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E-commerce Global Initiative

Becoming indispensable: Moving past e-commerce to NeXT commerce

A successful transition to the next horizon of digital commerce requires companies to get real about being customer first and make some hard choices.

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Companies are in danger of missing the next e-commerce wave.

With e-commerce sales doubling in the past five years[1] and markets expected to almost double again by 2026,[2] companies are making sizable investments in their e-commerce capabilities. The problem is that many of these companies are locked into an increasingly outdated view of e-commerce as a "bolt-on" to the main business.

This approach to e-commerce needs a big upgrade grounded in a commitment to become indispensable to the customer through an exponentially deeper level of engagement online and offline. Delivering on this vision requires companies to put digitally driven commerce at the center of their organizations so they can orchestrate experiences that meet customers' ever-rising expectations. We call this next horizon of value NeXT commerce.

This is not some far-flung fantasy. Some large incumbent companies are generating tens of millions of dollars in new value through a deeper commitment to digitally driven commerce, and they're doing it quickly. Many more, however, are struggling to make the leap or are scared off by cost or channel-conflict concerns.

To understand what shifts are needed and how incumbents are making them, we surveyed nearly 50 senior commercial executives, discussed the future of e-commerce with more than 75 business leaders, and analyzed the more than 1,000 digital-commerce programs we've helped clients implement over the past three years.

Three core findings emerged from this research:

— *Six global forces,* from rapidly shifting customer behaviors to a proliferation of new technologies, are exerting massive pressures on legacy business models.

— *Successful companies are becoming indispensable to their customers* by using digital to move past basic transactions and provide experiences that solve a much broader set of their customers' problems.

— *Many companies are avoiding the hard choic*es they need to make, often because of internal politics, fear of channel conflict, and large gaps in capabilities and tech, thereby missing out on the full potential value available to them.

[1] Daniela Coppola, "E-commerce as share of total retail sales worldwide 2015–2021, with forecasts to 2026," Statista, September 21, 2022.
[2] "Here's why e-commerce growth can stay stronger for longer," Morgan Stanley, June 14, 2022.

Why now for NeXT

Making the leap to NeXT commerce is based on a recognition that digitally driven commerce is the future of business. Six important trends are forcing the issue:

1. *Accelerating e-commerce.* All signs point to strong growth ahead in B2C and B2B, with e-commerce set to grow more than 12 percent each year through 2026.[1] The executives we surveyed expect total digital revenues to grow, on average, from 20 percent to 31 percent of total sales from 2022–24.[2] There are at least 25 million "high-potential" digital customers in the United States and Europe who tried e-commerce for the first time during COVID but have not fully adopted it.[3]

2. *Fast-changing customer behaviors.* Digital adoption rates over the course of COVID doubled around the globe, and a sample of leading executives expects that trend to continue.[4] Social commerce, for example, is expected to more than double from 2021–25.[5]

3. *Sky-high customer expectations.* Each successful digital innovation raises the customer-expectation bar for everyone else—Tik Tok for video, Amazon for convenience, Alibaba for relevance, to name just a few. If companies can't meet rising expectations, customers will leave. Some 74 percent of B2B customers want product availability shown online, while 72 percent want to be able to buy through any channel they want.[6]

4. *Less-forgiving capital market expectations.* The current approach to e-commerce is unsustainable for many companies, particularly in consumer businesses. Some three-quarters of retailers, for example, had negative EBIT margin growth, even as e-commerce became a larger share of revenue.[7] The market is now punishing that strategy. A sample of North American e-commerce companies, for example, saw an average decline of more than 10 percent in EV/EBITDA from 2018–22, versus a decline of 2 percent for companies in general.[8]

5. *Massive advances in tech and data.* New technologies have evolved to massively accelerate scale and speed. 5G has made data consumption cheaper and better for consumers, while the cloud has provided companies with enormous computational power for lower costs. Advances in AI and machine learning have enabled mind-blowing analytic capabilities and intelligence, while tech is enabling automation in almost every aspect of operations.

6. *Competitive pressures.* B2B and B2C companies are facing crushing competitive forces from two sides. From one side, large, digital-first companies are harnessing their advantages to move into new markets, potentially threatening every established sector. From the other side, a proliferation of start-ups are launching innovative business models that can quickly scale. Funding for e-commerce start-ups reached a record $54 billion in 2021, up from $19 billion in 2020.[9]

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[1] Suzy Davidkhanian, "US e-commerce forecast 2022," Insider Intelligence, July 26, 2022.
[2] Future of E-Commerce Executive Survey, September 2022, n = 46.
[3] Neira Hajro, Kate Smaje, Benjamim Vieira, and Rodney Zemmel, "Digital resilience: Consumer survey finds ample scope for growth," McKinsey, October 3, 2022.
[4] Ibid.
[5] "E-commerce: At the center of profitable growth in consumer goods," McKinsey, July 5, 2022.
[6] McKinsey & Company Global B2B Pulse, December 2021, n = 3,360, including the countries of Brazil, Chile, China, France, Germany, India, Italy, Japan, and South Korea.
[7] "Solving the paradox of growth and profitability in e-commerce," McKinsey, December 30, 2021.
[8] We analyzed valuation multiples for 17 leading global e-commerce companies versus more than 600 of the top multisector (omnichannel) companies by market cap. In particular, we looked at enterprise value (EV) to EBITDA and EV to revenue multiples trends from 2018–22 and 2022 versus 2021.
[9] *State of retail tech 2021 report*, CBInsights, January 27, 2022.

What to do: Focus on the three Cs—customer, customer, customer

Most leaders' thinking about e-commerce is too small. Time and again, we see companies trying to optimize existing products, services, or processes, thinking along the lines of "How can we improve our widget?" instead of "How can we better serve our customers?" To become indispensable to customers, companies need to develop a radically deeper and broader understanding of what their customers really want and how to provide it.

Making that shift starts with answering three questions.

1. Are you serving your customers or your stakeholders across channels?

Few will have missed the explosion in the number of channels (and variation across those channels), from live commerce to the nascent metaverse. As of the end of 2021, B2B customers were typically using ten channels to complete their buying journeys, up from just five in 2016 (Exhibit 1).[3]

Channel strategy can look a bit like a game of whack-a-mole, with businesses rolling out new channels in an effort to "catch up" to their customers and, as a result, trying to manage a dizzying array of channels, each with its own tech stack or data models. This creates major limitations on creating seamless and scalable customer journeys.

NeXT commerce brands have instead pursued a "headless" channel strategy, where no single channel is favored over another, in order to serve customers wherever they are, online and off. They have built fully integrated customer, inventory, and order management systems that manage data and experience flows across channels and inventory locations based on what customers prefer rather than on how systems are set up.

Grainger embraced this headless approach to provide whatever its customers needed by installing vending machines on factory floors so workers could access parts immediately. The machines are connected to automatic replenishment systems. The company also developed and continually added a range of services to its website and mobile app, such as access to previous orders, 24/7 customer service, and advanced search, as well as e-procurement and digital stock-fulfillment solutions. These digitally driven initiatives are now responsible for 75 percent of Grainger's revenue.

Exhibit 1

B2B decision makers are using more channels than ever before to interact with suppliers.

Number of distinct channels that B2B customers use during their decision journey,[1] US only

2016	2019	2021
5 channels	7.5 channels	10 channels

[1] Q: *What type of research have you used to research suppliers? Which of the following methods have you used to evaluate suppliers and products at this stage? How do you go typically go about submitting a new purchase order? How do you typically submit your re-order?* Count of distinct channels used across the entire buying journey (research, supplier evaluation, ordering, reordering).
Source: McKinsey & Company Global B2B Pulse, 2016, n = 648; 2019, n = 605; Nov 2021, n = 602

[3] Liz Harrison, Candace Lun Plotkin, Steve Reis, and Jennifer Stanley, "B2B sales: Omnichannel everywhere, every time," McKinsey, December 15, 2021. The ten channels include email, in-person, phone, supplier website, procurement department, mobile app, e-procurement portal, video conference, web chat, and Google/web search.

In China, trust issues mean that consumers will typically visit eight touchpoints before making a decision,[4] putting a premium on consistency across every channel. This dynamic has thrust stores—and specifically salespeople in stores—into the omnichannel spotlight, as consumers often turn to them for advice about products or services.

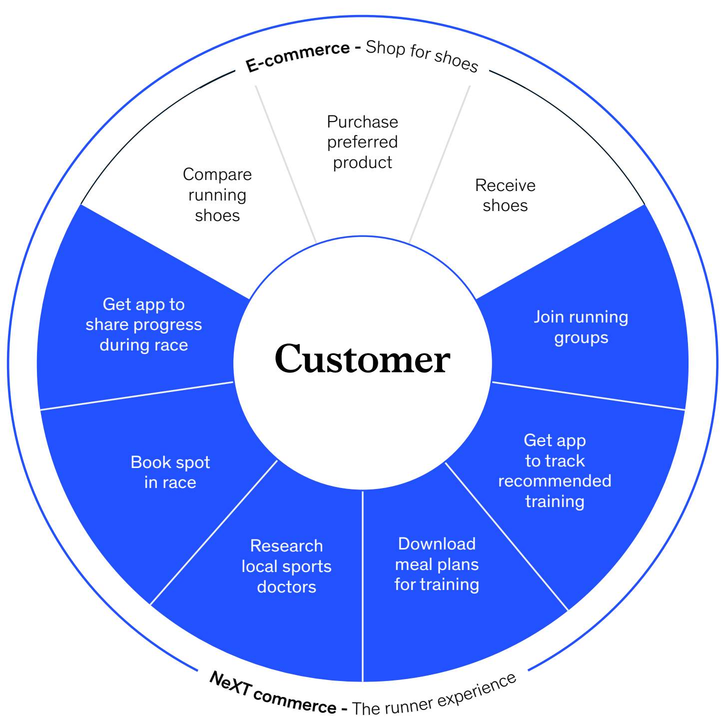
On the back of these interactions, salespeople are incentivized to deepen customer relationships by getting them to sign up for loyalty programs and communicating offers to them through WeChat. Chinese retailers have developed highly automated CRM-like capabilities to feed salespeople tailored offers and coupons to send on to their customers to drive online purchases. Kering, the luxury-brand holding company, has embedded this capability through an app called LUCE, which 16,000 sales associates worldwide use every day to drive customer engagement.

2. Are you so focused on selling more products that you don't understand all your customers' needs? Incumbent businesses often have unique advantages, including customer relationships, data, and infrastructure. But they generally do a poor job of thinking creatively about how to build on these advantages. Instead, they default to thinking about how to do a better job selling a product—for example, a running shoe—rather than about how to help their customers with all the issues related to that product, such as the full running experience (Exhibit 2).

Exhibit 2

NeXT commerce encompasses and goes beyond traditional e-commerce.

Illustrative B2C example: NeXT commerce versus e-commerce experience for a running enthusiast



[4] Rocky Chi, "Jump on the rise of Xiaohongshu, China's fastest-growing social media marketing platform," The Drum, June 9, 2021.

We're starting to see changes in this direction, such as car companies becoming "mobility" companies. This shift requires a total rethink about customer experience to encapsulate the full range of customer issues and interests related to a business's core product. Analyzing data and using focus groups help, but detailed ethnographic research to understand every single consideration and activity is crucial and the key to becoming indispensable to customers.

This goal animated Mars Petcare to expand from selling pet food to offering pet-care services. The ultimate goal is the creation of a "loyalty loop," a set of managed experiences that not only expands the ways companies can serve customers but also builds up their data advantage.

3. Do customers trust you enough to accept your moves into new markets?
Companies have always moved into adjacencies, but NeXT commerce casts a wider net of market opportunity: tech companies can offer payment services; retailers can offer banking services; marketplaces can offer media.

Making this kind of ecosystem move requires a critical mass of customers, deep insights into their broader needs, and—perhaps most important—a sufficient foundation of customers' trust. Flipkart, an India-based e-commerce company, invested heavily in building customer trust—for example, by making the digital sales process as accessible as possible. It pioneered, for example, cash-on-delivery services, since 60 to 70 percent of its target customers weren't comfortable paying digitally. This foundation of trust has allowed the company to rapidly expand into new sectors such as travel and healthcare.

Companies without the same size and scale advantages will need to develop a range of alliances, partnerships, and even acquisitions to serve the broader array of customers' needs.

How to do it: Hard choices

Making the leap to running a NeXT-commerce business begins with a long, hard look in the mirror and facing some uncomfortable truths. The most important is that the majority of companies, despite their protestations, simply do not put the customer first. A range of pressures—stakeholder agendas, internal politics, managing channel conflict, short-term financials—leads to significant compromises.

Leaders committed to moving forward into NeXT commerce should begin with an unflinching evaluation of their current reality and answer four critical questions.

1. Do you know where your profitability blind spots are?
No company gets into e-commerce *not* to turn a profit. But many companies settle for revenue over profits or have vague notions of turning volume into value at some future date. Executives still see the primary role of e-commerce as driving revenues (67 percent) versus driving profit (11 percent).[5] This is a dangerous view, especially with expected economic uncertainty ahead. "Brands need to be very practical and ask: How do we protect profitability in e-commerce looking ahead?" said Ajit Sivadasan, president and global head of e-commerce at Lenovo.

[5] Future of E-Commerce Executive Survey, September 2022, n = 46.

NeXT commerce enshrines profitability as a core capability based on two things:

— *Know what your customers value and where you're distinctive.* Customer acquisition costs have risen an average of 60 percent over the past five years.[6] To redress this issue, companies need to do less paid marketing (essentially buying share) and more engagement. Unfortunately, many companies have incomplete, narrow, or simply incorrect views of what their customers care about. In many cases, this is a result of entrenched mindsets or incentives that reward people for only optimizing experiences within the narrow bounds of their own operational responsibility.

  Addressing this blind spot starts by separating table stakes from distinctive sources of value to the customer that competitors will have trouble copying. When Alibaba set up its HeMa grocery business, it maintained market parity for delivery times (around 30 minutes) and pricing. It distinguished itself, however, by identifying "key value indicators," which included having the freshest seafood and providing ready-to-cook meals for young couples.

  For many B2B companies, finding this value entails using tech to help sales and service people. Grainger organized data about its customers to make it easily accessible. When a customer calls about broken kitchen equipment, for example, a Grainger service person is able to access a database immediately to identify the needed part and ship it quickly.

— *Operational efficiency.* Logistics typically are among e-commerce's highest costs and quickly erode margins. Fulfillment costs, for example, can account for 12 to 20 percent of e-commerce revenues, squeezing margins and making profitability a mirage.[7]

  The truth is that most companies have not effectively designed and implemented cost-efficient operations. But companies can often unlock sizable value by using AI to systematically optimize the full range of operations, from pricing and assortment to single-trip productivity and order pooling to long haul and last-mile delivery configuration and order density, to name but a (very) few. It requires a Toyota factory mindset to squeeze efficiency out of every process with the help of advanced analytics. One US-based energy company, for example, was able to save $20 million annually by using an advanced-analytics model to identify the root causes of repeat customer calls.[8] As Eddie Huang, the chief strategy officer of SF Express, said, "The stability of operations and logistics, among other things, is critical to service quality and customer experience."

Customer acquisition costs have risen an average of 60 percent over the past five years.

[6] "Brands losing a record $29 for each new customer acquired," Business Wire, July 19, 2022.
[7] "Solving the paradox of growth and profitability in e-commerce," December 30, 2021.
[8] "Using advanced analytics to build use cases," McKinsey.

Given the costs, companies will first need to focus on the biggest pools of value. Some companies, for example, are segmenting their products, customers, and locations to prioritize the highest-value options. Others will need to rely on partners, particularly for last-mile delivery. Similarly, companies should approach cloud service providers (CSPs), with their increasing number of offerings, like partners who can provide them an accelerated on-ramp to advanced capabilities. To support this extensibility, companies will need to put in place a core set of digital mechanisms to enable the necessary connectivity, from APIs that connect to different systems to cyber practices that protect data.

2. Are your people changes helping the customer?

Many of the most promising e-commerce programs falter because the business is simply not ready to change. There are a variety of reasons, but many of them boil down to a lack of expertise in digital and a fear of altering the status quo. Three actions are crucial to combat this tendency:

— *Hire "doer" talent at scale.* The natural tendency in addressing talent issues is to hire a head of e-commerce or a head of digital. But companies often don't provide these leaders sufficient authority or resources to make the necessary changes, leading many of them to leave in two to three years. Companies need to commit to hiring digital leadership and enough supporting digital talent to create critical mass for change. And while they need key skills—data science, cloud engineering, design—it's more important that they have key "doer" traits: a preference for action over analysis, an obsession with the customer, and a willingness to test ideas quickly with real customers. At one retailer, the e-commerce head hired 62 people within three months to sustain a digital business. This focus on talent at scale is so critical that we have seen successful CEOs spend as much as 70 percent of their time on recruiting.

— *Promote risk taking and learning over safe bets.* The pace of change will reward those companies that are fastest to learn and adapt. The best learning happens through constant experimentation. That requires companies to not only become comfortable with failure but also make experimenting easy and cheap. That means creating dedicated areas to test ideas and then capturing and sharing the learnings through transparent reporting and reusable code libraries that are easy to access. As a former digital executive for P&G said, "Fast-cycle learning is a killer app because it leads to a cumulative advantage that is hard for competitors to catch up to."

— *Use data to break through stalemates*. Without clear data that everyone is comfortable with, decision making is challenging and often slow. Good data helps create alignment and gives leaders the confidence to make decisions quickly, even when these decisions are not in line with historic experience.

"The stability of operations and logistics, among other things, is critical to service quality and customer experience."

—Eddie Huang, chief strategy officer, SF Express

[8] "Using advanced analytics to build use cases," McKinsey.

3. Are you rewarding your tech organization for delivering better customer outcomes?
Companies need to operate like digital natives, using tech to quickly test new ideas and scale the best ones. But IT at incumbent companies is often more of an inhibitor than an enabler of these efforts. The most important point to remember is that NeXT commerce goals should drive technology decisions, not the other way around. Three issues predominate:

— *Large, outdated systems constrain companies from moving and scaling at speed*. Companies need to focus on creating an infrastructure of services to untether them from their legacy systems. Microservices (code that performs discrete tasks) allow them to easily test and swap out selected capabilities without affecting the entire system. Those services can be bought outright and installed directly or used as part of an offering from a CSP. Through APIs, companies can allow this array of services to access data and algorithms trapped in legacy systems. Flipkart, for example, has relied heavily on APIs to allow systems across the enterprise to communicate with each other to deliver complete experiences.

— *IT's incentives generally aren't tied to customer or business outcomes.* Creating the right incentives begins with developing metrics so that problems cannot hide. The solution requires specific IT objectives and key results (OKRs) that are tied to customer experience and profitability, a set of input metrics to identify root-cause issues quickly, and a system of strict enforcement of those metrics.

— *Incremental changes just take too long.* The only antidote to incremental changes and glacial speed is a big-bet commitment to developing a cloud-based architecture to serve the most pressing needs, such as customer experience.

4. Are all relevant functions focused on delivering the best customer experience?
NeXT commerce requires a massive coordinating capability across the enterprise. That's because so many parts of the business are needed to deliver on the customer experience—smooth and fast delivery, inventory availability, tailored prices and promotions, consistent marketing, and informed sales. Mars Petcare's general manager of e-commerce, Jessica Hauff, had a clear view of how to make that happen: "My job was to build capabilities across the entire enterprise, so I embedded e-commerce teams in functions, including supply chain, product management, and sales." These teams are responsible for both helping functions better understand how to take advantage of digital capabilities and collaborating across functions on specific product initiatives.

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—Jessica Hauff, general manager of e-commerce, Mars Petcare

In China, a “middle office” capability has developed to manage and support various business needs across verticals and channels that interact with customers. It can orchestrate activities and roll out capabilities, such as personalization and content development, in a consistent way to each vertical.

This organizational shift must come with a big change in incentives and performance management. Sales reps simply won’t encourage customers to use digital channels unless there are incentives and goals to reward them for doing so. Each function in the business needs to have clear incentives oriented to customer experience.

Becoming a NeXT-commerce business requires a commitment to becoming indispensable to the customer. That means hard choices and significant change. But a handful of large companies have shown that it’s not just possible but also profitable and sustainable to make the leap from now to NeXT.

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