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Logistics the Trump Card in E-Commerce (Video)

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A 24-hour Ulmart collection point in east Moscow.

Overcoming Russia's logistical barriers has become the focus for many leading domestic e-commerce companies, who are less concerned with slashing prices than with growing a loyal customer base.

The stakes are high, with Internet-based commerce in Russia slated to hit $36 billion by 2015 and account for 4.5 percent of all retail sales, according to an estimate by Morgan Stanley.

"Distribution is the cornerstone of e-commerce in Russia. Russia is a large country with complex infrastructure, and as a result delivering goods quickly has always been problematic, particularly if the aim is to do so cheaply," said Mikhail Gritsenko, director of business development at Ozon.ru.

The Ozon holding, which includes Ozon.ru — Russia's equivalent to Amazon — online shoe

store Sapato.ru, tourism services and more, is one of the top players in Russian e-commerce, with total sales of 15 billion rubles ($440 million) in 2012.

Unable to rely on state-run postal services, Ozon.ru and other big players have resorted to creating their own delivery channels and other infrastructure in order to get goods to customers.

"In Russia it is very difficult with logistics, with the postal service, with delivery services, and so precisely for this reason we created our own," said Sergei Fedorinov, general director of market leader Ulmart.

Ulmart was founded in 2008 as an online electronics store and has since expanded to household goods, automotive supplies and other products. It became the first Russian Internet retailer to top $1 billion in annual revenue in 2013.

Majority shareholder and board chairman Dmitry Kostygin said that the company's logistics model represents "the next generation" of online shopping.

Dmitry Kostygin, co-owner and chairman of the board at Ulmart, on the company's "skyscraper" business model and Russia's underdeveloped postal service.

Rather than storing products in a few isolated warehouses and distributing exclusively via home delivery in the style of U.S. giant Amazon, all of Ulmart's warehouses double as pick-up locations.

Customers can order delivery or arrange to pick up their order at any one of the company's warehouses or outposts, which are spread across 165 towns and cities in European Russia.

"Basically, with Ulmart you either get the product here and now or the next morning," Kostygin said.

Self Service

A key ingredient to Ulmart's success was the realization that the majority of their customers would rather pick up purchases themselves than pay extra and wait for delivery.

In total, 68 percent of orders are picked up at Ulmart's warehouses, 20 percent are distributed via "outposts," and only 12 percent are delivered directly to the consumer, according to company statistics.

Competitor Ozon.ru is capitalizing on the same trend, offering, in addition to delivery by its private courier service, the option of receiving an order at one of 2,100 pick-up locations across Russia.

Delivery by courier simply is not convenient for many people here. Rates tend to be high, and for busy professionals, it is often difficult to arrange a delivery time, Ozon.ru's Gritsenko said.

There are psychological and cultural factors involved as well. Consumers want to feel that there is a physical place they can go in case of a problem, and people living in the regions are

less comfortable letting an unknown person into their homes, Gritsenko said.

Preferences vary significantly across Russia, he added. In Moscow about half of Ozon.ru's customers opt for delivery, while in St. Petersburg that number falls to a quarter and in the regions, a mere 10 percent.

"For now, in the regions, customer pick-up is by far the winner," Gritsenko said.

This could change, however, as investment in logistics grows. In January, search engine leader Yandex announced a million-dollar purchase of logistics services aggregator MultiShip and plans to invest "several million" dollars in developing the company's software.

"Russia's regions are driving a lot of the growth in the country's e-commerce market. The biggest obstacles to the spread of e-commerce are problems with logistics and delivery," said Alexey Avdey, head of Yandex.Market, an online price comparison service.

MultiShip functions as an intermediary between multiple logistics services and more than 300 small and mid-sized Internet stores, helping them to optimize delivery routes and providers across Russia.

Logistics, Not Price

In focusing their energies on logistics, major retailers are fine-tuning an aspect that is within their control, while Russia's shadow economy makes it very difficult to compete on price.

Of the more than 30,000 Internet retailers active in Russia, "the majority of them operate with violations of current legislation," said Vitaly Zhigulin, executive director of the Association of Online Vendors, or AKIT, in a statement on the association's website.

The majority of illegally imported goods today are sold online, and at prices substantially lower than those of legal imports, Zhigulin told Kommersant in December, adding that Internet companies achieve such price reductions by evading value-added taxes and customs duties.

AKIT estimates that the state lost 30 billion rubles ($860 million) to illegal imports in 2013.

What this means for large companies operating within the law is that, at least for now, there is always a cheaper price to be found somewhere online.

But e-commerce market leaders are confident that customers come to understand, sooner or later, the drawbacks of buying illegally imported goods online from third-rate suppliers.

"The issues are: a) how much time will you spend finding this item, and b) when will it really be available to you," Ulmart's Kostygin said, adding that delivery times of up to six weeks are not uncommon for such purchases.

Asked what will ultimately separate the winning e-commerce companies from the rest, Gritsenko said that price and product range are important, but that reliability will be the key differentiator.

"The bulk of consumers get used to stability very quickly, and value proven quality and service," he said.

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