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Ecommerce growth comes at expense of revenue growth: McKinsey

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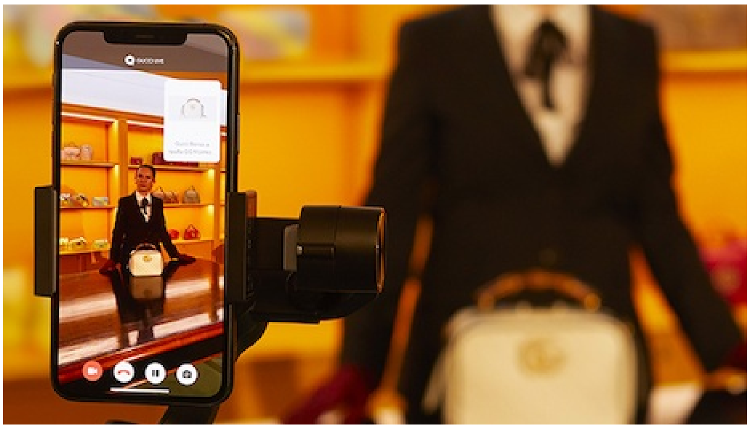


Different costs associated with ecommerce can add up. Image credit: Gucci

By SARAH RAMIREZ

While ecommerce sales have accelerated since the start of the COVID-19 pandemic, this does not necessarily translate to profitability.

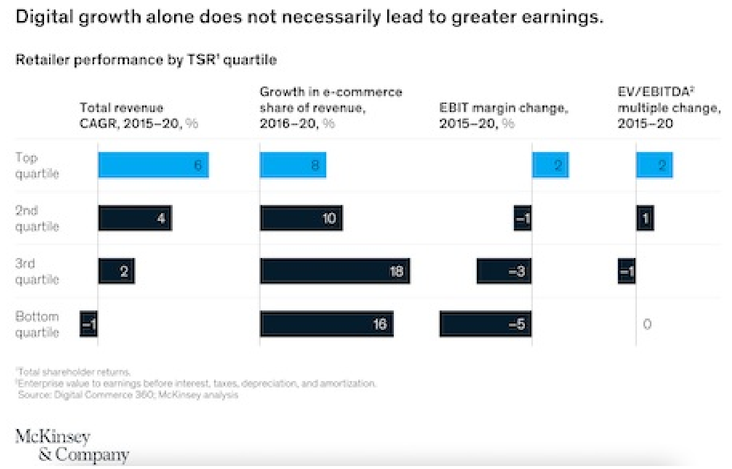
According to a partner from McKinsey & Company speaking at the Tinuiti Live conference on June 7, rising ecommerce costs often take a bite out of online sales. In response, brands and retailers should reduce operating costs and generate more value from fixed assets boosting profitability.

"It's going to be very expensive over the next five years to compete in ecommerce, and we'll only be able to fund it and pay for it if you're actually operating in a profitable way," said Steve Hoffman, partner at McKinsey & Company, Chicago.

Balancing act

Ecommerce is expected to represent about half of all retail sales by 2024, but this could be a problem for some companies if they do not improve their profitability.

According to McKinsey, the retailers with the most growth in online sales from 2015 to 2020 saw the biggest decline in their margins negatively impacting shareholder returns.



Growth in ecommerce is correlated to smaller margins. Image credit: McKinsey & Company

In many cases, growth in ecommerce has come at the expense of revenue growth.

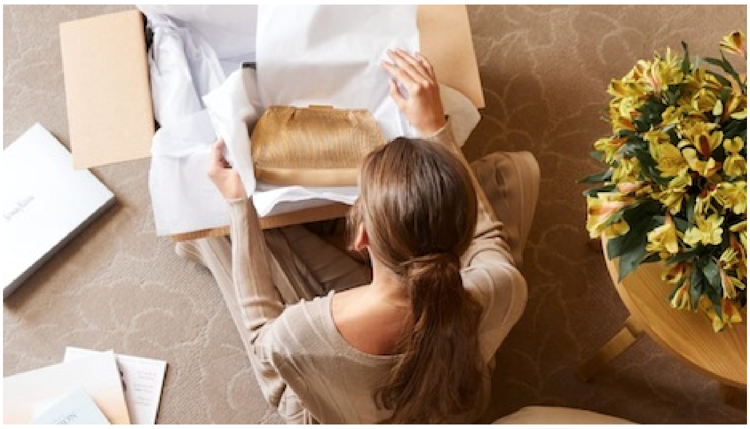
Some brands and retailers are likelier to have the upper hand in ecommerce, however.

"If you're selling luxury handbags, you're going to have an actual advantage because at the end of the day, I put a $5,000 handbag in a box versus a $10 pair of jeans in a box, it's going to cost pretty much the same to get the box to me," Mr. Hoffman said. "So, there is an inherent advantage with item value."

Companies that offer unique or custom products and services or specialize in categories with lower return rates also have advantages in ecommerce. Again, luxury brands can have the advantage over mass market brands with their differentiators.

Returns are one area that retailers and brands can scrutinize to generate more value from fixed assets.

According to recent research from software platform ReverseLogix, 80 percent of retailers identified the cost of managing ecommerce product returns as "significant to severe." Retailers are cognizant that their return processes need to improve for their bottom line, recognizing the need for better technology solutions (see story).



Ecommerce has many associated costs. Image credit: Neiman Marcus

"The idea of returns is an underappreciated complexity when it comes to retail," Mr. Hoffman said. "Returns is such a huge cost.

"In ecommerce, this means the whole cost of the returns, how fast you can kind of take displaced inventory into sellable inventory, the entire reverse logistics process," he said. "Return rates are for the most part rising because we're making it easier, which is great for the consumer, and it really makes it extremely hard to manage ecommerce in the long term."

Changing consumer habits

There are other ways for companies to reduce operating costs while improving customer experience.

Buy-online-pickup-in-store (BOPIS) offerings still have relatively low penetration rates but can get products into shoppers' hands faster. Another option for retailers is to incentivize debit card transactions, which cost companies less in terms of fees, by offering small discounts or more reward points.

Online, retailers can also push consumers to items that are more profitable by more prominently featuring them on ecommerce sites.

Although more shoppers are becoming adept at online channels of discovery, less than 20 percent of consumers begin their journeys directly on brand sites because they find them to be lacking relevance according to Coveo's 2022 Relevance Report: Ecommerce.

Brands and retailers are hampered because their owned sites do not offer the convenience, customer history or data-driven recommendations that Amazon or search engines offer. Relatedly, 68 percent of respondents reported they are not often provided personalized or relevant experiences when they are online shopping (see story).

"How do you start to get that mindset in the eyes of the consumers that you start to build these habits?" said McKinsey's Mr. Hoffman said.