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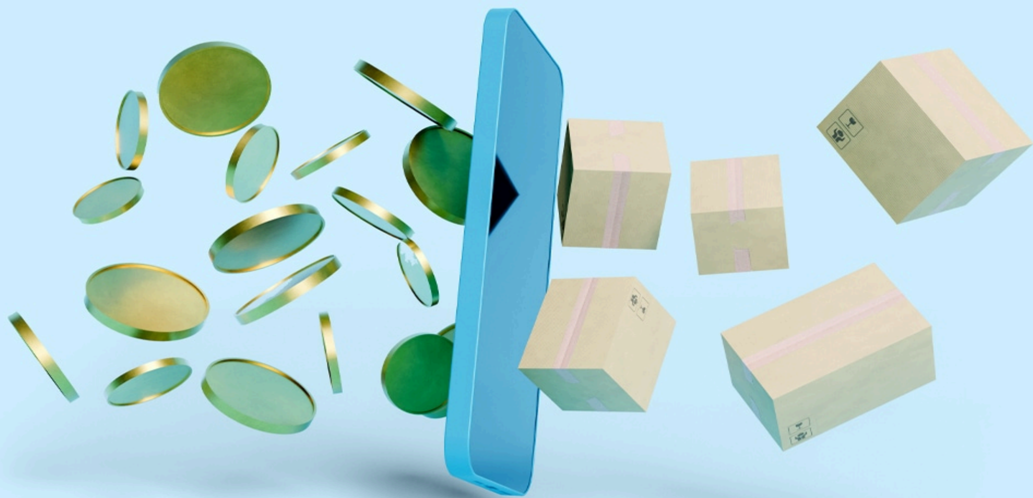
McKinsey Explainers

What is e-commerce?

E-commerce is the buying and selling of goods online. By optimizing e-commerce as part of a broader digital commerce transformation, sellers stand to attract more customers and earn more profits.



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In 30 short years, e-commerce has revolutionized the way we shop. No longer does shopping refer only to going to a store, picking out and paying for goods, then bringing them home. Shopping trips that used to take hours can now take seconds, and can be done from anywhere with an internet signal. The thrill of the purchase is now stretched out, starting with the click to buy and culminating with the "unboxing" (which has become an industry in itself).

Simply put, e-commerce is anything—goods or services—that is bought or sold on the internet. E-commerce has been growing consistently ever since the first online transaction in 1994, when someone sold his friend a Sting CD for $12.48 plus shipping. But when the COVID-19 pandemic hit, triggering lockdowns all over the world, customers went all in: year-over-year growth of e-commerce as a share of total retail sales grew 1.6 times in China, 3.3 times in the United States, and 4.5 times in the United Kingdom. E-commerce sales penetration in the United States more than doubled to 35 percent in 2020 from the previous year, roughly the equivalent of ten years of growth. Globally, nearly 20 percent of total global sales in 2021 were made from online purchases. By 2025, nearly a quarter of all global sales are expected to be made online.

Large retailers were the primary beneficiaries of this massive collective pivot, particularly those who had invested in e-commerce infrastructure and capabilities for years prior. But for businesses accustomed to operating offline, incorporating e-commerce into the customer experience can be fraught with challenges. According to McKinsey analysis, small and medium-size retailers (those with less than $5 billion in annual revenue) and brand manufacturers, such as consumer packaged goods and apparel companies, realize a much smaller portion of revenue from e-commerce than large retailers with years of experience in the e-commerce realm. For those who rushed to launch e-commerce services, cracks are already beginning to appear. But we've also seen that the e-commerce opportunity, particularly for SMEs, is tremendous.

Read on for a deep dive into e-commerce: we'll start with how e-commerce can drive value for small and large retailers. Then, we'll move onto how other types of organizations, including brands, consumer packaged goods companies, and B2B companies, can build value via e-commerce. Finally, we'll turn to how organizations in emerging markets are embracing e-commerce.

Learn more about McKinsey's Growth, Marketing & Sales Practice.

How does e-commerce drive value for retailers?

E-commerce builds value for retailers of all sizes by driving efficient sales and creating alternative revenue streams, like retail media networks.

Smaller retailers

Many small companies, in their rush to launch a new business, fall into traps that inhibit long-term growth. The stats for new business survival are grim: only 24 percent of new businesses launched in the past ten years have become viable large-scale enterprises.

Nascent e-commerce businesses face special challenges. McKinsey analysis has identified five short-term traps that hamper small- and medium-size companies' e-commerce growth, as well as ways to guard against them:

1. *Leading with tech focus,* while deferring investment in areas such as operations and channel management. To avoid inventory shortfalls, ensure that sales and operations leaders have the same success metrics as IT teams, and build all elements of the business in parallel.

2. *Building a directionless tech stack* solely useful for launch. The wrong tech architecture will create technical debt that hampers efforts to scale. To combat this, define the longer-term architecture and build a minimum viable product as a steppingstone to a larger goal.

3. *Underinvesting funds and capabilities.* Companies are frequently tempted to spend as little as possible on launching e-commerce businesses, and then expect an immediate ROI for every dollar spent. To guard against this trap, build in a "learning buffer" to any budget, to allow for necessary (and instructive) setbacks.

4. *Learning the economics on the fly,* rather than taking time to fully understand unit economics and implement a business model with long-term potential. Instead, work to understand the key drivers of growth and profitability through the lens of profit and loss.

5. *Building the new business too close to the core.* Corporate business-building activities are often hampered by internal policies that slow the development of new business. Combat this by creating distance between the new e-commerce business and core businesses. This allows for more agile ways of working to develop that reflect the nature of the new business.

Larger retailers

For larger retailers looking to get a piece of the e-commerce pie, time is of the essence. Generally, companies can create a working e-commerce site in less time than they think; in McKinsey's experience, new businesses can be launched in fewer than four months.

McKinsey worked with a European retail chain that had around 1,000 brick-and-mortar retail stores across the world, and that had decided to create an e-commerce presence. Thirteen weeks later, it had a fully functioning e-commerce business in one of its regions. Launch was successful from the first month, generating nearly 3 percent revenue growth in the region, tripling average basket size compared to retail stores, and maintaining high customer satisfaction. Here are the three main lessons from that program:

— *Be pragmatic.* Rather than attempting to launch a full-blown digital business across all markets at once, the retail CEO decided to go to market fast, in one region, with a limited offering. All initiatives that didn't have direct customer impact were postponed in favor of efforts that did.

— *Assign ownership, not tasks.* By clearly designating which teams were responsible for which tasks, the retail chain was able to launch at speed. The chain created four teams in charge of the launch: tech and design, operations, product assortment, and marketing.

— *Learn and adapt.* Putting in place the right key performance indicators early in the process of launching an e-commerce business is critically important. These allow companies to track what's happening, and adapt to drive continual improvement.

Learn more about McKinsey Digital.

What's a retail media network?

2020 was a tough year for traditional retail. Customers shifted to e-commerce channels by nearly 30 percent, adding to retailers' pandemic-related challenges. In order to compete, retailers have needed to rethink their growth strategies.

One way to approach the problem is by joining a retail media network (RMN). RMNs hold potential value for retailers by offering the chance to build a high-margin business to drive e-commerce innovation. RMNs work by leveraging retailers' detailed knowledge of their customers to offer advertising opportunities for brands to target customers through a retailer's digital channels, physical stores, and syndication on third-party platforms like Google. RMNs also offer brands the opportunity to access customers directly via first-party data. And finally, RMNs can help brands deliver a seamless, digitally enabled omnichannel shopping experience.

Many large retailers in the United States, like Amazon and Target, have already built and scaled RMNs. The biggest opportunity is for retailers in Europe, the Middle East, and Africa, where RMNs are still a relatively hidden and fast-growing profit stream. (For example, in the United Kingdom, RMNs are growing by more than 10 percent year over year.)

How can e-commerce drive value for brands?

One way brands can build value is via *direct-to-consumer (DTC) e-commerce*. There are distinct advantages for retailers establishing direct relationships with end consumers. Here are a couple of examples of brands that successfully used DTC e-commerce:

- Harry's, a men's grooming product company, used DTC to *generate customer insights and build community*. A pre-launch campaign helped the company gather 100,000 email addresses from potential customers through a waitlist and social sharing. Harry's also learned from its interactions with early customers and tweaked its products before releasing them more widely.
- DTC also gives brands like L'Oréal *direct access to consumer feedback* for evaluation and testing. In 2018, the beauty brand launched its augmented reality try-on service to let customers sample makeup and hair-color products at home. The use of this touchless service increased dramatically during COVID-19.

A clear strategy that identifies the opportunity and execution capability to convert consumers can help businesses get set up for DTC e-commerce success.

E-commerce can also drive value for brands via *live commerce and social commerce*. Live commerce blends entertainment with instant purchasing, offering retailers, brands, and digital platforms a new channel with massive scope for creating value. Its cousin social commerce is where consumers explore products and make purchases through social media and content creation platforms, within an app.

Both live commerce and social commerce got their start in China. Brands in China have achieved conversion rates of almost 30 percent on social platforms, up to ten times higher than conversion in conventional e-commerce. They've achieved these remarkable numbers by developing partnerships with social media influencers and participating in live-stream shopping (an experience that combines instant purchasing of a featured product and

audience participation). In 2021, Chinese consumers spent $352 billion—or 13 percent of total e-commerce gross merchandise value—on social commerce. The staggering numbers from China offer a glimpse of what's possible in the US and globally: already, in 2021, $37 billion in goods and services were purchased through social commerce channels. That number is expected to grow to nearly $80 billion, or 5 percent of total US e-commerce.

Live commerce was pioneered by Alibaba in 2016, with the launch of Taobao Live, a streaming service that allows users to sell items and engage with other users. Customers responded, and live commerce became a mainstay of sales campaigns for Single's Day, a major shopping event in China, as well as a reliable tool for boosting customer engagement and sales. The numbers speak for themselves: In 2020, the first 30 minutes of Alibaba's Single's Day campaign on Taobao Live generated $7.5 billion in total transaction value. And in a 2020 survey, two-thirds of Chinese consumers said they had bought products via livestream in the preceding year. Taking China's experience as a bellwether, live commerce seems to hold enormous potential for brands and e-commerce platforms.

Live commerce creates value in two ways. First, live commerce *accelerates conversion* by keeping viewers entertained during an immersive shopping experience. Time-limited tactics like one-off coupons can be used to create a sense of urgency. Live commerce also *improves brand appeal and differentiation* by increasing a brand's distinctiveness in the context of entertainment.

To get started in live commerce, brands will need to take a thoughtful, iterative approach to the medium, exploring low-risk options first. Test the waters, running infrequent streams on one social media channel or marketplace focused on only a few products. Also, track the performance of livestreams with key performance indicators for numbers of views, conversion rates, and best-selling products. Gradually, brands can begin to experiment with a regular schedule of live events hosted on their own websites, managed by a full-time in-house or agency team. Finally, brands can scale up to broadcast frequent livestreams across multiple channels, focused on different audience segments and product categories.

Learn more about McKinsey's Growth, Marketing & Sales Practice and McKinsey Digital.

How can e-commerce drive value for consumer packaged goods (CPG) manufacturers?

Consumer packaged goods are items used on a regular basis by most people, such as food, clothes, cleaning products, and toiletries. As we've seen, with COVID-19, there has been a rapid and large-scale shift from in-store retail to e-commerce. Before the pandemic, only 13 percent of US households had purchased groceries online; as of late March 2020, that number had risen to 31 percent. And consumer sentiment surveys taken as the pandemic wore on indicated that US consumers were happy with the shift to omnichannel shopping. McKinsey analysis shows that online sales in US retail jumped 40 percent year over year in 2021.

This news has come as a mixed blessing for CPG manufacturers. That's because e-commerce has, for many manufacturers, historically been less profitable than brick-and-mortar sales. Looking ahead, manufacturers should strategize about how to maintain margins.

McKinsey analysis points to four ways to improve margins:

— *Establish detailed transparency into e-commerce profits and loss.* This means integrating into business reporting the e-commerce metrics that enable business leaders to get a full picture of performance, make informed investment trade-offs, and align decision makers.

— *Earmark specific e-commerce marketing investment,* rather than drawing from shopper-marketing budgets.

— *Use e-commerce revenue growth management tactics,* including introducing channel specific products to prevent consumers from making direct price comparisons.

— *Incorporate omnichannel supply chain actions,* including improving demand forecasting and executional precision, and redesigned, lower-cost packaging.

McKinsey forecasts that, in the future, new ways to reach consumers will continue to emerge, competition for marketing and trade dollars will heat up, and personalization and precision targeting will become top priorities.

Learn more about McKinsey's Consumer Packaged Goods and Growth, Marketing & Sales Practices.

How can e-commerce drive value for B2B companies?

Misconceptions abound when it comes to B2B e-commerce. Despite e-commerce being a key purchasing gateway for many corporate buyers, McKinsey frequently hears from B2B companies that "customers aren't ready," or that "e-commerce is an immature space for a business like ours."

In reality, according to McKinsey research, two-thirds of corporate buyers rely on digital and remote channels throughout their purchasing journey. And B2B suppliers are ramping up their capabilities at incredible speed.

Here are five myths around B2B e-commerce that are past due for dispelling:

1. *Most B2B companies don't offer e-commerce.* Actually, 65 percent of B2B companies across industries now offer e-commerce capabilities, up from 53 percent in early 2021. And in a remarkable first, B2B sellers are now more likely to offer e-commerce channels than in-person selling.

2. *B2B buyers prefer face-to-face interactions.* In reality, two-thirds of corporate customers prefer digital or remote in-person engagement when given the choice.

3. *A basic e-commerce site is enough.* Incorrect: McKinsey research shows that a majority of B2B companies treat e-commerce as a full-service channel and are investing accordingly. More than 80 percent of B2B companies say they hold their e-commerce channel to the same or higher standard as other channels.

4. *E-commerce is only for repeat or low-ticket B2B purchases.* This assumption is based on outdated wisdom. These days, businesses have shed any trepidation about conducting large transactions online. More than one-third now say they are willing to spend $500,000 or more on digital channels, and 15 percent say they are comfortable making purchases of over $1 million online.

5. *Digital marketplaces are a next-level nice-to-have.* The opposite is true. B2B buyers see digital marketplaces as a critical part of the purchasing mix. Sixty percent of buyers say they are open to purchasing on digital marketplaces.

How can e-commerce support business growth in emerging markets?

E-commerce in Africa, for instance, supports a very mobile population in efficiently accessing goods and services. In an interview with McKinsey, Sacha Poignonnec—the CEO of Jumia, Africa's largest internet group—says e-commerce gives users in villages and small cities more choice than they would have otherwise.

A major challenge in Africa, and other emerging markets, is logistics. Because there are no address systems in most cities in Africa, e-commerce players need local partners who know where to find customers. Sometimes the address is "the third street by the church with the blue door," Poignonnec says. You need someone on the ground who knows what that means.

Poignonnec also emphasizes the potential for small businesses in emerging markets to grow via e-commerce, because the investment required is small compared to the number of customers a business can reach. Rather than going offline to online, as many merchants are doing in Europe and the US, retailers in emerging markets can start small, invest in an online store, then eventually leverage e-commerce success to open a brick-and-mortar store.

Learn more about Growth, Marketing & Sales consulting at McKinsey—and check out job opportunities related to e-commerce if you're interested in working at McKinsey.

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