2023 Online Retail Report

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FTI CONSULTING

2023 Online Retail Report Executive Summary

Key Points on Online Retailing

1 Store-based retail sales growth has slowed sharply since 2H22 following strong gains in early quarters post-pandemic.

2 E-commerce sales growth is trending higher again recently following a lull in the early post-pandemic period. We estimate e-commerce is capturing **40%–45%** of total retail sales growth.

3 E-commerce has retained market share gains since 2020, but gains have slowed considerably since the pandemic surge. Overall e-commerce market share hovers above **21%**, though it is considerably higher for several major product categories.

4 E-commerce sales growth (YoY) will moderate to **10%** or less in coming years.

5 Late-mover categories in e-commerce, including grocery and health & beauty, were the biggest beneficiaries of the pandemic surge in online sales.

6 We estimate Amazon's share of total U.S. e-commerce sales is at an all-time high just above **40%** going into Prime Day, with 3P sales now accounting for nearly **70%** of Amazon's gross merchandise value ("GMV"). Prime Day prospects are subdued given slowing consumer spending.

Key Points on AI-Driven Personalization

Personalization Interests

- About **80%** of consumers believe personalization can enhance their online shopping experience, and **75%** are very interested in receiving personalized product offers and advertisements.
- Almost **70%** are likely to switch to competitors offering better personalized experiences.
- Baby Boomers' interest levels and trust levels are typically much lower (10pp - 20pp lower than other generation groups).
- Personalized content focused on discounts appealed to **77%** of respondents, and **69%** welcomed local recommendations/offers. Interestingly, these preferences generated higher levels of acceptance even from Baby Boomers. Gen X, Gen Z and Millennials are also open to receiving personalized content as it relates to new products or personalized product recommendations.

Personalization Concerns

- Undermining these high interest levels, **only 48%** are comfortable sharing personal data (e.g., browsing history, demographic data, transactions).
- Only **38%** think retail platforms can be entrusted with the personalization task at hand.
- Racial/gender recommendations are of concern to **51%** of respondents; to manage the concerns, **62%** prefer to control personalization via privacy settings.
- **58%** prefer to have businesses provide shoppers with the flexibility to control data collection and usage, while another **58%** prefer to have the capability to opt out of receiving personalized content.

Revival of Store Shopping Fades While E-Commerce Digests Pandemic Gains

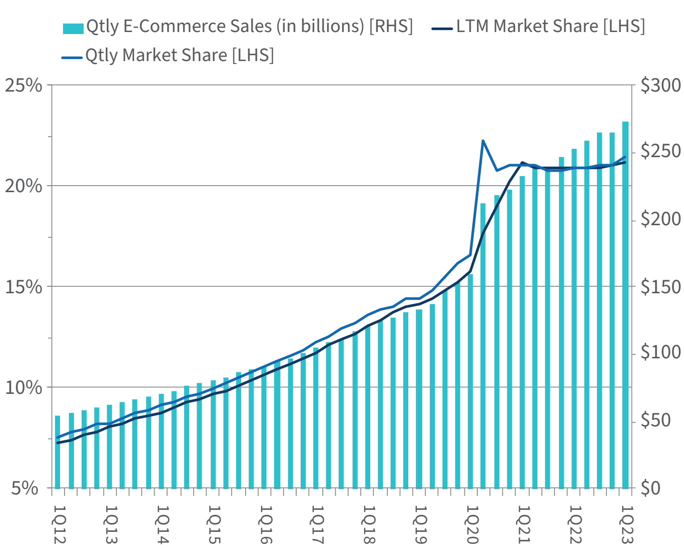
The paramount question for the retail sector as the United States began to emerge from the COVID-19 pandemic in 2021 was whether outsized sales growth and market share gains for e-commerce[1] sales could be sustained once Americans were free to roam around again and return to their pre-COVID lifestyles and habits. The answer that has emerged is an equivocal "mostly but not entirely."

While e-commerce retail sales growth continues to build on its huge pandemic-driven gains, online market share of total retail sales has been mostly unchanged for the better part of the last two years (**Figure 1**) following its gigantic leap in 2020. In the aggregate, online market share remains far above its 2019 share but has weakened a bit from pandemic-year highs in several broad product categories (see **Appendix A**), as many shoppers opted to return to stores for some purchases, such as apparel or sporting goods, that involve fitting or touching. That was to be expected as Americans increasingly got out of the house once they were vaccinated, and online shopping again became a preference rather than a necessity.

The e-commerce channel as a whole has not surrendered its pandemic gains. Rather, subsequent growth in online sales and market share has slowed since that banner year of 2020, as some of these COVID-19 gains were from previous online purchasing holdouts. Some of that extraordinary demand in 2020 and early 2021 undoubtedly was pulled forward when holdouts were converted to online shopping sooner than they otherwise would have been. Moreover, some home-related spending was accelerated as tens of millions of Americans lived and worked from their upgraded dwelling places. In short, some pandemic era spending was taken from future years' demand.

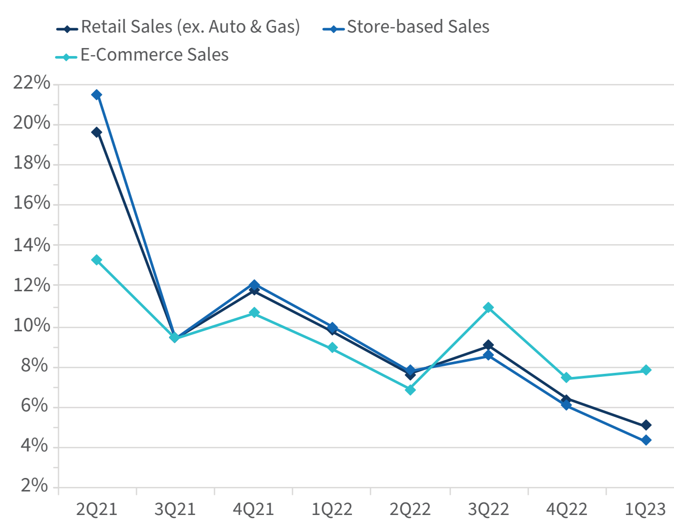
For the most part, Americans have resumed their pre-COVID activities. Hybrid work remains one of the few pandemic period vestiges that is sticking around. Planes are packed this summer, as are hotels, gyms and concert venues. What isn't packed are shopping centers. An early post-pandemic get-together between stores and shoppers is proving to be more of a dalliance than a rekindled romance. Store-based sales growth had a nice run from mid-2021 to mid-2022 — outperforming or matching the online channel for five consecutive quarters — but it seems that since 3Q22 shoppers again have lost that loving feeling for stores (**Figure 2**) as that novelty fades and the online channel reasserts its advantages. For large omnichannel retailers, another breakup isn't crushing news, as online interactions with customers can still sustain those relationships. But for retailers more highly dependent on store-driven sales, it is more of a heartache — and a headache.

Figure 1: U.S. E-Commerce Sales and Market Share



Source: *U.S. Census Bureau, FTI Consulting Analysis*

Figure 2: Total U.S. Retail Sales Growth (Nominal, YoY)



Source: *U.S. Census Bureau, FTI Consulting Analysis*

One Last Look Back at the Pandemic's Impact on E-Commerce

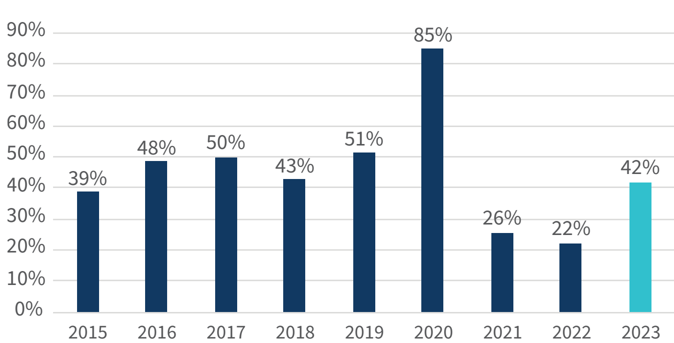
On balance, the COVID-19 pandemic was a net positive for large retail chains and the e-commerce channel, which includes online-only sellers like Amazon, as well as omnichannel retailers. Cumulatively, total U.S. retail sales (excluding auto & gas) from 2020 to 2022 were approximately $1.4 trillion greater than we expected prior to the COVID-19 outbreak, or about 12% more over this three-year period, as Americans directed less of their total spending to services and more to consumables and creature comforts. Considering that nominal annual retail sales growth was consistently in the 4.0%-4.5% range prior to COVID-19, this pandemic sales bump represents significant incremental growth for retail — though much of it has been inflation-driven since mid-2021. Consumer-level inflation has averaged 6.9% (YoY) since mid-2021 compared to 2.2% in the two decades prior to COVID-19.

The online channel was the primary beneficiary of this retail sales surge. In dollar terms, cumulative e-commerce sales between 2020 and 2022 were $610 billion more than they would have been in our pre-COVID forecast model. So by implication, the online channel captured 44% of the total incremental bump in retail sales during these three years, more than double the channel's low 20% share of sales within the retail ecosystem. However, that statistic is somewhat misleading, as e-commerce took 85% of total retail sales growth in 2020, followed by much smaller pickups in 2021-2022 (**Figure 3**). In terms of market share, e-commerce gained 500 basis points (bps) of share in 2020 alone — to 20.3% from 15.3% — or approximately 350 bps more than it would have gained without the pandemic per our pre-COVID forecast model, the equivalent of more than two *additional* years of market share gains in that one year alone.

E-commerce market share currently hovers just above 21.0%, only slightly higher than two years ago, as store-based sales growth mostly kept pace with online sales growth during that period until 3Q22. Consequently, e-commerce market share is approaching the path it would have been on in our pre-COVID-model, which projected stronger market share gains in 2021-2022 (**Figure 4**). But the good news is that total retail sales are considerably larger than anticipated in our pre-COVID model, so even a fairly stagnant online market share since 2020 translates into considerably more e-commerce sales dollars than originally expected — and that will continue to be true going forward as sales continue to build on a higher base. Moreover, e-commerce sales growth and market share gains have accelerated in the last three quarters, and we expect that trend to continue its recent improvement at least through 2023.

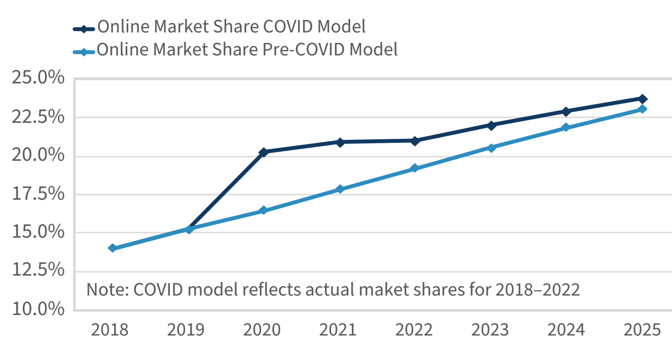
Arguably, the biggest online winner during the pandemic was grocery, which saw online market share more than double since COVID-19 hit. Grocery was the most challenged category to win online market share prior to the pandemic, with customers revealing in survey after survey that they preferred to shop in-store for their perishables and other select grocery items. COVID-19 upended that preference as millions of shoppers made the leap reluctantly during the pandemic, and many liked it better than they imagined, particularly with curbside pickup. Consequently, online grocery's ultimate market share potential of 15%-20% is appreciably higher today than its pre-COVID ceiling, and soon it will be a $100 billion category. The health & beauty category likewise received a pandemic boost, though not to the same degree as grocery. Unlike other broad product categories that saw slight declines in online market share after 2020, neither grocery nor health & beauty experienced a post-pandemic market share backslide (see **Appendix A**). COVID-19 was a game changer for these low-market-share product categories, which will propel the e-commerce channel in the years ahead as other high-market-share categories approach their ceilings.

Figure 3: E-Commerce Share of Total Retail Sales Growth



Source: *U.S. Census Bureau, FTI Consulting Analysis*

Figure 4: U.S. E-Commerce Retail Market Share



Source: *FTI Consulting Analysis*

Precarious Prospects for Prime Day

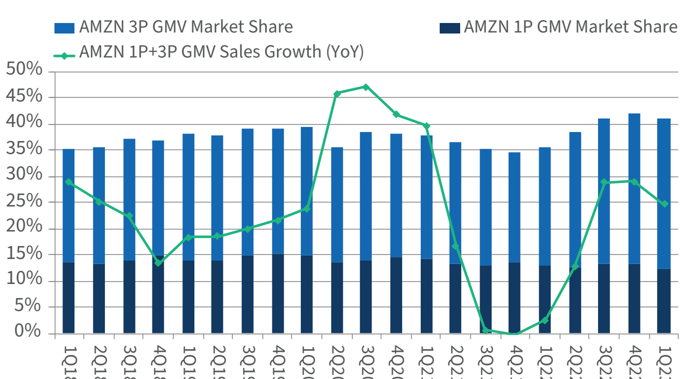
It is inevitable that this year's Prime Day event will be hailed as "record setting" no matter how modest or marvelous the results may be. Any positive comp over a previous record high — which 2022 was — will be a new record high no matter how meager that gain might be, and surely that is how it will be characterized. Technically speaking, every annual Prime Day event is a new record, though the importance of that factoid surely has diminished somewhat. Moreover, inflation alone will nearly guarantee a positive nominal comp over last year's $12 billion of total online sales during Prime Day events. So, another Prime Day record seems to be in the bag, though it is doubtful that sales growth will approach last year's hefty increase.

Regardless of how Prime Day performs this year, Amazon's retail results in recent quarters indicate that it seems to have found its groove again after an uncharacteristic sputter from late-2021 into mid-2022

For all the hype, this upcoming Prime Day could be the most subdued in recent memory. For starters, many consumers are getting tapped out, financially or otherwise. Shoppers have bought lots of discretionary goods for three years running, and this particular appetite might be sated, as consumers are diverting more of their spending back to travel and other experiences. Secondly, this year's Prime Day event comes at an uncertain moment for the domestic economy as consumers are wary of slowing growth and a widely predicted downturn just as pandemic-fueled savings are running low. Lastly, Prime Day has become a very competitive event with many other large retailers offering competing promotions to Amazon's. Media references to Prime Day event sales generally refer to the totality of online sales in that two-day period, not just Amazon's. Perhaps more concerning, a recent Ziff Davis consumer survey conducted for *RetailMeNot* indicated that shoppers intend to cut back materially on their Prime Day purchases this year[2] compared to 2022 — a cautionary note if you put much stock in consumers' stated shopping intentions. It is worth noting that survey respondents last year also said they would cut back when Prime Day online sales jumped by 8.5%, according to Adobe Digital Economy.[3] Sometimes good intentions don't stand a chance against a good deal. If there's one thing we've learned since COVID-19, it's that consumer sentiment and discretionary spending can be very disconnected. Overall nominal retail sales growth in 1Q23 remained fairly robust but decelerated to a mid-single-digit range, which was attributable to slowing inflation and a more cautious consumer.

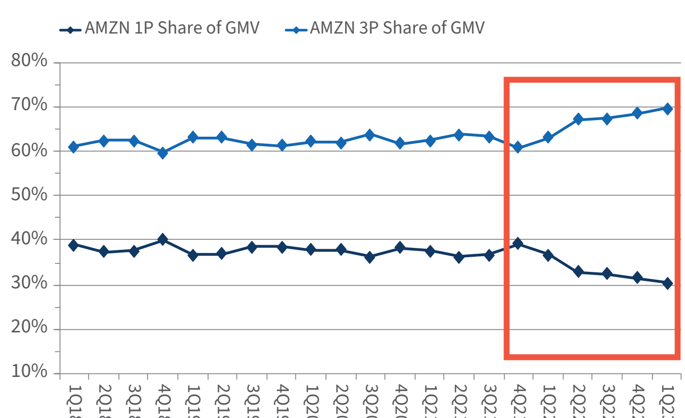
Regardless of how Prime Day performs this year, Amazon's retail results in recent quarters indicate that it seems to have found its groove again after an uncharacteristic sputter from late-2021 into mid-2022 that saw its retail sales growth slow sharply while its estimated market share of online sales slipped slightly (**Figure 5**). Some of that underperformance was attributable to consumers' pivot back to stores, but Amazon also underperformed relative to the rest of the online retail channel. Amazon's retail sales growth has gotten traction again since mid-2022, and its share of U.S. online sales has crept up just above 40% recently, led by strong sales of third-party (3P) merchandise, which we estimate to be nearly 70% of total gross merchandise value (**Figure 6**), its highest relative share for Amazon's 3P sales.

Figure 5: Amazon's Online Retail Sales Growth & Market Share



Source: *FTI Consulting Analysis*

Figure 6: Estimated Breakdown of Amazon's GMV



Source: *FTI Consulting Analysis*

U.S. Online Retail Forecast

The COVID-19 pandemic has altered the trajectory of e-commerce retail sales, not just during those impacted years but in years to come. We continue to utilize a logistic growth model (or S-curve) to forecast online retail sales and market shares. The model was developed using historical online sales and estimated market shares since 2000 to quantify a best-fitting logistic curve equation, which is revised annually as new data become available. A logistic curve is the most suitable growth model to apply to the trajectory of online sales and market shares, since it recognizes inherent limits to growth.

E-commerce sales will settle down to more predictable growth and market share gains now that the pandemic and post-pandemic transition are behind us. We project U.S. online retail sales will hit $1.14 trillion in 2023, an increase of $103 billion, or 10.0%, over 2022, which is consistent with our pre-pandemic sales growth trajectory for the channel. Our forecast model expects e-commerce market share gains of approximately 90 bps in each of the next three years compared to share gains of just 65 bps and 10 bps in 2021 and 2022, respectively, but slightly less than our pre-COVID model projected. We expect annual online sales growth through 2025 to be double the rate of store-based sales growth, as consumers continue to migrate away from store shopping as the post-pandemic afterglow fades. This sets up a predicament for large omnichannel retailers. As they close more money-losing and marginally performing stores and generally reduce their store footprint, shoppers increasingly will gravitate to website visits and online shopping, further weakening store-level performance. Some have called this a potential doom loop, and large retail chains will need to be wary of such a scenario and maintain a sufficiently sized store base to stay relevant with shoppers, keeping in mind that stores are also billboards. It’s a delicate balance.

Conclusion

With the COVID-19 pandemic safely in the rear-view mirror, Americans continue to resume pre-pandemic habits and lifestyles. Categories such as travel & lodging are nearly back to 2019 volumes. However, other areas of the economy, such as office occupancy, remain well below pre-COVID norms, and many Class B and C shopping centers are also in that category. Shoppers have less and less desire to spend their free time in these uninspiring venues and will be doing so less frequently, just as they were prior to COVID-19. It is a problem that won’t be going away or be easily resolved.

The biggest issue confronting the U.S. retail sector today is that key operating metrics have weakened since 2021, with EBITDA margins and return on invested capital (“ROIC”) trending lower for nearly all major store categories (**Appendix B**), though they remain above pre-COVID levels…for now. With respect to profitability, the COVID-19 impact may have been a one-time windfall for large retailers, as many store-level expenses were curtailed while shoppers spent like crazy from home. Full store re-openings since late 2021 combined with hefty ongoing expenses and investment in omnichannel, supply chain and integration are helping to generate sales but are hurting ROIC. Trends in place suggest that leaner times lie ahead for the U.S. retail sector compared to 2020-2021.

Moreover, the restart of student loan payments in October after a three-year pause is an underappreciated story with respect to its potential impact on consumer spending. Some back-of-the-envelope math indicates that the resumption of interest accrual and loan repayments on $1.7 trillion of outstanding student loan debt can potentially sap more than $100 billion from consumer spending following the Supreme Court’s decision to strike down President Biden’s attempt to forgive some student debt by executive order. It is the end of a material financial reprieve for many of the 43 million Americans with student loan debt and surely it will hit their spending habits.

Finally, the topic of generative artificial intelligence (“AI”) is inescapable these days, and retailing is no exception. AI-enhanced search will ensure that our online product searches get smarter and know us better, as search engines increasingly incorporate AI and other aspects of deep learning. Targeted ads served to us will hit more bullseyes as AI-driven search allows “Big Brother” to better understand our preferences as consumers and as human beings. The possibilities are simultaneously fascinating and frightening, and people will continue to grapple with the tradeoffs involved in having AI-based platforms that know us too well. Consumers’ opinions and personal decisions on these issues will be far-ranging, but there is little doubt that no matter how this ultimately shakes out, e-commerce can only benefit from this game-changing technology.

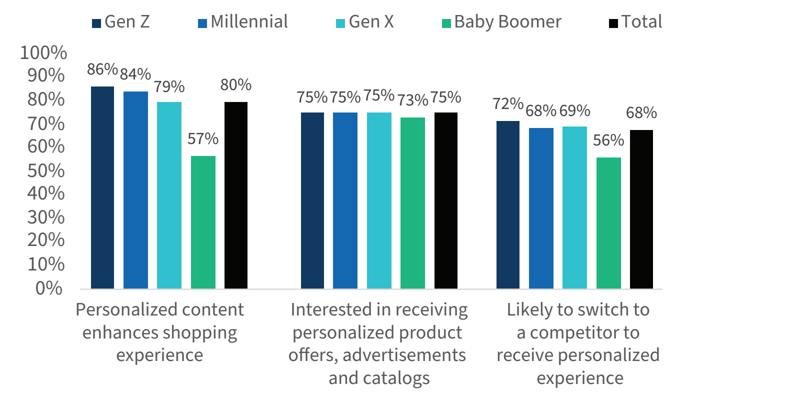
Understanding Consumers' Preferences on AI-Driven Personalization

It is expected that U.S. e-commerce retail sales will more than double over the next decade to $2.2 trillion, a CAGR of 8.0% and nearly double the projected growth rate of overall retail sales in that time. With so many shopping options available to consumers, it has become increasingly difficult for businesses to grow their share of mind and wallet. AI-driven personalization offers a way for retailers to reach their target segments with customized content that resonates with customers and eventually converts into more sales.

FTI Consulting conducted a survey of 1,000 respondents across varying demographics to: (1) understand consumers' openness to personalization; (2) identify areas where consumers expect or want more personalization; and (3) identify concerns regarding personalization, especially as it relates to maintaining a balance with privacy. FTI Consulting assessed responses based on gender, income and age groups.

It is noteworthy that consumers are extremely receptive to receiving personalized content that aligns with their interests and allows them to make quick decisions. As seen in **Figure 7**, 80% of respondents consider personalization to be helpful and agree that it enhances their shopping experience. From the survey, we also identified that 75% of respondents are very interested in receiving personalized product offers, advertisements and catalogs. Additionally, 68% of respondents said they would likely switch to a competitor if the competitor offered a better personalized experience — all of which means businesses will have to consider making investments in developing "AI-driven personalization" capabilities.

Figure 7: Consumers' Interest and Perspective on Personalization

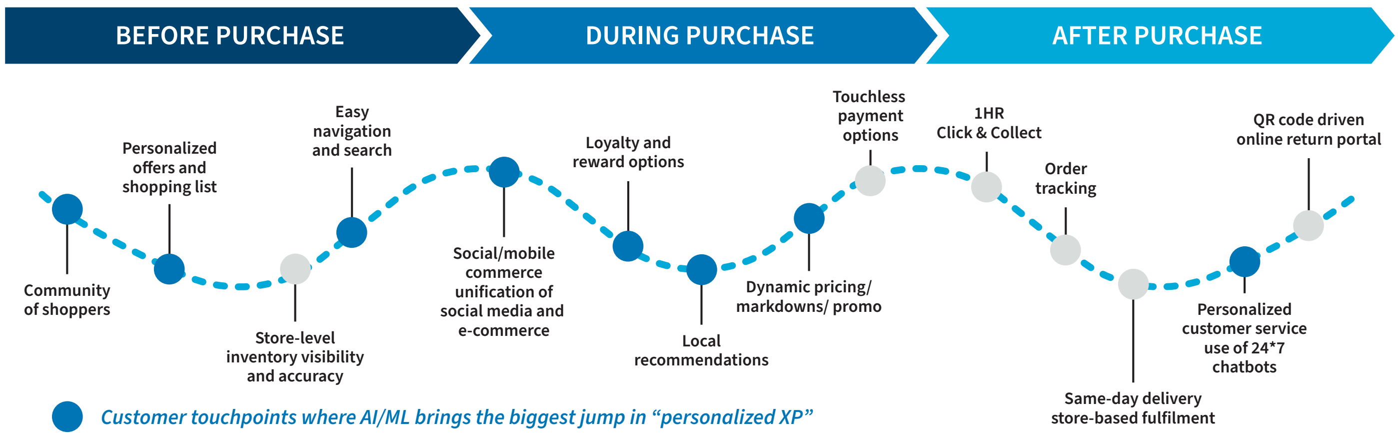


Source: *FTI Consulting Consumer Preferences on AI-Driven Personalization Survey, 2023*

In the past, businesses have extensively used A/B testing to personalize marketing messages. However, this method is less effective, as it focuses on using macro-segmentation techniques versus the ability to use micro-segmentation with AI/machine learning ("ML")-based personalization techniques.

Personalization can drive value for both consumers and companies across the purchase cycle, from showing personalized offers in the pre-purchase phase to providing customized content, reward options, local recommendations and dynamic pricing during the purchase phase to real-time personalized customer service during the post-purchase phase. AI-based personalization has the ability to increase customer engagement across the purchase cycle to improve the customer experience and to strengthen customer loyalty.

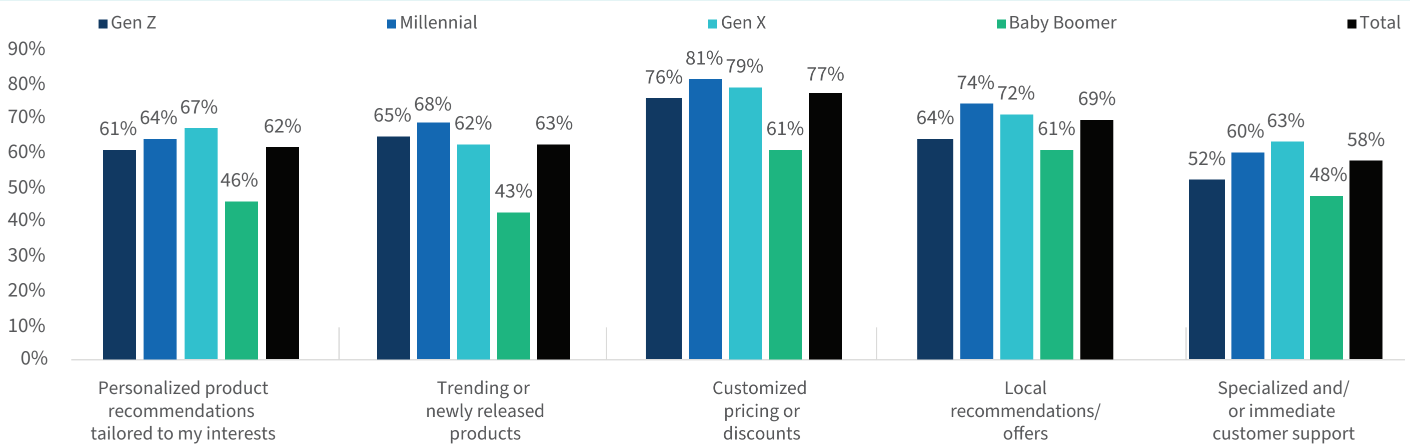
Figure 8: Customer Touchpoints Where AI/ML Brings the Biggest Jump in "Personalized Experience"



Based on the survey responses, we found that Baby Boomers are much less inclined to dive into personalization compared to other age groups. So understanding the types of personalized content that resonate with each age group will be a key consideration for businesses. To better understand this, FTI Consulting asked for perspectives on the type of personalized content that respondents are interested in. As shown in **Figure 9**, respondents welcome personalized content focused on discounts and local recommendations/ offers. Interestingly, these preferences generated higher levels of acceptance even from Baby Boomers. Gen X, Gen Z and Millennials are also open to receiving personalized content as it relates to new products or personalized product recommendations. When we looked at preferences for Baby Boomers based on their income levels (**Figure 10**), lower-income respondents were relatively more open to personalization in discounts, local offers and receiving specialized/immediate customer support. High-income Baby Boomers were less interested in these attributes.

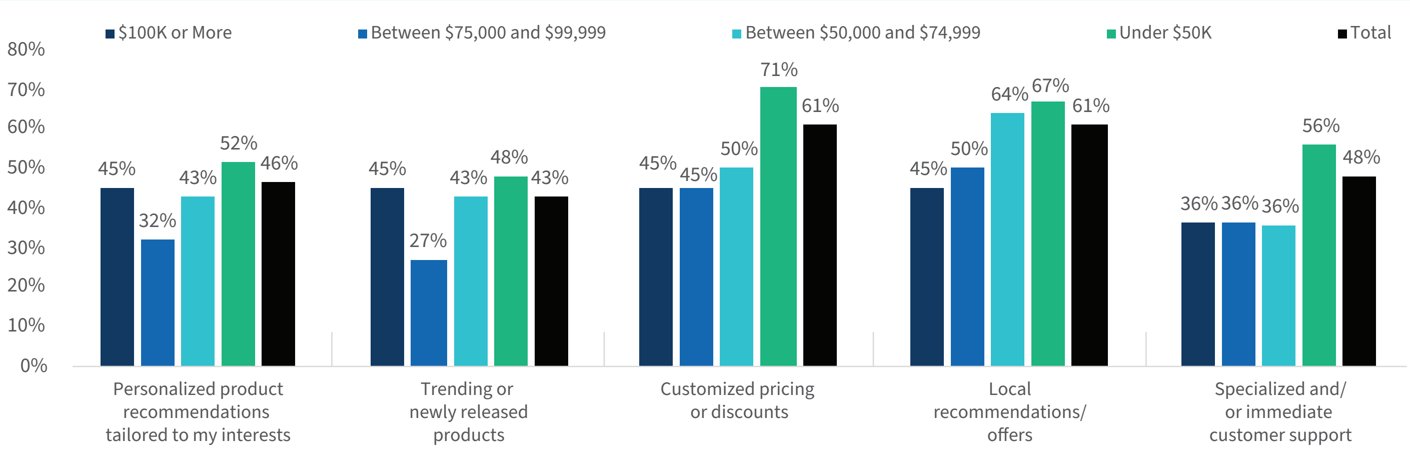
The success of personalization depends on a single factor: data. This data can be derived from various sources; for example, from data that businesses collect, such as transactions data, 3P research, customer experience feedback, email/text/ social interactions, or from third-party data sources and consumer surveys. The famous adage, "With great power comes great responsibility," is applicable to the use of AI for personalization. In order for businesses to utilize these datasets for personalization, there are two primary areas to prioritize: privacy and security. As shown in **Figure 11**, only 48% of respondents said they are comfortable sharing personal data, with the level of concern increasing to 51% when that data includes race, gender and income details. Additionally, an even lower percentage of respondents (38%) would trust online retailing platforms with data security and usage.

Figure 9: Consumers' Interest in the "Type" of Personalized Content Segmented by Generation/Age Groups



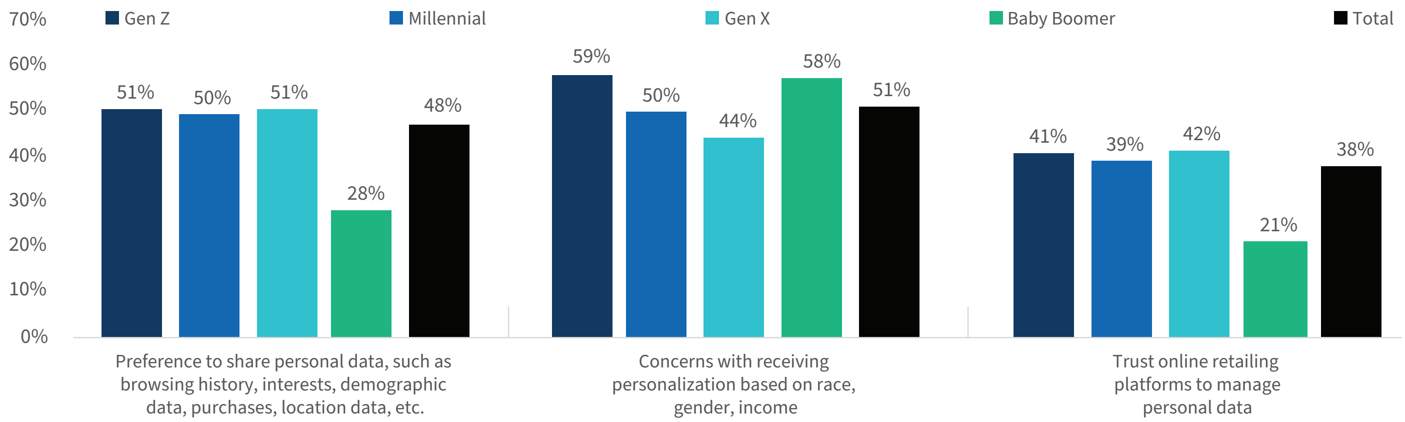
Source: *FTI Consulting Consumer Preferences on AI-Driven Personalization Survey, 2023*

Figure 10: Baby Boomers' interest in the "Type" of Personalized Content Segmented by Income Brackets



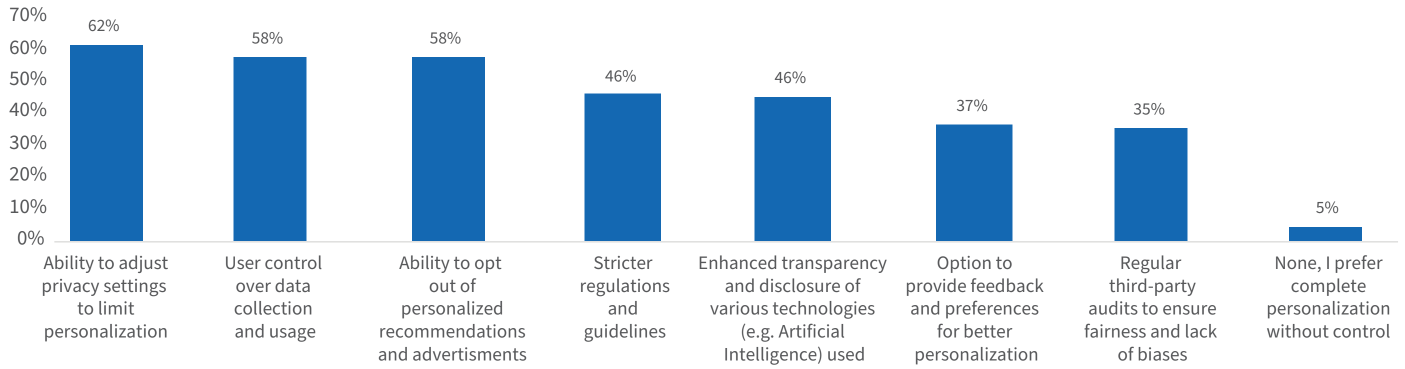
Source: *FTI Consulting Consumer Preferences on AI-Driven Personalization Survey, 2023*

Figure 11: Consumers' Preference and Level of Concern with Sharing Data for Personalization



Source: *FTI Consulting Consumer Preferences on AI-Driven Personalization Survey, 2023*

Figure 12: Consumers' Preference on Level of Control Over Personalization



Source: *FTI Consulting Consumer Preferences on AI-Driven Personalization Survey, 2023*

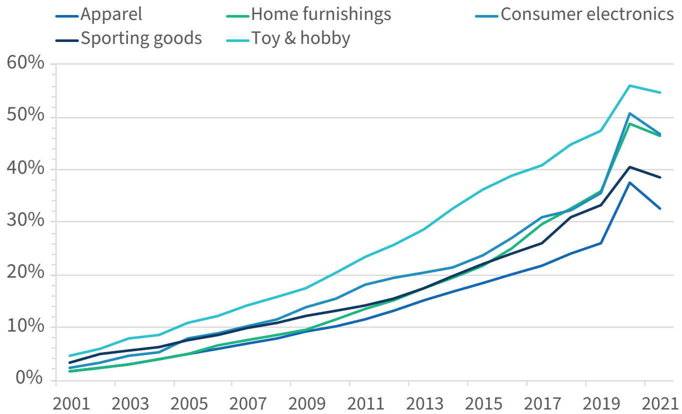
It will not be an easy task for businesses to win the level of confidence from consumers required to have them willingly share their personal data. Success of AI-driven personalization depends on the extent to which businesses identify consumer concerns and develop strategies that will directly address these concerns. This is a process and it cannot be achieved quickly. However, businesses that move steadily with openness and transparency will be the ones to gain an edge over competitors in this shift towards micro-segmentation-based personalization.

As shown in **Figure 12**, 62% of respondents prefer to control personalization via privacy settings, 58% prefer to have businesses provide shoppers with the flexibility to control data collection and usage, and 58% prefer to have capability to opt out of receiving personalized content. If businesses put appropriate controls in place, our survey findings support the idea that by providing transparency and a reasonable degree of consumers' control over their data, many shoppers eventually will realize that the benefits of the AI-driven personalization experience outweigh concerns about the collection and use of their data.

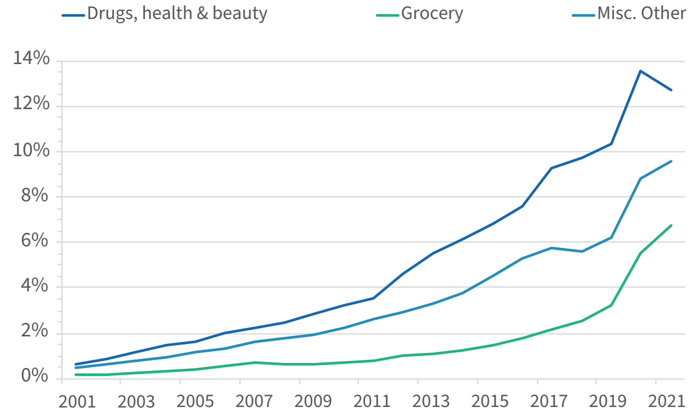
Conclusion

Use of disruptive technologies like AI and ML will revolutionize shopping personalization. This unique opportunity for businesses to acquire large datasets and mine them to deliver tailored experiences to customers will help to propel winners in this never-ending race to gain e-commerce market share. These technologies will enhance the customer experience throughout the purchase cycle, increase customer engagement and loyalty, and in the process, enable businesses to have first-hand data on what resonates most with customers, allowing them to make product suggestions that result in higher sales conversion rates.

Appendix A: Estimated Online Market Shares



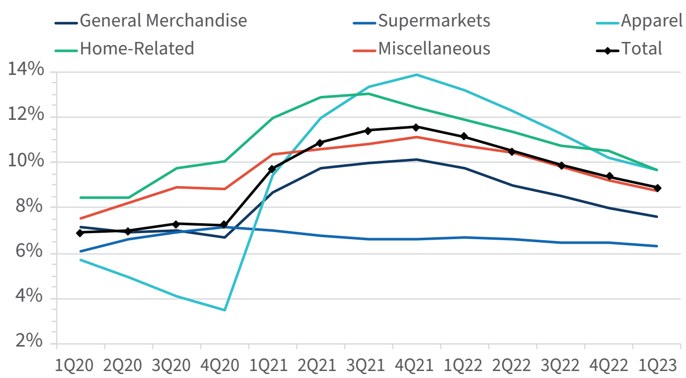
Source: *S&P Capital IQ, FTI Consulting Analysis*



Source: *S&P Capital IQ, FTI Consulting Analysis*

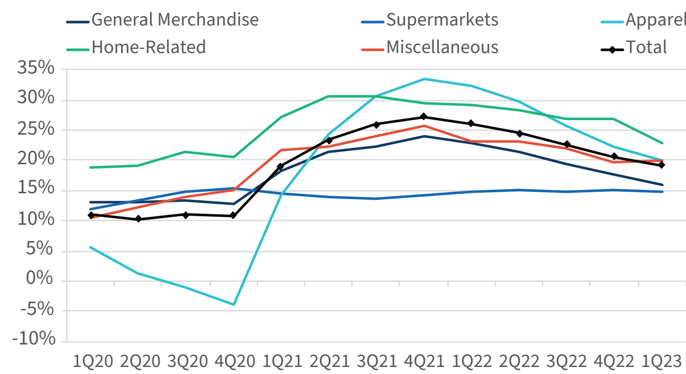
Appendix B: Key Operating Metrics of Publicly Owned U.S. Retailers

EBITDA Margin



Source: *U.S. Census Bureau and FTI Consulting, Inc.*

Return in Invested Capital (ROIC)



Source: *U.S. Census Bureau and FTI Consulting, Inc.*

Endnotes

[1] The terms "e-commerce" and "online retail" are used interchangeably throughout this report to describe a retail sale of a product that was consummated via a digital medium, regardless of how or where the buyer took possession of the merchandise.

[2] Prime Day Shopping and Spending by the Numbers (2023), The Real Deal, June 12, 2023

[3] Prime Day 2022 Breaks Records with $11.9 Billion in Sales, Chain Store Age, July 7, 2022

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