GMV/GTV Multiple – The Fallacy of E-Commerce Valuation

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GMV/GTV Multiple – The Fallacy of E-Commerce Valuation

The valuation stories of E-Commerce companies, which almost always follows an exponential path, has always baffled me. This has made me wonder if there's an alternative school of thought that may have a contrarian view to this valuation story/theory. If there isn't any until now, I would want to be the founder of that alternative school.

The flaw in this valuation theory, the way I see it, is by assigning market multiples to the Gross Transaction Value i.e., GTV (also referred as Gross Merchandise Value or GMV) as opposed to the actual revenues booked by the e-commerce companies by way of reseller fees or commission earned. In order to understand it better, let's dissect this step by step so that we get to the root of this fallacy…

…E-Commerce Companies, Unless They Sell Their Own Branded Merchandise, Are Commodities:

My focus here is on e-commerce companies who are aggregators (i.e., companies that operate as a market place) are commodities in the language of asset pricing/valuation, and will have high price elasticity. The reason being, these aggregators are frontline distributors – in the distribution value chain – to a producer's merchandise, and, therefore, when a sale takes place, it's because of the brand retention/loyalty of the producer's merchandise and not of the aggregator. Therefore, if a competing aggregator offers the same merchandise on its platform at a lesser price, the consumer would go with the one that's priced less due to value-for-money. That's where the price elasticity kicks in, which hardly leaves aggregators with any differentiators other than price competitiveness.

Therefore, this distribution system i.e., Market Place Aggregators, without any key differentiators, is a commodity, and, hence, an unusual high valuation for such aggregators would certainly raise an eyebrow.

Differentiating GMV/GTV with Revenues Would be a Step Closer to Understand the Fallacy of E-Commerce Valuation:

GMV or GTV is the aggregate volume of the merchandise sold to the end consumers multiplied by the listed price of the units. While the transaction/POS happens at the aggregator's domain, the gross retention for the aggregator is limited only to the agreed revenue sharing for the merchandise, and the rest of the transaction value is passed on to the producer of the merchandise. For example, if the revenue sharing between the producer of the merchandise and the aggregator is 70% and 30%, respectively, it means for a transaction of every INR 100, the aggregator would keep INR 30 as its reseller fees/commission income, and the remaining INR 70 would be passed on to the producer of the merchandise.

Therefore, if the valuation multiple, in the above example, is applied to the entire GTV of INR 100, it would be fundamentally incorrect because INR 70 – in this GTV – does not even belong to the aggregator. That's the fallacy I am trying to highlight, since the actual revenue of the aggregator, in this example, is only INR 30. Therefore, assigning multiples to GMV/GTV as opposed to actual revenues would not only be fundamentally incorrect but also create…

…An Asset Bubble Trap:

The practice of GMV/GTV multiples would continue to keep the underlying asset price (i.e., the aggregator company) artificially high, thereby creating bubbles. While the early investors may perhaps get an exit, it's the late entrants – who would usually enter at an astronomically high valuation – who would likely get trapped. An exit at this point would be next to impossible since the business fundamentals won't be able to support the underlying price of the asset.

To Conclude – Always Bet on the Cash Flows:

If I am an investor looking at investing in e-commerce companies, I would bet my money on the ability of the company to generate cash. Let alone GMV/GTV, what's the point of even having an exponential revenue trend if it fails to cover the cost of generating such revenues? Therefore, unless the company has the ability to not only turn cash positive, but also sustains it, valuation based on revenue multiple has no meaning, let alone GMV/GTV multiple. ◆

'The views expressed in the column are of the author, and may or may not be endorsed by the publication.'

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