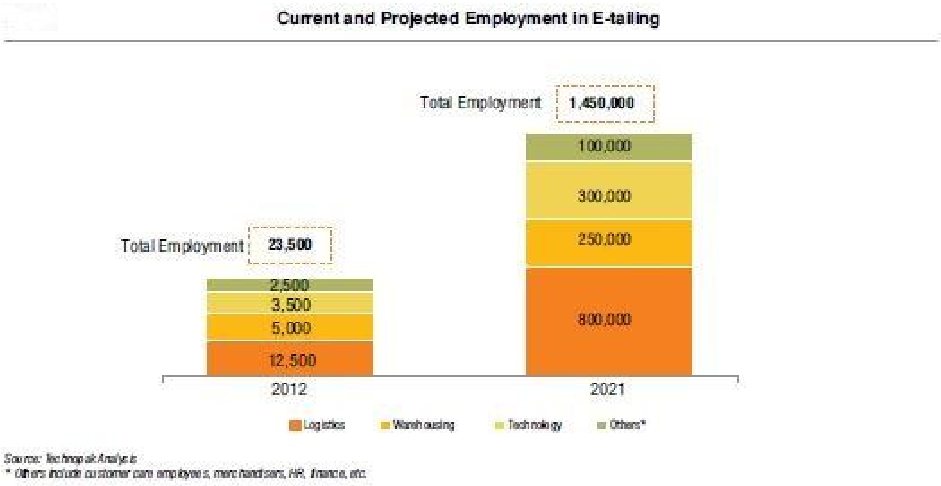

Fig. 9: Technopak analysis.

Financial details of the deal, including Myntra's valuation, were not disclosed by the two companies, but Mukesh Bansal said: "It is a fair valuation."

4.3 To examine major challenges faced by e- commerce industry of India

On most other dimensions, India's Internet infrastructure and e-engagement levels are limited, and its Internet foundations have significant scope to improve India's low levels of user adoption and engagement (ranked 49 out of 57 countries in Internet user engagement and accessibility) are due to the following obstacles:

Limited availability of Internet infrastructure: While India scores well on the availability of human and financial capital, it rates poorly on Internet infrastructure, Internet engagement, the e-commerce platform, the ease of Internet entrepreneurship, and the impact of e-governance. On most indicators of the strength of the Internet ecosystem, India ranks in the bottom quartile of our comparison set of 57 countries. Average international bandwidth capacity for every 10,000 people across the seven aspiring countries is 28 Mbps versus 6 Mbps in India.

Poor distribution channel management: Payment Options Vary for rural and urban customers. Customers in the metros are provided with an option of cash on delivery while advance payment is required for non-metro customers or rural area customers. Customers have a fear that whether they will receive the product or not if advance payment is done.

High cost of access and usage: At $61 per Mbps (on a PPP basis), India has one of the highest median costs of broadband access among comparable aspiring countries — more than four times that of China, Brazil and Argentina, and 20 to 30 percent higher than that of Vietnam and Malaysia [McKinsey, 2012 see Fig. 10]

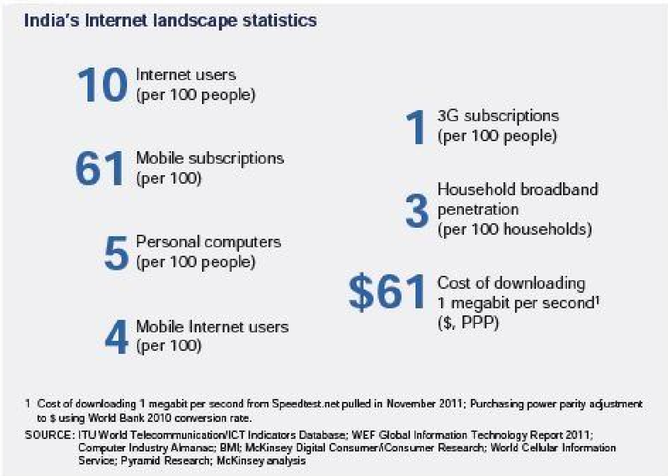

Fig. 10: Source McKinsey analysis.

Small range of applications and services: Internet applications are yet to scale up in a wide range of areas that impact society, such as agriculture, education, health care, and citizen services. Access to online government services across the country is low, with a large quantity of government data, such as land or health records, yet to be digitized, and large flagship Internet infrastructure projects such as the National Optical Fiber Network yet to become fully operational

Lack of digital awareness: Only 35 percent of businesses in India offered online services such as Web presence, compared with an average of 56 percent in aspiring countries. In an online survey of India's SMEs in the organized sector, they cited the lack of education on using the Internet as among the top three reasons that prevent consumers from using the Internet [McKinsey survey of 554 SMEs, 2012]

4.4 The future of Indian e-commerce industry: Attracting shoppers, investors and global players

One of the major catalysts for e-commerce is the breadth of Internet penetration in a country. The current penetration rate in India is at 10.1 per cent penetration rate, India has a huge Internet consumer base of around 125.0 million (as of 2011), the third largest in the world after US and China. By end-2012, the number of Internet users is expected to increase to 150.0 million. A study conducted by IMRB and IAMAI observed that of the total 99.0 million urban Internet users, 80.0 million were active compared to 31.0 million active users out of the total 38.0 million in rural areas as of June 2012. At its current pace, this number could multiply three-fold to nearly 380.0 million by 2015, surpassing the US and China. Notably, rural India has witnessed a significant increase in penetration of active Internet users – from 2.1 per cent in 2010 to 3.7 percent in June 2012. By end- 2012, the number of active rural Internet users would touch 38 million as against 24 million a year ago. However, even with its large consumer base, just 1.0 per cent of the total (less than 10.0 million Internet users) is engaged in e-commerce activities, thus reflecting a huge untapped opportunity. This number is expected to touch 39.0 million users by 2015 as Internet penetration increases and ecommerce becomes more secured.

The changing consumer lifestyles, supported by the younger population base of India, have given a boost to the e-commerce business. More than half of the total 1.2 billion population of India falls under the ‘below 25 years of age’ bracket. Also, 65.0 per cent of India’s population, representing the working age group of 15 to 64 years, would aid the further growth of e-commerce, driven by their rising disposable income. Notably, discretionary spending in India is expected to jump to 70.0 per cent by 2025 from 52.0 per cent in 2005.

With the underlying opportunities, the industry is set to benefit, driven by strong fundamentals and provision of continuous assistance by various PE and VC firms to fund their expansion plans. Notably, on the investment front, the sector enjoyed inflow of around $800 million in 2011, up from $110 million in 2010. Investments made in e-commerce businesses by PE firms alone more than quadrupled to $467 million in 2011 compared to $99 million in 2010. The number of deals increased to 78 compared to just 22 in 2010. The robust deal activity continued in 2012, with $242 million invested during the January-April period. The trend over the period reflects that the average deal size has more than doubled due to increasing traction in e-commerce activities, which requires larger investments for growth.(see Fig. 11)

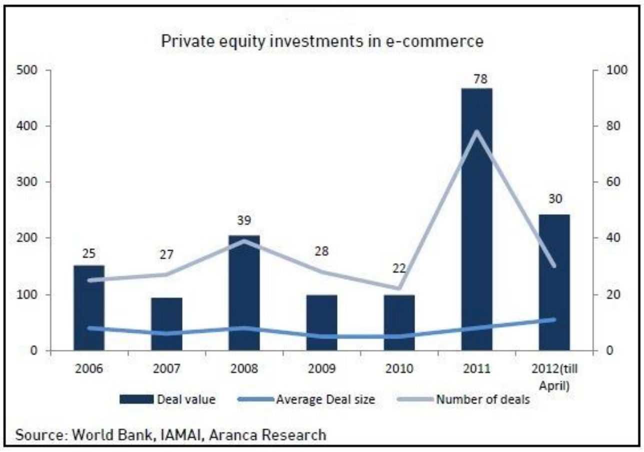

Fig. 11: Source world bank, IAMAI, Aranca Research.

If India achieved developed country levels of share of the Internet in ICT expenditure through increased Internet-driven usage and applications, the Internet's contribution to India's GDP could potentially double, to about 3.2 percent even at today's levels of expenditure. Even if we apply aspiring country benchmarks, India has the potential to almost double its share of Internet-related GDP to 2.8 to 3.3 percent by 2015.

Industry surveys suggest that e-commerce industry is expected to contribute around 4 percent to the GDP by 2020. In comparison, according to a NASSCOM report, by 2020, the IT-BPO industry is expected to account for 10% of India's GDP, while the share of telecommunication services in India's GDP is expected to increase to 15 percent by 2015. With enabling support, the e-commerce industry too can contribute much more to the GDP. The projected growth of e-tailing in India will successfully address all the above challenges. The cost of distribution will reduce because the multi-layered distribution system will be replaced by an order fulfillment process arranged in a hub and spoke model. The layers of distributors will not be required here as this role will be fulfilled by warehousing and logistics operations which offer margin enhancement opportunities for manufacturers and better prices for consumers.

5. Conclusion

There are numerous reasons why companies decide for strategic alliances. Some studies indicate that companies merge for improving efficiencies and lowering costs. Other studies show that companies acquire to increase market share and gain a competitive advantage. The ultimate goal behind a merger and acquisition is to generate synergy values. Good strategic planning is the key to understanding if synergy values do in fact exist. A well-researched and realistic plan will dramatically improve the chances of realizing synergy values. The strategic partnership of Myntra and Flipkart will provide a guidance for traditional players. They'll leverage existing capabilities and platforms by pursuing adjacent growth. They can expand to vertical segments, collaborate with brands by designing their websites and open offline stores to grow their customer base. The rapid growth of Indian e-commerce (especially e-retail) are attracting global players and increasing investors' interest. India needs to extend the benefits of the Internet into sectors of the economy that have so far not been touched. Strong internet infrastructure need to be extended beyond the top cities into Tier 2 and Tier 3 cities, and deeper into the semi-urban and rural parts of the country, that are home to 70 percent of the population and represent an estimated 50 percent of total household consumption.

The Indian government has restricted foreign companies from selling their products in India through the online medium. This regulation safeguards Indian companies against competition from global leaders such as eBay and Amazon. Currently, 100 per cent FDI is allowed in business-to-business (B2B) e-commerce in India, but when it comes to business-to-consumer (B2C), it is prohibited. Besides, there is a mandatory 30 per cent local sourcing norm for foreign players. According to a recent report by IAMAI-KPMG, Indian inventory-based e-commerce sector failed to grow as much as international counterparts that have FDI support despite having one of the largest internet populations. While B2C players have been in conversation with the government from the beginning of 2013. However, new government might allow FDI in e-commerce. Government should provide legal framework and guidelines in e-commerce to expand companies' horizons, basic rights such as intellectual property, prevention from fraud, consumer protection, confidentiality, and etc. through which they can expand their businesses by lowering cost and can contribute maximum to the progression of Indian economy.

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