R&C Trendwatch

July 2015

Politics and e-commerce in emerging markets: Three things to watch

Executive summary

- Developing markets will offer the biggest growth potential for e-commerce in the next five to ten years, albeit from a low base.
- Many of the factors underpinning e-commerce growth in these countries are driven by politics.
- Understanding these issues and how they are likely to develop can help retailers devise an online strategy that is efficient, effective, and appropriate for these markets.

Introduction

The combination of rising disposable incomes and increased internet access equates to strong growth potential for e-commerce across the developing world. The explosion of this sales channel has enabled retailers to reach customers in a variety of ways, changing the experience for both seller and buyers. In a recent report, Credit Suisse said it expected e-commerce as a share of total retail sales to become bigger in nine key emerging markets than in developed economies. These markets are Indonesia, India, Turkey, China, South Africa, Saudi Arabia, Mexico, Brazil, and Russia. Indeed, e-commerce growth across Africa and Southeast Asia is expected to outpace that in the developed world over the next ten years. While these are exciting headlines, there are significant challenges to overcome, ranging from poor connectivity and logistics bottlenecks to regulatory hurdles. Understanding some of the trends underpinning e-commerce expansion in developing markets is crucial, and many of these are driven by politics. This report discusses three ways in which politics will affect e-commerce in emerging markets.

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*This publication is produced in collaboration with **Eurasia Group (www.eurasiagroup.net).** Eurasia Group is a leading political risk research and consulting company.*

Policies to improve connectivity, particularly through smartphones

Retail is not typically considered a strategic sector by governments. Unlike the energy or food sectors, governments generally leave retailers to the business of attracting customers and selling products. Although the same can be said for e-commerce, the information communications technology (ICT) infrastructure that underpins online retailing can be heavily influenced by state policy and investment.

Online retailers will experience more success in areas where e-commerce is supported by good ICT infrastructure. In many developing countries, improving the digital economy is a priority, but the way this is achieved is likely to have an impact on how potential consumers get connected, in turn affecting online retailers' expansion strategies. Many emerging market policies focus on enhancing accessibility to the internet via smartphones, for example. Given that fixed-line networks across rural areas in emerging countries are typically underdeveloped, the widening of smartphone coverage will help online retailers reach a new segment of previously underserved customers. This is particularly the case across Africa and Asia—the two continents likely to experience the biggest growth in e-commerce over the next decade, albeit from a low base.

Southeast Asia

E-commerce in Southeast Asia is reasonably underdeveloped. Online sales account for less than 1% of total retail sales, even though the six ASEAN countries are home to 8% of the world's population and about 3%–4% of global GDP. By comparison, online sales in Europe, China, and the US range from 6%–8% of total retail sales. There is wide variation in internet usage across Southeast Asia. Only 16% of Indonesians are online, and less than half of the populations of Thailand, the Philippines, and Vietnam use the internet. In contrast, more than two-thirds of people in Malaysia and Singapore are online, a figure closer to developed market standards. Among internet users in the region (not counting Indonesia), 60%–80% shop online. Indonesians seem less enthusiastic, with only 12% of connected people engaging in e-commerce.

A common theme across Southeast Asia, however, is the popular use of mobile phones for online shopping. Fifty-seven percent of internet users in ASEAN countries use their mobile phone to buy online compared with 44% in the rest of the world. And e-commerce is growing fast. In the past four years, the ASEAN online retail market has expanded by 15% annually. Rising purchasing power and greater connectivity means this growth rate is likely to increase further, and spurring it are a few government initiatives worth highlighting.

To accelerate the shift to a digital economy, **Indonesia** has stopped issuing permits for the sale of 2G cellular phones, automatically heightening demand for low-cost 3G smartphones in a country where tens of millions depend on wireless communications. Although the smartphone has become popular since its arrival a few years ago, 70% of phones in Indonesia have no online capacity. The policy, which will be introduced later this year by the Ministry of Communications and Information, seeks to bridge the digital divide between residents of affluent cities and those who live in the outer islands. If affordable phones are available, there will be mass migration to 3G by next year among lower-income groups. This will be an exciting opportunity for consumer goods firms and retailers to connect with a new customer base online.

In **Thailand**, authorities plan to extend broadband coverage nationwide over the next two years, particularly in rural areas where capacity remains low and demand is on the rise. Unlike other telecommunications initiatives, including the auction of 4G spectrum, this effort is not part of the broader Digital Economy scheme that is mired in political controversies owing to the inclusion of a cyber-security bill to allow state surveillance. The broadband coverage plan is a standalone project and will likely advance at a faster pace given broad political support.

The plan is among the government's more well-defined projects. Getting 75,000 villages connected to low-cost, high-speed internet will include installations of fiber-optic cable across rural areas. This will be financed and implemented by public-private partnerships to be formed in the next six months. The National Broadcasting and Telecommunications Commission, the national regulator, says it expects the domestic wireless market to grow 3% in 2015, while demand for smartphones and other mobile devices will go up at least 10%, though with this initiative demand may climb even higher.

Sub-Saharan Africa

Over the past few years, sub-Saharan Africa has benefited from enhanced international connectivity thanks to the activation of submarine cables along the continent's east and west coasts. And although there are bottlenecks within and between many African countries, particularly inland, these are being addressed by regional initiatives to improve connectivity. As a result, mobile data usage and revenue are experiencing robust growth and creating a platform for the expansion of e-commerce across Africa.

Helping the spread of e-commerce across the continent is the fact that mobile phones are also facilitating increased financial inclusion. In many countries, mobile banking solves the problems posed by limited physical infrastructure and the cost of setting up branches and ATMs. It enables unbanked Africans to make transactions using their cell phones—and, as this becomes an established means of trading and transacting, e-commerce will be a natural progression, especially as broadband, 3G, and 4G networks are established and the cost of smartphones decreases. The widespread use of payment via mobile indicates that most users regard this as a secure method of transaction.

In **Angola**, the Angolan Investment Bank (known by the acronym BAI) recently launched its e-Kwanza BAI, an electronic payment service for goods and services. The tool enables customers to transfer money to individuals anywhere in the country and to make payments to traders registered with the BAI, all via mobile phone. The introduction of Angola's first electronic money transfer and mobile phone–based payment service will expand m-commerce and financial inclusion, with positive knock-on effects for the retail sector. And in a country where mobile phone penetration far exceeds ownership of a fixed line or fixed internet connection, the introduction of this m-payment service is transformative. At the end of 2014, Angola's mobile penetration rate was 70% (up from 62% in 2013), compared with 1.5% for fixed lines and 26% for the internet.

Smartphone penetration is on the rise across Africa (particularly among wealthier urbanites) as the price point for an entry-level smartphone declines. Informa estimates smartphone penetration at about 79 million users in 2012 and expects this to grow to 412 million users by 2018. There were an estimated 62.05 million mobile broadband subscriptions in Africa at the end of 2012, up from 41.92 million a year earlier, representing year-on-year growth of 48%. By 2018, mobile broadband subscriptions are expected to account for about 66.8% of the continent's mobile subscriptions. Low-cost smartphones are the key enabler of mobile data access in Africa, and therefore the key to e-commerce.

With this in mind, **Ghana** announced plans to abolish the 20% import duty tax on smartphones in 2015. As communication in Ghana transitions from voice to data, mobile data usage is projected to ramp up at least six-fold between 2013 and 2018, as reported in the 2015 budget statement. Internet penetration stands at 40%, but the greater affordability of smartphones should help enhance access with a positive knock-on effect for e-commerce. Whereas mobile phone penetration is high in the country (at 108 mobile cellular subscriptions per 100 people), smartphones account for only 15% of the total number.

Nigeria's goal to extend 3G broadband access this year to 50% of the population, up from about 10% at present, is probably unrealistic, but the country is nevertheless likely to experience steady growth of 3G access. Given the size of the market, broadband penetration of about 10% translates into 16 million consumers, mostly concentrated in urban areas with economies of scale. As access expands, it could have a transformative impact on Nigeria's small yet growing e-commerce market championed by local companies such as Jumia and Konga. These first movers have shown that the industry is already profitable.

Through the East Africa Communications Organization, negotiations will progress throughout 2015 on key initiatives such as the implementation of an East African Internet Exchange Point (EAIXP)—infrastructure that would make the transfer of traffic between networks faster and cheaper, and the first of its kind in the region. The EAIXP will ultimately help participating governments achieve the goal of better online service provision and promote the expansion of e-commerce.

Investment rules

Retailers can expect a wide range of e-commerce investment rules in emerging markets and these will affect the way they do business in these countries. Moreover, these regulations can change along with shifting political priorities, so it is important to keep up to date with what is and is not possible to achieve through an e-commerce platform. Some markets will require local partnerships, or permit sales only through third-party vendors such as Amazon or Flipkart, while others will be much more open to attracting foreign online retailers, particularly if authorities can extract revenue for online sales. In a number of countries, the regulations are in flux.

In **Indonesia**, for example, the government will soon liberalize the nascent e-commerce market, allowing for foreign ownership of local sellers. Until now, e-commerce has been on the so-called negative list of business sectors in which foreign companies can neither operate nor own shares. To skirt around the regulation, foreign players can serve as intermediaries or fund local companies through debt or securities offerings. In 2014, for example, Japanese mobile carrier SoftBank Corp and US investment firm Sequoia Capital injected $100 million into Tokopedia, one of Indonesia's biggest online marketplaces, through a funding round. Some form of protection for local players is likely to be established before the government opens the sector to foreign investment, probably in the second half of this year. Officials are discussing the permitted level of foreign ownership in e-commerce firms and will seek to balance liberalization with nationalist sensitivities.

In May, **India**, a country infamous for protectionism in its retail sector, initiated consultations with online retailers and industry lobby groups on allowing FDI in e-commerce. There are currently no limits to FDI in business-to-business (B2B) e-commerce ventures, or online marketplaces, but foreign online retailers cannot sell goods directly to consumers. Though there are no firm indicators yet on whether the government is likely to permit foreign ownership, and to what degree, developments are worth monitoring because India's e-commerce market is expected to grow from $2.9 billion in 2013 to more than $100 billion by 2020. In 2014, it attracted investments of more than $4 billion. The growth in online retail is upsetting traditional brick-and-mortar sellers in India who are demanding heightened protection from the government.

In **China**, foreign firms can fully own e-commerce companies in the Shanghai Free Trade Zone, which was established in 2013. This is a significant development given the scale of the Chinese consumer market. Foreign e-commerce firms previously were required to have a local joint-venture partner.

Consumer protection

In its survey on emerging consumers, Credit Suisse notes that the majority of Chinese consumers choose their favorite website based on its trustworthiness, rather than a website's product listings, cost, or brand type. Security-related concerns, they argue, need to be overcome to drive e-commerce further. With this in mind, governments in developing countries are getting up to speed in implementing e-commerce rules designed to enhance online security and protect consumers.

China's first e-commerce law is likely to be completed in the second half of 2015 and implemented by mid-2016. The aim is to establish greater data security, intellectual property, and consumer protection online. The law will also probably lead to stricter security protocol for authentication, electronic signature, taxation, and online finance systems. Once passed, compliance and implementation will be strong given the high-level government buy-in for nurturing the e-commerce sector, which the leadership views as critical to supporting consumption-led economic growth. For foreign retailers, the law should help boost consumer confidence and online sales. In addition, more rigorous reviews of product authenticity will benefit foreign brands. Approval of a sweeping national security law on July 1 by China's top legislature will also extend Beijing's authority for more rigorous oversight and control over data transmission and networks.

India's consumer affairs ministry is preparing an amendment to the 1986 Consumer Protection Act that would update and widen the scope of the law to cover a bigger variety of services, including e-commerce, and expand product liability. The changes would likewise establish a new Consumer Protection Authority with the power to investigate product safety, order recalls, police misleading marketing, and levy fines. The amendment is likely to be introduced later this year, with passage around mid-2016. Improving consumer protection, particularly for online sales, enjoys widespread political and popular backing as increasing numbers of Indians embrace e-commerce.

Not all markets are prioritizing consumer protection, however, and laws governing online data can actually dent consumer confidence. Last October, for example, a **Cambodian** government directive ordered 12 mobile and internet providers to allow interior ministry officials to inspect their networks, billing records, and data logs. While the government is happy to monitor the online activity of its citizens, it has done nothing to protect its consumers from fraud in online transactions—factors that reinforce Cambodians' reluctance to use online services.

In countries with a lack of initiatives to fortify consumer protection online, retailers themselves must do all they can to ensure the safety and security of transactions. But even then, this may not be sufficient to overcome consumers' distrust of the internet.

For retail and consumer goods companies, future growth in emerging markets will be heavily impacted by e-commerce. Understanding how politics play into this – and keeping a watchful eye on developments in countries of interest – is critical to success.

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