FUTURE OF ECOMMERCE

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INFLATION

Growing pains: how ecommerce firms can fight inflation

Ecommerce businesses are struggling against ratcheting borrowing costs, as interest rates rise and capital grows more expensive. How can they rework their business models and weather the storm?

Emily Seares

Generations of consumers have never experienced a world of high prices, with business models, value propositions and retail relationships built on the assumption of low inflation. This is no longer the case, posing serious challenges for ecommerce businesses.

The cost-of-living crisis, fuelled by rocketing energy prices and soaring inflation – forecast to reach double digits for many European countries over the coming months – combined with the rising cost of raw materials, packaging, transport and labour, is putting insurmountable pressure on retailers and increasingly price-conscious consumers.

"The era of being rewarded for hyper growth at any cost is quickly coming to an end," US venture capital firm, Sequoia Capital, warned in an advisory note to its portfolio companies in May.

Ecommerce businesses were set up on high-growth, low-profit models after more than a decade of cheap lending. They are struggling against ratcheting borrowing costs, as interest rates creep up and capital becomes more expensive.

"We've been in an era of cheap money since the global financial crisis," says J. Walker Smith, knowledge lead at global data and insights firm Kantar. This featured "a cheap money cycle supported by the kind of focus on running a start-up with the purpose of valuation, as opposed to creating bottom line value and profitability", he says.

During this period, investors, venture capitalists and private equity companies could afford to underwrite growth-orientated business models. "But the investor climate has changed, and this is a wake-up call," he warns.

What, then, can high-growth ecommerce businesses do to rework their business models and weather the storm?

Erin Brookes is head of retail at Alvarez & Marsal, a global consultancy. For Brookes, "taking a razor-sharp look through their entire operating model and every single cost within the business is essential".

> **For retailers, granular understanding of their customer base could mean the difference between survival and liquidation**

This is about asking and understanding what really works at the core of the business "that we can back and that customers are really engaging with", she explains. "What's got to be the focus for this business to be healthy? And are there parts of the business, in adjacent categories or different geographics, that aren't giving the return and are distracting from the core?"

There needs to be a shift in the kind of metrics used to drive these businesses, says Smith. The most immediate focus should be less about driving novelty in the offering to get attention and users and less about building an overall user base. It should instead be about driving value per customer. He advises retailers to focus on value-orientated strategies that look at the value they can drive per customer, then evaluating success against a metric of profitable customers.

Alex Charlton is senior vice-president of technology, media and telecoms at international research and insights agency Verve, which works with brands such as H&M, Samsung and No7 (Boots). He says part of the shift is understanding what 'value' means to different customer groups, then using this information to shape what you're offering and how you communicate it.

"For retailers, granular understanding of their customer base could mean the difference between survival and liquidation over the coming months," he explains.

"Factors such as market segmentation, targeting and positioning will be key, such as allowing them to target and tailor products and messaging to different customer groups accordingly."

Charlton says retailers should become an authentic ally to their customers, especially those who are struggling financially. The thought process should shift from focusing on how they can sell more to asking how they can help, he says.

"Customers will remember and it will be an opportunity to create lasting brand loyalty," he adds.

Tony Preedy, managing director of global marketplace Fruugo, says it's crucial that online retailers measure, understand and manage unit economics to overcome rising inflationary pressures.

"Ultimately, businesses are going to have to make trade-offs between profit now and growth later, so it's important for them to analyse their data closely," he says. "Inevitably, rising costs are likely to cause retailers to put up their prices in the short to medium term. But online retailers can be highly agile in how they price to optimise how they sell through their inventory, and they can also be cute about how they target discounts to prompt a purchase."

However, he warns about a strategy of indiscriminate discounting to drive volume. "Very few businesses properly calculate the impact on gross margin of reduced prices and the massive growth in units required to keep income stable, never mind growing," he says.

With a myriad of data at their fingertips and agility in their pricing and marketing, ecommerce businesses have some strong advantages over their bricks-and-mortar counterparts as conditions change.

However, the overarching issue for online retailers, compared to physical retail, is the cost of distribution and the impact this has on margins. This is "a weakness in the business model that is only exacerbated in the current trading environment," says James Hankins, founder of strategy consultancy Vizer Consulting and co-chair of the IPA Share of Search ThinkTank.

With bricks and mortar, the cost of fulfilment is held by the consumer. But with ecommerce this relationship is inverted, with the retailer having to sink the cost.

"This is a huge cost base that ecommerce players have to shoulder, and it's very difficult to optimise," says Hankins. In today's market of soaring costs, it's becoming increasingly untenable.

To mitigate these fulfilment challenges, retailers such as Zara and Boohoo have started charging customers for delivery and returns. Returns are a costly element of the distribution model for online fashion businesses, with Asos saying in June that a "significant increase" in returns contributed to its latest profit warning.

Some retailers are supplementing their core ecommerce channel with other revenue streams. In March, the fashion retailer H&M started trailing the sale of third-party brands on its website in Sweden and Germany, opening its distribution network to other brands and effectively renting it out.

Meanwhile, German ecommerce giant Zalando has bought a majority stake in retail media business Highsnobiety, "which offers the opportunity for high margins and relatively low effort" says Hankins. This allows it to sell advertising and helps to cross-subsidise the weakness in the ecommerce business model.

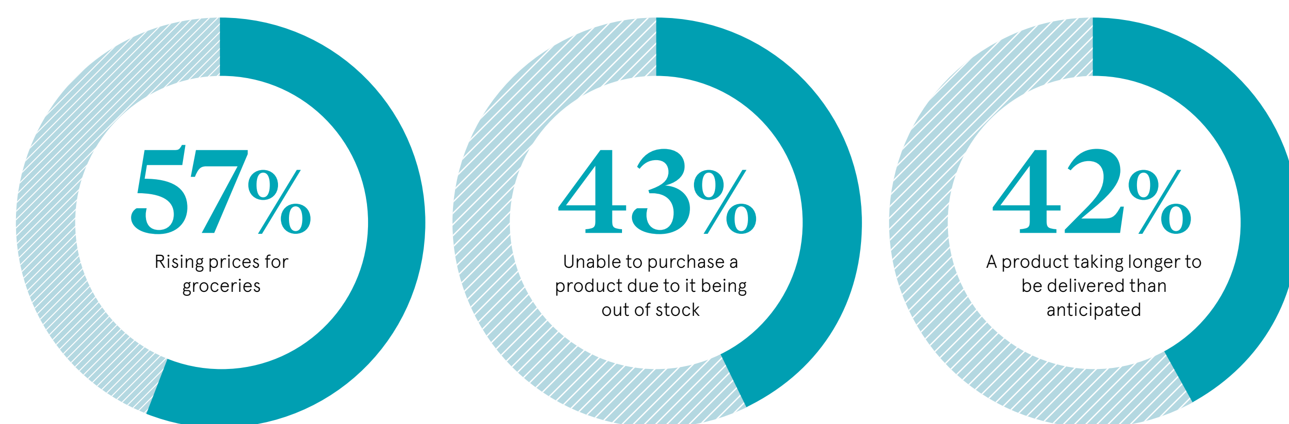
Online furniture retailer Made.com, which has made little profit comparative to revenue in its 12 years of trading, bought online marketplace, Trouva, in May.

"If consumers are buying more than Made products by shopping across the marketplace, you are opening up the potential demand," says Hankins. "This means your marginal costs should hopefully reduce because you're getting more brands to use your distribution network."

Pressure is growing as interest rates rise and banks start to call in loans. High-growth retailers must think long-term and strategically about building operations that support their core business, while bolting on multi-revenue generating arms that have been tested, scaled and managed appropriately to cross-subsidise the cost challenges in their distribution model and the wider economic climate.

WHAT IS WORRYING CONSUMERS IN 2022?

Percentage of global consumers who say the following are the main issues impacting their online shopping experience in 2022



PwC, 2022

9.9%

inflation rate for the Consumer Prices Index in the UK in August 2022

up from just...

0.2%

in August 2020

Office for National Statistics, 2022

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India: open for business

An initiative on the subcontinent could change ecommerce as we know it. Should UK firms be paying attention?

Natasha Khullar Relph

The world's lowest data and smartphone costs, increasing levels of online shopping in small cities and villages, and a pandemic that forced people into digital purchases have led to a dramatic rise in ecommerce in India.

The ecommerce market on the subcontinent is expected to reach £103bn by 2026 from £32bn in 2021, with online shoppers from rural areas expected to account for 24% of online retail spending by 2030.

However, India also has an ecommerce duopoly, in which Amazon and Walmart-owned Flipkart control more than 60% of the market, squeezing out kirana stores, the locally owned shops that provide daily supplies and essentials to small neighbourhood communities.

The between 12 and 20 million kirana shops in India contribute 10% of India's GDP and employ 8% of the workforce. However, they lag behind in terms of digital adoption.

A recent government initiative aims to do address this. The Open Network for Digital Commerce (ONDC) is a non-profit established by the Indian Department for Promotion of Industry and Internal Trade. Its goal is to develop open ecommerce and level the playing field for small businesses across retail, travel, hotels, food ordering and delivery, and other sectors.

ONDC will allow store owners to sign up to the network once and have their products appear on all participating ecommerce platforms and in search results across all apps. Commissions are capped at 3%, a 10th of what sellers pay on larger platforms.

For shoppers, this means that instead of having to do price comparisons by logging in to each individual ecommerce store, there will be a single app where results from all participating buyers will be shown.

"ONDC goes beyond the current digital commerce model, where the buyer and seller have to use the same platform or application to be digitally visible and do a business transaction," the union minister of state, commerce and industry, Som Parkash, noted in a response to the Lok Sabha (the Indian parliament).

"ONDC protocols would standardise operations like cataloguing, inventory management, order management and order fulfilment. Thus, small businesses would be able to use any ONDC-compatible applications instead of being governed by specific platform-centric policies."

The pilot phase of the project launched in April 2022 in five cities: Coimbatore, New Delhi, Bengaluru, Bhopal and Shillong, with 100 more cities serviced by August. The goal is to have ONDC covering the entire country by the end of the year. It is hoped that the initiative will bring 1.2 million sellers and 900 million shoppers to the network, while achieving a gross merchandise value of £4bn.

In theory, the concept is appealing and aims to answer the questions that advanced and emerging economies are grappling with, says Amol Kulkarni, director of research at Consumer Unity & Trust Society International, an organisation that seeks to protect consumer rights through research-based advocacy. On the one hand, big tech networks bring credibility, trust and some level of certainty but they can also be exclusionary, with high prices and sometimes anti-competitive practices.

"The government is saying that because we're pioneers in technology and have good use cases of population scale in government tech and digital public goods, we'll come up with both seller- and buyer-side apps, and connect these apps to create an ecosystem and marketplace where sellers don't need to reach out to buyers themselves."

In practice, there are still a few kinks to be ironed out. For one, there is no clarity on how smaller players will defend their competitiveness on the platform, says Sanjay Mehta, a venture capitalist who has invested in more than 150 global startups, including Wizzy.ai, a search engine for ecommerce stores that is working with ONDC.

"We might see bigger players use their abundant resources to scavenge the market early on, dismissing any sort of democratisation in its real sense. Price differentiation may favour larger players as they might burn a lot of money initially to gain market share on the network."

Another issue is that the more complex the ecosystem, the harder it will be to get both buyers and sellers on board. A senior employee at Amazon was reported as saying that one of the reasons Amazon, Flipkart, and other platforms are reluctant to join ONDC right now is because of the lack of clarity about the architecture.

In August, Microsoft became the first big tech company to join the ONDC initiative. The software giant said it intends to introduce social ecommerce in the Indian market. The company will establish a shopping app in India, which will be available on the ONDC network and allow buyers to discover the best prices offered by retailers. Amazon, Flipkart and Google are also reportedly in talks to join.

Despite some reservations, most experts and businesses are excited about ONDC and how it could change the ecommerce landscape, not only in India but globally. Infosys co-founder Nandan Nilekani, who is advising the government on the adoption of ONDC, calls it "an idea whose time has come". He told *Fortune* magazine that ONDC "will provide a glimpse for the whole world of how open commerce can drive positive non-zero-sum outcomes for business and society."

> Price differentiation may favour larger players as they might burn a lot of money initially to gain market share on the network

If successful, ONDC could be a template for how to democratise ecommerce globally. Much like the Unified Payments Interface (UPI), a payment system developed by the National Payments Corporation of India that simplified peer-to-peer money transfers – and which is being introduced in countries including Singapore, Malaysia, Thailand, Hong Kong and the UK – ONDC could easily become the go-to model for digital commerce.

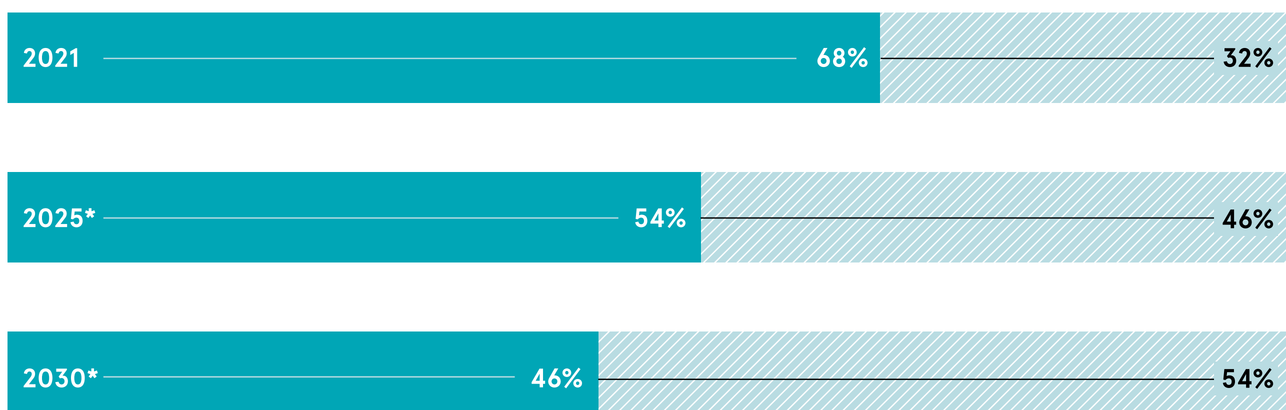
"All of us have seen the exponential growth of UPI over the past few years," says Mehta. "The ONDC has the potential to be the UPI of the ecommerce space."

It is likely to be a number of years before ONDC's full potential can be realised. But, in the meantime, the initiative is encouraging small kirana shop owners to digitise their stores and start competing with – and often beating – the bigger platforms in their own communities. ●

THE RURAL POPULATION IS DRIVING THE ECOMMERCE REVOLUTION IN INDIA

Current and *forecast share of total online shoppers across India

Urban · Rural



BCG, 2022

Commercial feature

How hyperlocalisation is transforming ecommerce

Local fulfilment, employing digital technology to optimise warehouse operations and the availability of asset-based financing all drive ecommerce forwards, says **Jack Williams**, CEO of Selazar

The growth in ecommerce since the Covid-19 pandemic has proven just how much consumers value convenience. Same- and next-day delivery is now an expectation of an online order, rather than a premium that customers are willing to pay for.

Today's demand for consumers and companies to be as sustainable as possible is a significant catalyst for change within the global supply chain, especially for that important 'last mile'.

Hyperlocalisation is the strategic spread of stock across a localised network of hubs; bringing businesses closer to their customers with fulfilment centres, delivery locations and collection points tailored to their regional markets.

This drives businesses to leverage warehousing to their advantage, enabling them to reach as many customers as they can in the shortest possible time.

Spreading stock across a wide network is becoming the desired goal and this doesn't – as many companies believe – mean they must hold a high amount of stock in each location to be able to fulfil same-day delivery expectations.

In fact, through the intelligent use of technology, a whole range of efficiencies can be gained to make the process more cost-effective with a lower environmental impact.

This is to be welcomed at a time when economic headwinds look set to impact bottom lines. As inflation rises, fuel costs increase and business spending cutbacks are universal, getting much more from much less becomes a commercial imperative.

There are two strands here that connect for the greatest success: hyperlocalisation and warehouse virtualisation. They go hand in hand. Hyperlocal operations facilitate same-day delivery expectations and support efficient local returns. What's more, the shift towards localised stock distribution has far less of an impact on the wider environment.

For example, there is no need to use big diesel-laden lorries when orders can be sent by bike carriers or electric vehicles. Retailers know their customers want hyperlocalisation. Who wouldn't like to receive their order fast, whether that's first thing the following day or within hours of making a transaction online?

In the US, micro-hubs have become a necessity due to the country's vast geography. In the UK, they can be employed strategically to enhance customer experience.

Hyperlocalisation is a boost for UK exports

For most companies today, competing solely on price is no longer an option. Instead, retailers of all shapes and sizes are turning to customer experience as their key differentiator – and fast delivery times are a significant factor in ensuring that it is a positive one.

At Selazar, we plan to offer same-day delivery in 15 cities across the UK from our warehouses later this year through a network of micro-hubs. Not only does this benefit our clients' last mile, but it also helps them meet CSR targets on the environment and sustainability. We aim to achieve this in the US, South America and Europe too.

Growth-oriented businesses need the ability to expand their customer base into overseas markets to increase their turnover and boost profitability – this is especially the case for smaller and more regional brands. If you are a cosmetics company in the UK wanting to sell to Latin America, it shouldn't take three weeks to ship your product there to a customer's home. It also shouldn't take the same time – or longer – for that customer to return it.

According to Shopify, 32% of consumers have abandoned a purchase due to estimated shipping times being too long (37% in North America).

That is why hyperlocalisation is a huge opportunity. You ship a product selection in bulk and then delivery is taken care of locally on the ground. Not only does this open new markets, but it reduces customs paperwork, delivery and returns times, all while mitigating environmental impacts.

No longer is the experience clunky for the consumer or the company they are buying from, which in turn builds brand loyalty and promotes word-of-mouth recommendations.

However, the key to successful hyperlocalisation is warehouse virtualisation. This is what makes hyperlocalisation economically viable and provides consistently outstanding service across the globe.

Through warehouse virtualisation, businesses have complete control over their logistical operations globally via cloud-based technology. This ensures consistent fulfilment operations; from guiding storage and packing practice to managing couriers and delivery speeds.

Brands that opt to partner with Selazar have the benefit of clearly understanding how much stock they need to keep at hand and what SKUs are most likely to be ordered.

As we make advancements in tech-led fulfilment, it is clear to see that the legacy way of owning and operating dozens of globally filled warehouses comes with high fixed costs, overheads, employee wages, and the initial capital outlay. Replicating stock across them all also means tying up a lot of money; this can be a big challenge for a brand, whatever their size, blocking them from their true growth potential.

Asset-based financing to free up cash

By working with a trusted partner such as Selazar, companies can take advantage of intelligent stock propagation that is all set up and ready to go via a prebuilt warehouse network. This uses artificial intelligence and machine learning to understand where stock is required, what stock that is and how much must be held in each location. Forecasting promotes efficient distribution.

Our systems can tell what is needed where, and how to load balance your operations. It does this by analysing historical data and making educated predictions, mitigating many risks.

The more data you have, the better the outcomes. Over time this will measure, track and predict seasonal trends and promotional activity. It helps to manage peaks and troughs in demand and supply; real-time oversight allows different stock locations to be turned off and on as order levels dictate.

> Growth-oriented businesses need the ability to expand their customer base into overseas markets to increase their turnover and boost profitability

Alongside hyperlocalisation and warehouse virtualisation, there is another solution to a common problem. Many businesses lack the liquidity to make these options work for them. At Selazar, we offer asset-based financing, with money released against the value of the stock held. We also have 90-day credit terms to ease cash flow worries.

Towards localised global fulfilment

Since Covid-19, ecommerce expectations have changed. Consumers want things faster; brands want a simple solution to meet that expectation.

Hyperlocalisation and warehouse virtualisation work together neatly to achieve this, successfully meeting demand, driving revenues and cutting carbon. It reduces management and operational efforts too.

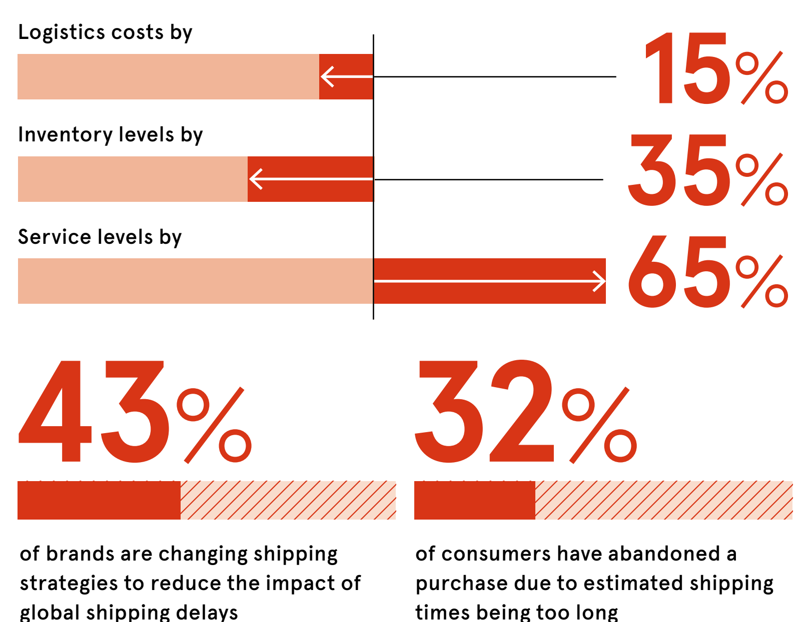
Downtime, friction and products being out of stock are dealt with, as is having to find the right talent internally to run warehouses or implement effective logistics technologies and software. Cost savings come through scalability.

As a future-thinking 3PL, we customise everything we do to each of our client's requirements on a global level and provide a single user interface for 24/7 visibility and control.

Shopify's research suggests early adopters of artificial intelligence-enabled supply chain management can improve logistics costs by 15%, inventory levels by 35% and service levels by 65% – compared with slower-moving competitors.

However, a move away from the traditional way of doing things throws up many fears. Some companies, especially bigger ones, have invested significantly in costly warehousing infrastructure or are tied to long leases.

But as ecommerce continues to grow fast, fulfilment will head further in this direction. The choice now for C-suites is how quickly they accept joining this journey.



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