The Trading Intelligence Quarterly

July 2010
Issue 1

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"The most successful retailers of the future will be those who understand profoundly both the physical and virtual channels."

Sir Martin Sorrell, CEO, WPP

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Welcome to the first edition of The Trading Intelligence Quarterly

Ecommerce is of critical importance to retailers and brand owners, yet we see many organisations failing to take it seriously and grasping the opportunity it represents.

We hope to offer you insights and advice that help provoke your thinking on how to make your ecommerce more successful.

In our opening edition, we present the findings of independent research into how UK ecommerce directors are viewing and developing online retail offerings. It offers a fascinating perspective on the roles, challenges and opportunities within this newly forming sector. While physical retail is a mature industry, with fairly consistent views and approaches to growth, ecommerce is clearly much more diverse with organisations at very different levels of development and understanding. This makes it an exciting place to be – with huge opportunities for those who innovate and adapt quickly to the new market dynamics.

We are also delighted to include thoughts from some of the industry's leading names. In this edition, Sir Martin Sorrell discusses how ecommerce is changing the rules of retail and Sir Tom Hunter considers the critical role of the board.

It is clear that ecommerce is not the same as retail. To succeed online retailers must think differently. They must consider how to organise their operations. They must gain clarity on the metrics that drive ecommerce success. If they are to compete with companies like Amazon they must move towards real-time trading. They must grasp the opportunities for significant growth, and never be satisfied with growth rates benchmarked to store like-for-likes.

I hope you enjoy this first edition of The Trading Intelligence Quarterly, and find it helpful as you consider how to make the most of ecommerce within your own business.

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The march to real-time trading

Michael Ross – co-founder and director, eCommera
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Highlights

- The impact of technology on ecommerce will be profound.
- The march to real-time trading is driven by retailer scale, increased competition and the economics of ecommerce.
- Trading real-time demands re-thinking retailing basics.

The slow pace of physical retail

Retailers live by their weekly trading meetings – the rhythm of the weekly review of stock and sales has been their engine for growth and works very successfully for most retailers. The core aspects of every category – their margin, stock turn and sell-through – are so well known that a good retailer can quickly see where a problem lies.

However, despite being able to identify issues quickly, resolving them is typically blunt or slow.

Technology's impact on physical retail has been fairly evolutionary. Many retailers still operate successfully with basic trading systems, although a few such as Tesco and Walmart have shown how growth can be achieved through embracing technology.

The impact of technology on ecommerce will be more profound: technology will transform ecommerce in much the same way that technology has revolutionised stock trading and airline pricing. After the 1986 'Big Bang', stockbrokers who previously enjoyed a fairly leisurely pace of trading had to deal with thousands of trades each second. Similarly airline prices in the 1950s were fixed and broadcast; while today with yield management, a typical airline might set 100,000 prices a week.

Faster, faster, faster

Ecommerce is not the same as physical retail – it needs to be managed differently to stores, and as it becomes a larger part of retailers' growth will require more fundamental changes to core aspects of their whole business. Recognising the need to operate ecommerce separately and distinctly will be critical to ecommerce retailers' success.

So why does ecommerce need real-time trading?

1. More data, real-time.
   There is quite literally a tsunami of data available online, increasingly real-time and at relatively low cost.
   - Web analytics data: every click from every customer on every product
   - Marketing data: every impression and click across typically hundreds of thousands of marketing touch points
   - Operations data: the order, shipping and delivery time of every order
   - Competitor data: price and availability data from competitors

2. More levers, real-time.
   Online retailers have considerably more levers to pull when adapting their trading, many of which can be activated within minutes. The challenge for ecommerce

retailers is knowing which levers to pull and in what order – and then having the capabilities and systems to make them work.

Some of their options include:
- Running targeted promotions to customer/visitor segments
- Changing delivery price or free delivery threshold
- Changing keyword bids on Google
- Sending triggered emails
- Changing product sort orders (e.g. upweighting margin, stock or newness)
- Enabling preorders/backorders with a future delivery date

The growing pressure to trade real-time

The move towards real-time trading is rapidly gathering pace, driven predominantly by three trends:

1. As retailers scale, the value of managing in real-time outweighs the cost. It is an economic inevitability that retailers will be compelled to start trading daily, hourly and, in due course, real-time.

2. Once your competitors start trading real-time, you will simply get out-traded if you stick to a weekly cycle. Amazon is already a master of this. They frequently change prices, both up and down, making any competitor's 'surprise' marketing campaigns almost useless.

3. The economics of ecommerce demand that retailers take action. If Amazon reduces its price on a product and you don't respond for a week, you can end up spending marketing money *and* sitting on aging stock.

Preparing for battle

To trade real-time competitively will require re-thinking some retailing basics and I believe there are three fundamental building blocks:

1. Management skills.
   Managers have to oversee thousands of micro-tasks (or inputs), such as Google keywords, landing pages, sort orders, promotions and triggered emails.
   Many of these inputs are not easily visible. Managing in this world requires new skills. In particular, the people skills of the store manager need to be augmented by process and analytical skills.

2. Data, KPIs and insight.
   Having the right data at the right time is critical. Making sense of this data and turning it into useful insights can be complex.
   In particular, retailers need to distinguish between "input measures" of activities they control (e.g. availability), and "output measures" which happen as a consequence (e.g. conversion rate). They should then focus on understanding the relationship between these inputs and outputs.

3. Organisation.
   Organisations need to be completely aligned. For example, if you are overstocked on televisions, you may need to discount, spend more on Google or offer free delivery. It is very hard to make a timely decision if the budgets for these activities are owned by different people, who meet once a week.

***

Goldman Sachs predicts that by 2019, over 50% of the absolute dollar growth in US retail will come from ecommerce. It is a brave retailer that does not prepare itself for this new world.

Ecommerce performance and priorities: early findings indicate route to success

Highlights

- Reporting lines are critical. Higher growth ecommerce operations report to the CEO/board; lower growth operations report to the CMO or CIO.
- Retailers are prioritising new customer acquisition over satisfaction and retention – potentially a short term strategy.
- Few retailers are actively monitoring their lost profit from products that are viewed but not bought.

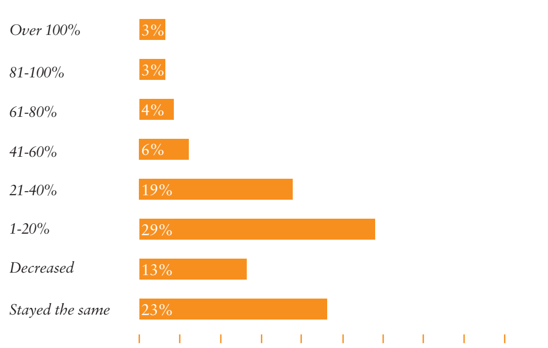
The data for this report is based on independent research, from interviews with 100 UK ecommerce directors during April 2010.

Overall, there is an interesting lack of consistency amongst the ecommerce directors, with a particularly wide spectrum of responses on organisation structure and performance management. This is in stark contrast to the generally consistent approaches observed within physical retailers. The findings suggest that while some online retailers are well prepared for growth, others are still feeling their way or failing to take their online sales channel seriously enough.

Growth

Unlike the market leaders such as Amazon and ASOS, significant growth eludes all but a few. Many retailers are facing growth rates similar to their store like-for-likes, maybe deluding themselves that this is acceptable on the basis that ecommerce is 'just another store'. This significantly fails to recognise the scale of the opportunities for exponential growth from ecommerce.

Growth rate



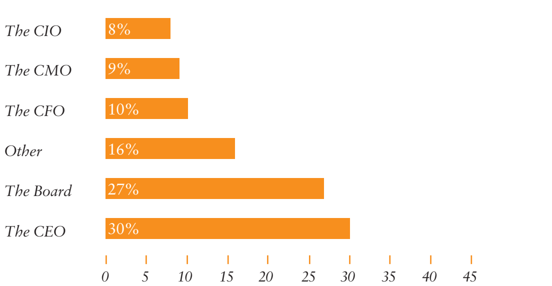
Reporting lines

The reporting line for ecommerce appears to be critical. Of those businesses reporting growth, 61 per cent of respondents report into either the CEO or the board. The lower growth businesses are those where the ecommerce operation reports into the CMO or CIO. Where ecommerce sits within the organization shapes both:

- the ecommerce strategy (e.g., whether technology or marketing led); and
- the ability of ecommerce to influence overall business decisions, budget and resource allocation.

We see many examples where a retailer is unable to expand their offer because ecommerce is treated as another "store" that has to select product from the core range. Or others where profitable marketing is cut from ecommerce because the overall marketing budget is reduced.

Who does the ecommerce director report into?



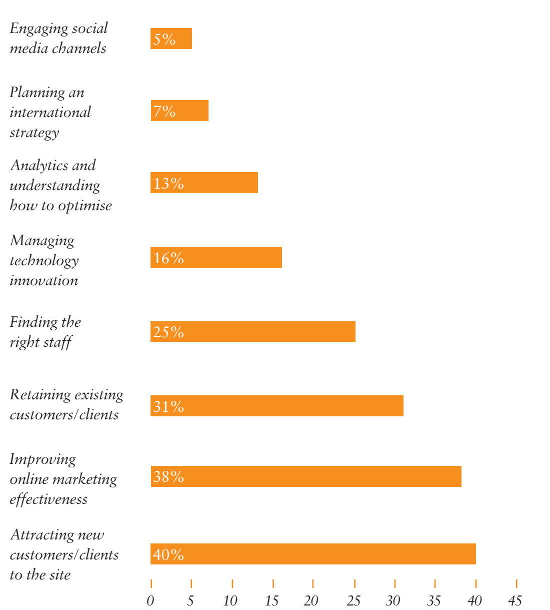
Ecommerce concerns

The greatest concerns for ecommerce managers are attracting new customers and online marketing effectiveness. Whilst this is not bad in itself, it is a worry if combined with a lack of concern over how best to retain customers. This reflects our observed trend that retailers are obsessing over scatter-gun customer acquisition across all marketing channels without understanding their relative profitability.

Also concerning was the low interest in harnessing the data that drives ecommerce. It is very hard to make good trading decisions if you do not understand what is driving performance. Harnessing ecommerce data is fundamental to achieving this.

That said, we were encouraged by the lack of concern over social media, recognising that this is currently a distraction. It is easy to get excited about "the next new thing" but retailers should watch this area closely in the future.

What are the greatest concerns...



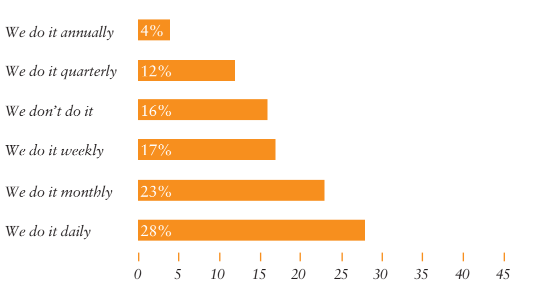
Frequency of profit measurement

Part of the reason for the variations in growth rates – excluding external factors such as the economy – may be that so few businesses are embracing the different trading model of ecommerce.

The research highlights that more than half of companies only measure the profit of their website monthly, or less frequently, while 16 per cent of respondents do not measure the profitability of their online sales channel at all.

If businesses don't have transparency of weekly or daily profit, it makes planning and reacting to opportunities far more difficult. One retailer ran a 2-week 'free delivery above £30' promotion and it took six weeks to discover it had cost them tens of thousands of pounds. Had they been measuring daily profit, they could have adjusted the threshold. In addition, if you are competing against retailers who are measuring profitability daily (as 28% are), you will simply get out-traded.

How regularly is profit from the website measured

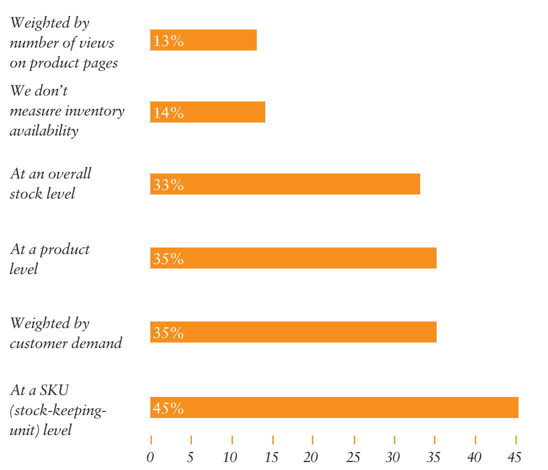


Missed opportunities

This lack of trading insight is highlighted further by the small number of businesses measuring their lost opportunities through lack of inventory. Retailers are failing to keep track of how many people 'walk out of the shop' because they couldn't find what they wanted.

This suggests that many businesses run their online sales similarly to high street stores, measuring availability on an unweighted product/SKU basis. Few are analysing their web traffic and looking at products that are not being viewed or being viewed but not sold. This data is critical to understanding missed opportunities online.

How is inventory availability measured



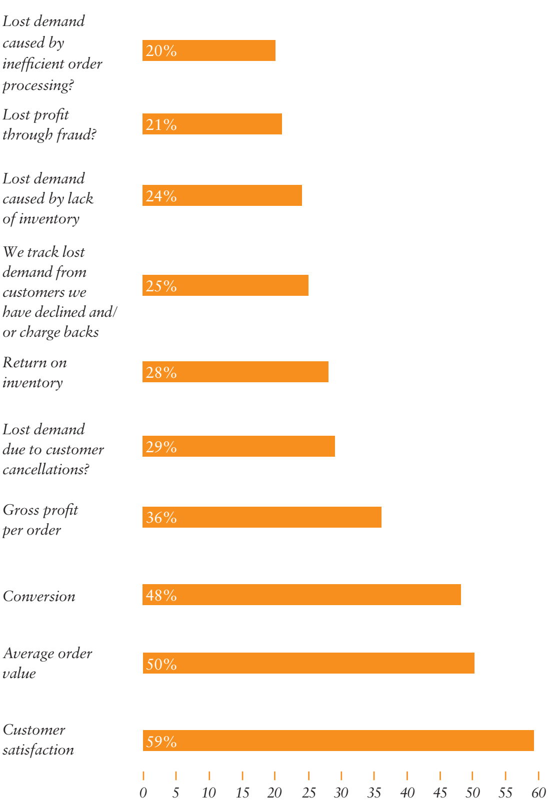
Measuring performance

Perhaps most surprising of all is how few organisations are measuring a complete set of ecommerce KPIs. Only 59% of the respondents measure customer satisfaction, despite it being critical given the delayed gratification of online retail.

In addition, retailers are treating metrics such as average order value and conversion rate as "KPIs". In our opinion they are lower level performance indicators that need to be tracked but are subsidiary to profit per order.

Few respondents measure return on inventory, so they are unlikely to think creatively about where best to hold stock in the supply chain – something that Amazon has turned into a science.

What website Key Performance Indicators (KPIs) do you measure?



Sir Martin Sorrell: rewriting the rules of retail

Shopping plays a very important part in all of our lives.

Like many aspects of our lives the pace of change is fast and the speed with which change is happening is accelerating. The rapid growth and importance of ecommerce is proof that in the fast paced world of retailing the rules of the game are being re-written.

It was not long ago that consumers were reluctant to buy online anything other than books and CDs and retailers resisted selling them anything else. How absurd that feels today! Today it is difficult to predict if there will be anything that can't generate sales through ecommerce.

Online retailing has passed the experimental stage and is now an important part of creating and growing shareholder value. But it is not easy. Like anything that is new and fast growing it presents multi-dimensional challenges across all business functions inside retailers and their supplier partners. It requires different skills and different types of business metrics to measure success, pinpoint areas for improvement and isolate the new drivers for profitable sales. Brilliant, entrepreneurial merchants will always have an important place at the heart of retailing. But they will need to marry their intuitive feel for buying and selling with the metrics and the analysts that can isolate and harness the abundance of data available in the ecommerce world, if they want to understand why a product is turning – or not.

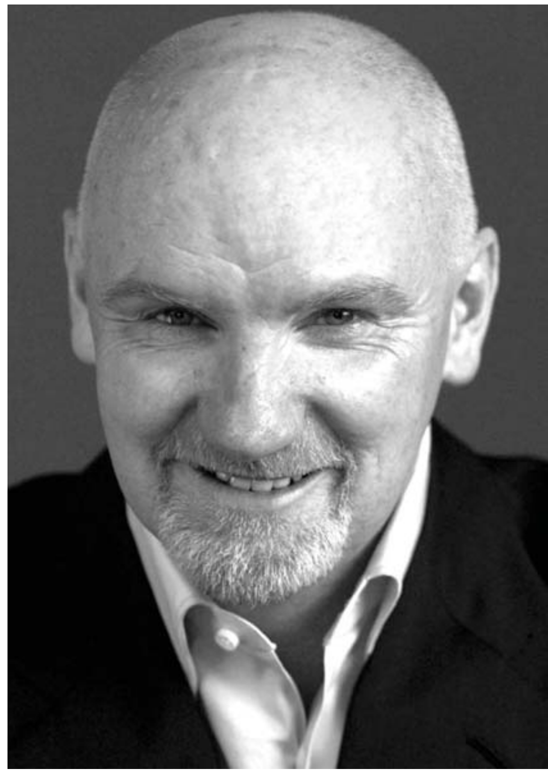
Ecommerce is moving at different speeds in different countries but it's all moving in the same direction. Consumers across the world want access to information in real time to help them make informed choices, undertake research, involve their socially networked friends in their decision making and to make a purchase at a time and at a channel that works best for them, not which is convenient to the retailer.

Sir Martin Sorrell, CEO, WPP

The growth of ecommerce does not mean the end of shops, not by a long way. Consumers love physical stores and the physical environment offers many things that the virtual one cannot match. But it does mean that the most successful retailers of the future will be those who understand profoundly both the physical and virtual channels and learn the lessons from each to build and operate a solid and integrated multi-channel retail brand. Such unions of physical and virtual, merchants and analysts will require wisdom and humility. But they will produce remarkable competitive advantage.

Sir Tom Hunter: the role of the board

I was surprised by a number of the findings in The Trading Intelligence Quarterly report but the only one that truly shocked me was the suggestion that many CEOs do not have their finger on the pulse of their ecommerce operation.



Sir Tom Hunter, Chairman, West Coast Capital

How can this be?
The future of retail is undeniably multichannel – clicks and mortar – and the next real win will be for those that can use the competitive advantage of bricks to combine with the clicks to offer a seamless customer service. Pick up from store; global inventory available to all customer touch points – store, web, phone and of course iPad. Why miss a sale your competitor will grab?

Any business not trading effectively online is missing an opportunity not only for growth, but for survival.

CEOs need to take their online sales channel just as seriously as their offline one, but equally they need to treat it differently as a channel in and of itself. For that you need to understand the sum of the parts – finance, marketing and technology are three components of a successful ecommerce operation but they are only components. The CEO must make it his or her priority to pull together all those components and get the bigger picture.

Sadly I suspect, despite the importance to the business, many CEOs over the age of 49(!!!) dodge discussions on the web through a cultural or fear perspective – it's a different beast from a store you can walk through. Put simply, some believe they don't, can't and shouldn't have to 'get' the web. Either that, or they have bought the line that ecommerce must report into a line of business such as marketing or technology because it is in some way specialist – a niche, a fiefdom. But it's not. It is mainstream and vital to the success of the business.

The CEO must understand the metrics, the trends and the priorities of successful ecommerce and hold those component parts of their business accountable. And unlike physical retail the CEO must gain this understanding because they cannot walk through the store and see with their own eyes the successes and failures. They must dig deeper to understand when, why and how their business is succeeding or failing online.

Only then can they push the envelope to secure significant and increasing profitable sales from a multi-channel business.

Ecommerce performance: putting the K back into KPI

Michael Ross – co-founder and director, eCommera
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Highlights

- You can't run an online business on gut feel.
- Growing an online business demands a command of the data.
- Ecommerce KPIs must be aligned to profit and must drive behaviour.

A successful retail CEO once told me that he could work out what was going on in his business simply by looking at like-for-like sales. This single data point per store allowed him to differentiate between a bad manager, a bad location or a bad economy.

He added that he could walk into a poorly performing store and know immediately what was wrong – be it staff, layout or product. Great retailers operate on this combination of basic data and gut instinct. Unfortunately, you can't run an online business on gut feel.

Online differs from physical retail in two fundamental ways. Firstly, physical retailers make the mistake of thinking of online as a single retail store – but online is not constrained by footfall. Secondly, trying to re-create the experience of "walking the store" online misses the point that online customer behaviour is highly variable and complex. There is no typical customer experience and the website is only one part of it.

Growing an online business necessitates a command of the data. Retailers applying traditional retail metrics online will at best sub-optimise, and at worst risk being outmanoeuvred by more sophisticated competitors.

This article explores the importance of KPIs, why ecommerce KPIs have missed the target thus far and posits what I believe are the five fundamental ecommerce KPIs.

Importance of KPIs

Firstly, a little bit of history. For many years, airlines focused on "profit per seat". Then in the 1960s, an MIT professor observed that "profit per flight" was a better metric, more closely aligned to airline profitability. This directly led to the birth of the low-cost carriers which now represent some of the world's most profitable airlines. In the car industry, Toyota developed a set of KPIs for waste which directly led to the development of lean manufacturing and helped make Toyota the world's leading car manufacturer. For supermarkets, the insight that profit per linear foot was the right metric led to the discipline of category management that every major supermarket operates under today.

So what makes a good suite of KPIs?
Overall, the *set* of KPIs should be:

- Holistic – KPIs must cover everything good, bad and ugly that can happen in the enterprise. There should be nowhere to hide; and
- Hierarchical – from the CEO to the coal face, all KPIs should roll-up with no more than 3-5 KPIs at any level. More than this leads to paralysis.

At an *individual* level, a KPI should be:

- Aligned with profit – an improvement in a KPI should increase profit (all other things being equal); and
- Actionable – KPIs must drive behaviour. Specifically, this means that they should be non-financial. While P&L/balance sheet metrics are good measures of historical performance, KPIs need to be indicators of current and future performance.

Why ecommerce KPIs are hard to define

For the past 10 years, the rapid growth of ecommerce has masked a lot of poor online retailing. Many online retailers have watched sales grow without needing to do anything clever. But times are changing: ecommerce growth has slowed; online has become much more competitive as all retailers have looked online for growth; and online retailers are focused increasingly on driving profit. In this new environment, tracking the right KPIs moves from being a "nice to have" to being fundamental to online success.

The challenge is that no-one can agree on the right KPIs. For example, many online retailers use these KPIs:

- *Conversion rate and average order value (AOV)*, missing the point that a free delivery offer will increase AOV and conversion but at the cost of profitability.
- *Web analytics,* learning nothing about profit, inventory or the end-to-end customer experience.
- *Over-generalised averages* that miss, for example, the distribution of customer service response times to emails.

The five ecommerce KPIs

The ecommerce industry is still at an early stage of its evolution so the definitive list of KPIs is yet to be set in stone. Based on my 15 years in the industry, I believe that the following five are a good starting point.

1. Number of orders.
   The number of orders placed on the website. In due course, as retailers better understand cross-channel behaviour, this will also include the offline purchases influenced by online browsing.

2. Profit per order.
   The key to growing an online business profitably is to understand the trade-off between order volume and profit per order. Online retailers have lots of levers to pull – increasing marketing spend, personalised offers, flexing free delivery thresholds as well as the traditional retail toolbox of prices and promotions. The challenge is that flexing these levers independently gives no insight into their overall impact on profit.

3. Lost profit per order.
   Good mail order retailers measure lost demand. When a customer calls to place an order for a sold out item, this is captured. Online retailers have many ways to lose demand between order and net sales – cancellations, declined orders, fraud, returns or lack of availability – yet measure few. Understanding lost profit is critical for a retailer to decide whether to focus on optimising profit or reducing lost profit.

4. Return on inventory.
   All sophisticated retailers monitor stock turn and sell-through as key measures of inventory efficiency. The online world has further subtleties. Increasingly, retailers work with a number of drop-ship or just-in-time suppliers and can make more subtle trade-offs of inventory vs. profit. Return on inventory exposes where best to hold stock in the supply chain.

5. Customer satisfaction.
   The delayed gratification that is a feature of all online retailers selling physical goods means that monitoring customer satisfaction becomes critical. One component of this is "delivery on promise" which systematically measures the distribution of orders that arrive before, after or as promised. It is staggering how few retailers actually track it. As retailers increasingly rely on drop-ship vendors or just-in-time suppliers, delivery on promise becomes ever more important.

So the next time your CEO asks you what's a good conversion rate, you can say with confidence that it's not a good question!

This article featured in Internet Retailing, 2009

Spotlight on Amazon

Amazon is the grandmaster of ecommerce – the largest online retailer in the world with sales of $24.5bn. It is the competitive benchmark every online retailer aspires to.

This regular feature will highlight different aspects of its business model to learn from what it does well… and where it may have potential weaknesses.

Amazon does many things exceptionally well but at its core is a unique metric-driven approach to trading.

Extract from Jeff Bezos's letter to shareholders, April 2010:

> "*Senior leaders that are new to Amazon are often surprised by how little time we spend discussing actual financial results or debating projected financial outputs. To be clear, we take these financial outputs seriously, but we believe that focusing our energy on the controllable inputs to our business is the most effective way to maximize financial outputs over time.*
> *Our annual goal setting process begins in the fall, and concludes early in the new year after we've completed our peak holiday quarter. Our goal setting sessions are lengthy, spirited, and detail oriented. We have a high bar for the experience our customers deserve and a sense of urgency to improve that experience.*
> *We've been using this same annual process for many years. For 2010, we have 452 detailed goals with owners, deliverables, and targeted completion dates. These are not the only goals our teams set for themselves, but they are the ones we feel are most important to monitor. None of these goals are easy and many will not be achieved without invention. We review the status of each of these goals several times per year among our senior leadership team and add, remove, and modify goals as we proceed. A review of our current goals reveals some interesting statistics:*
> - *360 of the 452 goals will have a direct impact on customer experience.*
> - *The word revenue is used eight times and free cash flow is used only four times.*
> - *In the 452 goals, the terms net income, gross profit or margin, and operating profit are not used once.*"

We lose count of the number of trading meetings we've observed where people debate why – as an example – average order value (an 'output') went down last week, triggering a flurry of in-meeting opinions and post-meeting analysis to hunt the culprit. By the time an answer is found, it is typically too late to take action and was the wrong question in the first place!

Retailers need to understand the drivers of their business and the pertinent input measures. They should then focus their trading meetings discussing and making decisions on the things that are actionable.

eCommera is a pioneering provider of intelligent ecommerce trading solutions, enabling brand owners and retailers to sell efficiently and intelligently across multiple channels.

A selection of our clients include Asda Direct, Hamleys, House of Fraser, Magasin Du Nord, Horze and the London 2012 store.

eCommera. Trading Platform

Take control of your ecommerce business through our flexible and multichannel retail trading platform

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- Empowers you to take control without IT intervention

eCommera. Intelligent Trader

Trade intelligently using our ecommerce dashboard and decision support tools

- Unique ecommerce dashboard provides a holistic view of ecommerce performance
- Decision support tools rapidly identify next best action
- Full service intelligence and decision support across the ecommerce enterprise

eCommera. Assured Services

Give us responsibility for managing and evolving your ecommerce technology

- Delivered on demand - but with you in control
- Continuously evolved to keep you ahead of the competition
- You stay focused on trading not IT

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