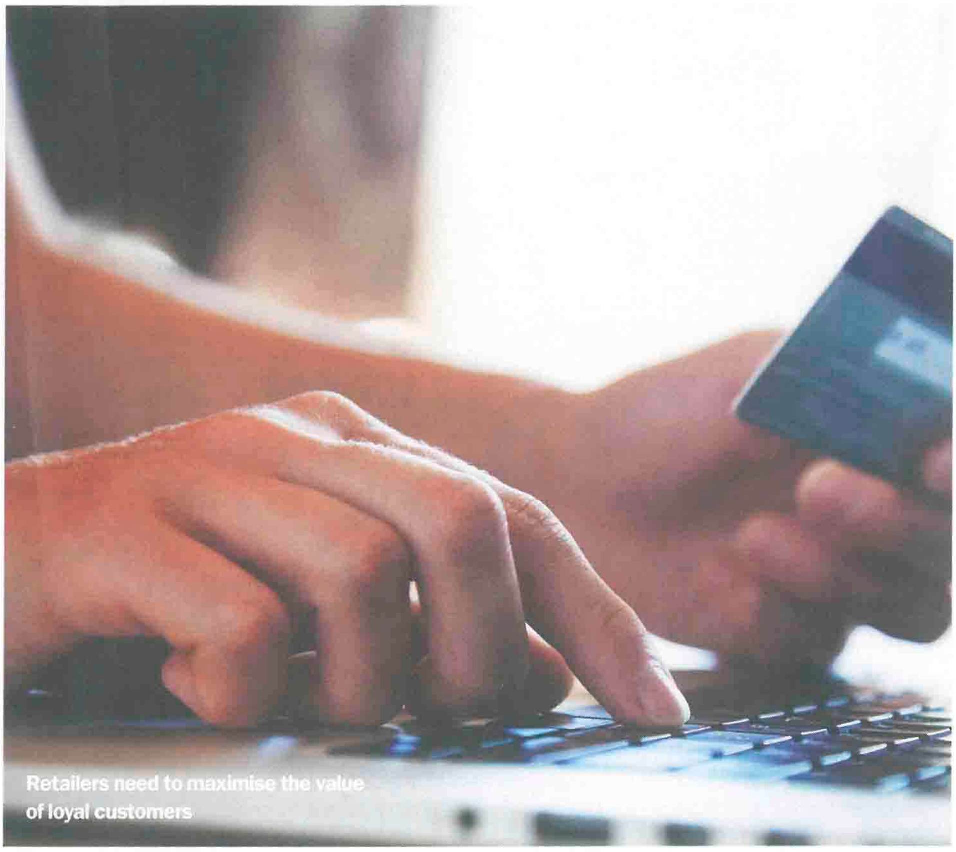
ANALYSIS

Solving the online profit equation

Growing digital sales used to be all about land-grabbing. But as online matures, retailers need to ensure growth is profitable. By Becky Waller-Davies



Retailers need to maximise the value of loyal customers

When retail giant Tesco admits it can't make money selling general merchandise online, it shows that something has got to give.

The grocery giant pulled the plug on its Tesco Direct business last month, admitting that it couldn't make the economics work.

Finally, it seems, retail is coming to recognise that its favourite idiom, "sales are vanity, profits are sanity", applies to online as well as stores. And, as online sales become an ever greater proportion of revenue, it's more important than ever that retail solves this equation now.

So how can retailers improve online profitability? And what are the key levers to pull?

The profit pressure online comes down to the fact that retailers have to compete with Amazon, says Salmon's global head of retail and marketing Patrick Munden.

"The reason a lot of online companies are not profitable is because consumer expectation is governed by Amazon's offer. Online, prices are very easy to compare. Price transparency together with free delivery and returns is the gold standard. If retailers can't emulate that, then that is where they will lose," he says.

However, for the majority of retailers there are certain things they can do to boost the bottom line.

Target the right customer

The first step is to ensure you are targeting profitable customers.

"Online is about maximising the value of loyal customers," Munden says. "Retailers need to be able to identify high-value, frequent customers through really good data and personalisation. They should not be targeting one-off shoppers looking for bargains.

"If customers keep buying, returns get lower because they know what they are getting and their expectations are set. That means that costs will also fall. That's where retailers can really begin to compete against Amazon."

Practicology chairman Martin Newman believes that retailers would be advised to remember the 80/20 rule, which dictates that for most retailers, 80% of sales come from 20% of their active customer base. Understanding that 20%, he adds, is crucial.

"Retailers don't think about serving those customers nearly enough," he asserts. "How to stop them from churning, how to find more people like them. If you have already identified a type of person with a propensity to shop more than most, find more people like that.

"Profitability is driven by extending the lifetime value of those customers. So, find more of them and give them reasons to come back."

> **One of the keys to profitability is unlocking the technology you already have**
> **Mark Leach, User Conversion**

Use tech wisely

Selling online requires significant investment, but retailers can become blind to just how much money they are pumping into ecommerce, User Conversion managing director and former head of ecommerce for Missguided Mark Leach says.

"Some of the investment in tech that retailers make is because they are so keen to appear as though they are doing the right thing. They want to attract the best talent and to keep up with the competition. But one of the keys to profitability is unlocking the technology you already have."

For instance, he adds, many retailers do not take full advantage of their A/B testing technology.

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Tesco closed its Direct business earlier this summer

"A lot of retailers have this test software but do two or three A/B tests a month," he says. "But those testing platforms are really sophisticated."

He adds that retailers could do much more bespoke A/B testing based on user behaviour and argues that this would increase profitability. "If you know that the average order value is higher at lunchtime than during the evening, you can take that information, do something with it and attract higher-value orders," he continues.

He lists targeted marketing as one such activity – if customers tend to spend more at certain hours, then it makes sense to prompt them to spend at that particular time.

The price is right

Making sure the price is right is of course critical to every retailer, and there are now tools available to help retailers make smarter pricing decisions.

Pioneered by Amazon, dynamic pricing tools monitor competitor pricing and allow retailers to alter prices according to consumer supply and demand.

This can mean lowering prices to match competitors, and also raising prices when items are in demand or prices are out-of-kilter with rivals.

"Pricing intelligence tools are always valuable," affirms Javelin chief executive Richard Wolff. "And I think that while retailers are generally collecting lots of data, they are not always doing analytics on it and driving value from it.

"Intelligence like competitor pricing is extremely valuable and there's probably more opportunity to use that. If retailers can make sure that data is distributed properly across the business, then buying and merchandising can then make better stock management and buying decisions.

"The business can then increase revenue and margin."

Online is about maximising the value of loyal customers... not targetting one-off shoppers
Patrick Munden, Salmon

Efficient fulfilment

Targeting profitable customers and boosting average order prices is only part of the solution; retailers also need to ensure that their fulfilment operations are as efficient as possible.

Generating profits from last-mile delivery is notoriously difficult, with most retailers simply opting to cover their costs and avoid eroding margin as much as they can rather than making a profit.

Last-mile technology advancements such as platforms that allow customers to redirect parcels already en route, or autonomous delivery fleets such as ground drones, will help retailers ensure their operations are as efficient as possible – but until then, one of the best ways to keep costs down is to try and control the rate of returns.

While retailers are generally collecting lots of data, they are not always doing analytics and driving value from it
Richard Wolff, Javelin

Almost every retailer offers free returns despite the cost involved, because paying for returns puts off shoppers from ordering in the first place. Research by Retail Week Connect found that for 77% of consumers, free returns were the most important element of a retailer's returns service.

When it comes to minimising returns, Asos is one example of a retailer that does this well. By providing fitting guides, videos of the clothes moving on a body and showing product on three different body types, the etailer cuts down on returns, and the cost of fulfilling them.

Online profitability is a delicate balance to achieve, but it can be done – and it's more important than ever to achieve as digital sales provide the growth that stores cannot. RW