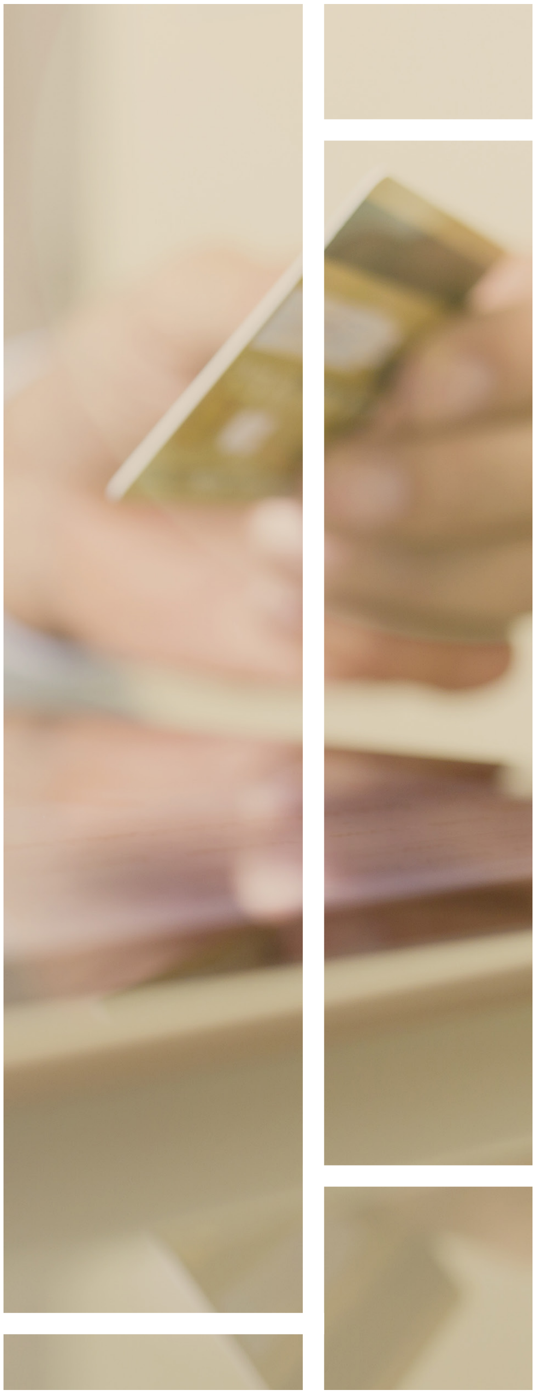
E-commerce and the Compression of Retail Disruption



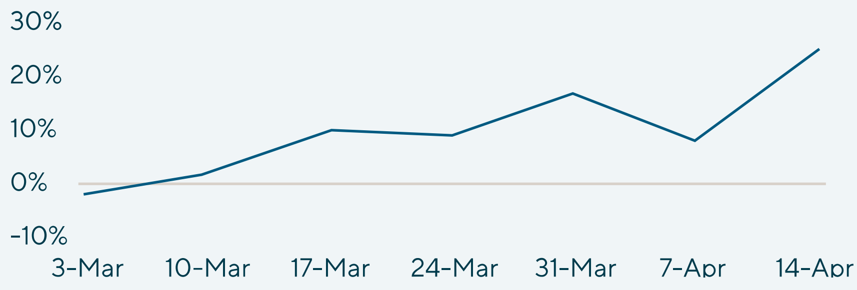
CONTRIBUTORS

Eddie Krule, Director
Chris Stradling, Managing Director
Brad Akason, Managing Director
Dominic Rispoli, Managing Director

In recent years, the consumer shopping experience was already experiencing rapid upheaval with e-commerce growing from 6.5% of total retail sales in 2014 to 11.0% in 2019[(1)]; COVID-19 only accelerated the disruption traditional brick and mortar retail was feeling. Businesses are shuttered and employees are working from home, while people are following social distancing and shelter in place guidelines nationwide. E-commerce went from being the disruptor shopping channel to, for many product categories, the only available option leading to increased adoption and more frequent use. While the current crisis is temporary, the effects on consumer shopping habits will be long-lasting.

E-commerce has proven to be a resilient sales channel, often growing despite declines in broader retail sales and even through periods of economic softness. The current crisis highlights this theme: while U.S. Q1 retail sales data is not yet final, e-commerce sales are expected to increase meaningfully, driven by categories such as online grocery (100% sales growth since the start of March[(2)]) and home products (Wayfair for example has seen its growth rate double as more consumers invest in home offices). Meanwhile, brick and mortar sales are expected to plummet, as evidenced by a 60% reduction in foot traffic in March[(3)]. The convenience of e-commerce has never been questioned, but now we must recognize its criticality in a time of crisis. The business model and infrastructure are exceptionally well situated to handle market and environmental disruption.

U.S. E-commerce Weekly Spending growth during the lockdown[(4)]



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THE ONLINE SOCIAL EXPERIMENT

Customer acquisition and retention has always been the biggest hurdle for the adoption of e-commerce, and the most expensive part of the equation for all direct-to-consumer platforms. In return though, once consumers have been "retrained", there is tremendous purchasing behavior momentum. In today's shelter-at-home and online world, an interesting social and economic experiment is taking place. Massive shifts in consumer purchasing behavior that would have occurred over many years have now taken place in weeks. Consumers, many of whom are new to online shopping, are relying on e-commerce for the purchase of goods and food, almost to the exclusion of the brick and mortar channel. Take online purchases of alcohol: in the first week of April, e-commerce alcohol sales through platforms like Instacart and Drizzly grew 441% year-over-year, dwarfing total alcohol sales which grew 26.2%(5). Many of these purchases are by new customers – Drizzly in particular has seen new customers grow to 33% of overall sales(6). The net outcome is that any historical reluctance to buy online has gone to the wayside and ecommerce will be incorporated into normal shopping behavior go forward.

LINCOLN PERSPECTIVE

E-commerce businesses will benefit immensely from a lasting influx of customers as a result of newly learned shopping behaviors; those with a future liquidity event in mind should measure and quantify retention of new customers to illustrate the magnitude of the benefit and the "stickiness" of their platform.

HEIGHTENED IMPORTANCE OF AN EFFICIENT SUPPLY CHAIN

Those looking to benefit from the robust e-commerce tailwinds should consider the challenges faced even by strong online platforms during this crisis. Maintaining an efficient supply chain is critical in normal times. In the current environment, this became the single greatest bottleneck for many e-commerce businesses. Consider that many companies rely on Chinese suppliers for their primary source of supply, and that many companies were already experiencing production slow downs due to the Chinese New Year. That typical holiday respite extended well beyond expectation once factories were closed as part of China's pandemic response. Geographic concentration of suppliers is not a new issue; the recent tariff wars caused concerns but were not painful enough to force many companies to increase supplier diversification. Going forward, companies looking to best position themselves for continued operational success and an eventual liquidity event should invest in supply chain diversification to avoid future region-specific challenges.

Further underlining the importance of a strong supply chain and infrastructure (ie, fulfillment, distribution, shipping and logistics) is the accelerated adoption of e-commerce and the "stickiness" of those customers. Winning e-commerce businesses in the recovered economy will be able to support what is anticipated to be a permanent increase in online sales. For companies lacking the necessary infrastructure and resources, it will be critical to prioritize this investment as demonstrated by hiring surges from Amazon (175,000 new hires), Instacart (300,000 new hires) and Walmart (200,000 new hires). In all cases, the inability to meet demand is a problem. Zeroing in on the many business selling on Amazon however can be crippling. If a product goes out of stock on the platform, Amazon's algorithm demotes the product and removes sponsored ads, causing plummeting visibility and creating a long, challenging road to recover the previous sales rank.

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The best positioned e-commerce businesses will view their supply chain as both a key strength and a growth opportunity; investment must continually be made to ensure minimal disruption even in challenging times, and to fully capitalize on the growth driving the category.

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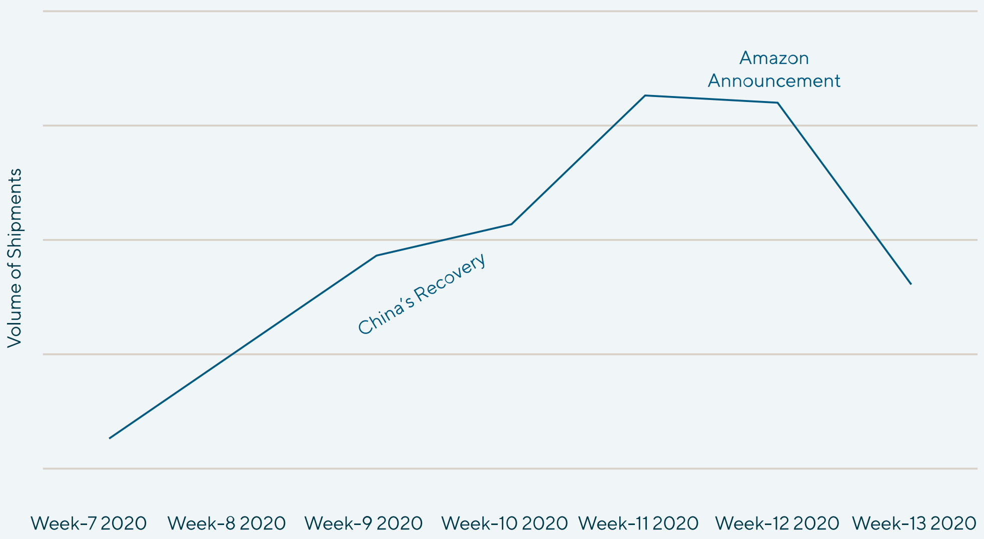
SPOTLIGHT: AMAZON

As Amazon makes up 39% of U.S. online sales, so too will we devote 39% of this article to the 800-pound gorilla. Companies evaluating e-commerce marketplaces consistently choose Amazon as it continues to present a huge opportunity for sellers with its well-invested infrastructure and volume of shoppers. Additionally, Amazon's FBA service provides significant leverage to small business and eliminates the logistical headache of fulfillment. However, Amazon also poses a threat to sellers that must be weighed. Educated sellers are well aware of the risks: it enforces punitive inventory policies described above; it has been long rumored and now recently validated that Amazon gathers and leverages what was thought to be proprietary seller data to improve sales of its private label products. Now the marketplace's recent unilateral actions around sales of essential and non-essential goods highlight one more reason to be wary of the marketplace. Though well-intentioned, sellers of products deemed non-essential lost fulfillment support and experienced near total elimination of sales on the platform. This only emphasizes the importance of partnering with multiple marketplaces to avoid the total loss of e-commerce sales in the event of a similar action.

FBA Shipments During COVID-19[7]



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Amazon's industry-leading logistics, distribution and fulfillment network and unmatched audience make it impossible to ignore, but it is becoming increasingly impractical to rely solely on Amazon.

Implications for M&A

Well-capitalized buyers are looking to accelerate their recovery and invest in recession resistant business models. E-commerce businesses able to thoughtfully articulate a strategy to capitalize on bolstered secular trends in the online economy will achieve premium outcomes, unencumbered by the impact of reduced valuations across other sectors.

For e-commerce businesses eying a future sale, investing in the supply chain infrastructure should be considered a defensive and offensive priority. This will position the business for stronger operational performance in downturns while enabling greater capture of the sales opportunity driven by e-commerce tailwinds. Strategic investments in the supply chain today will be rewarded with strong interest from buyers and meaningful value creation in a future sale process.

Interested in learning more? Get to know Lincoln's global Consumer Group at www.lincolninternational.com/consumer.

Sources: [1] Federal Reserve Bank of St. Louis | [2] Digital | Commerce 360 | [3] Coresight Research | [4] SIGNIFY'D | [5] Nielsen | [6] CNN | [7] Freightos.com