THE STATE OF RETAILING ONLINE

A Shop.org study by The Boston Consulting Group
in association with Forrester Research

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Shop.org and The Boston Consulting Group would like to thank the 107 U.S. retailers that took part in this year’s Shop.org survey, as well as the 23 retailers that granted interviews. Our thanks also go to all Shop.org members who have supported this important research throughout the year.

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Retailing online has evolved rapidly since our first report was published, in 1998. Demand has blossomed from a narrow group of early adopters to the consumer masses. Financial markets championed, then dumped, many online-retailing start-ups, while many established retailers made successful transitions to the online arena. Not only are the established retailers winning back valuable customers, they’ve become major online players in their own right.

These retailers are now among the leaders in the online-retailing world, making the highest profits and deepening customer relationships to increase sales across channels. A number of Web-based retailers also continue to thrive and innovate.

Our aim in producing this series of reports is to help retailers assess their progress in this complex and fast-changing environment. We encourage retailers to track their performance against the benchmarks laid out here and in the more detailed companion report, *The State of Retailing Online 5.0: Performance Benchmarks*. Together, these two reports constitute the fifth round of findings in the ongoing research partnership between Shop.org—a division of the National Retail Federation—and The Boston Consulting Group. Forrester Research, an emerging-technology research firm, has joined the partnership this year, providing information on market sizing to produce a more comprehensive report.

We hope that retailers will find *The State of Retailing Online 5.0* a valuable tool as they seek to capitalize on growing online-consumer demand in an environment that continues to be marked by rapid change.
SUMMARY OF KEY FINDINGS

Retailing online continued to grow in 2001 and is headed for even stronger growth in 2002.

- In 2001 the U.S. industry grew by $8.9 billion, or 21 percent, to $51.3 billion, with strong gains across nearly all categories.

- In 2002 the industry is projected to grow by as much as another $20.8 billion, or 41 percent, to $72.1 billion, with renewed expansion across all categories and most of the growth coming from established online retailers.

- Retailing online continues to build its position as a mainstream shopping option, with penetration now exceeding 5 percent in 7 out of 15 categories and with online sales across those categories expected to account for 3.2 percent of retail sales in 2002.

- Profitability has finally become the norm for online retailing.

  - More than 50 percent of retailers reported positive operating margins for online businesses in 2001.

  - In aggregate, the online-retailing industry reduced operating losses from more than $5 billion in 2000 to about $3 billion in 2001, or from 15 percent of revenues to only 6 percent. This continues the trend of improved profitability: in 1999 the industry recorded losses of 19 percent in operating margins.

  - We expect online retailers in aggregate to reach the breakeven point in 2002. This will represent the group’s average performance. There will be both winners and losers in the mix.

Retailers improved the economics of the online channel in 2001 by enhancing the effectiveness of their marketing and by tightening controls on expenses.


- Retailers plan to continue their focus on marketing effectiveness and economies of scale across functions in 2002.

Multichannel retailers—retailers that sell across online and traditional channels—are thriving in the online market.

- Multichannel retailers control 67 percent of online retailing and continue to gain share.

- Multichannel shoppers are valuable, spending 72 percent more per year than single-channel shoppers.

- Multichannel retailers are more profitable than their Web-based counterparts, with catalog-based retailers enjoying operating margins of 6 percent of revenues, store-based retailers losing 5 percent of revenues, and Web-based retailers losing 13 percent.
As multichannel retailers continue to leverage their brands, customers, merchandise, and other assets, they will continue to gain share in online retailing from Web-based retailers and generate profitable growth.

Having reduced costs as a group, Web-based retailers will need to maintain strategies of differentiation with economically sound business models to achieve their “fair share” of industry growth.

All costs below gross margin were reduced in 2001, but marketing costs saw the most dramatic decline—from 66 percent of revenues in 2000 to 10 percent in 2001—aligning them with the industry as a whole, which had costs of 11 percent.

However, Web-based companies are still the least profitable in the industry on average, with gross margins of only 19 percent, compared with 34 percent for the industry. As noted above, these companies showed an operating loss of 13 percent of revenues. Single-channel players continue to be disadvantaged along many elements of the value chain, including product sourcing, distribution, and fulfillment.

The future of retailing online will be characterized by an increasing convergence with traditional channels.

Multichannel market leaders will continue to integrate the online channel into the traditional business. Leading players are already starting to take a customer-centric approach to managing the business, allowing a holistic understanding of their customers and segmentation to drive marketing and channel decisions.

Online retailing will increase its share of wallet among current online shoppers and ultimately expand its reach to the tens of millions of households that have not yet shopped online.

Retailers that successfully mine and use customer data to develop profitable, tailored consumer propositions will become the industry leaders.

Many of those leaders will be able to offer multichannel shopping experiences that maintain consistency across brand, price, merchandise, service, and fulfillment.

Consumers’ expectations of the online and multichannel experience will continue to ratchet up as market leaders and innovators repeatedly raise the bar.

The leaders of tomorrow’s online-retailing world will focus on three principal areas.

They will establish and maintain preeminent brand positions in their categories. That means leveraging information about their customers to create targeted, meaningful consumer propositions and a positive shopping experience.

They will improve the bottom line by focusing on high-value consumers. This effort will entail expanding their share of wallet with their current customers and acquiring the new ones whom they’ve targeted. They will also manage financial and operational metrics to seek efficiencies in marketing, the supply chain, and customer service with a view to driving profitable growth.

They will create a consistent multichannel shopping experience by aligning the organization with the appropriate incentives and applying customer relationship management to support the effort.
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