The Decade of Online-to-Offline Retail Disruption

" I thought Adility really nailed the future path of payments/commerce/ data and the impact of online to offline. I couldn't agree more, and I think you're leading a vision in the space."

Robert Peck
Former Internet Equity Analyst, Bear Stearns

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The First Phase of Retail Commerce Disruption 1995 – 2009

For the last 15 years, you have been able to go online and purchase a book. The book is boxed by the online retailer, shipped via UPS to your home and arrives a couple of days later.

Over the last few years, these models have evolved. Rather than being squeezed out of the commerce transaction, offline retailers such as Wal-Mart and Target have built multi-channel, well-integrated commerce funnels that serve the consumer where they are: online or in the store.

The past few years have been phenomenal. The percentage of total retail sales for ecommerce has steadily grown to 5.8% in 2010 according to the US Department of Commerce and according to Forrester will grow further to over 8% by 2014. As a leader in ecommerce, Amazon had a 36% growth rate in 2010 and is outperforming any traditional retailer.

2010: The First Year of the Next Wave of Retail Commerce Disruption

During 2010, more than $451 billion in consumer incentives were delivered via FSI coupons, up 17.1 percent from 2009. Considering the increased available of smart phones, mobile applications and Internet access (now nearly 80% of the US population has access to the Internet), a drop in printed FSI coupons would have been expected.

Considering the technology trends, the continued growth of FSIs is amazing. However, digital coupons are by far the fastest-growing coupon segment. Distribution of digital coupons has grown 100% over the past year. According to a study from Coupons.com, the average digital coupon user is more affluent, with an average annual household income of $105,000, 26% higher than the US average.

Overall FSI Activity

Changes 2009 to 2010

2010 versus 2009

Measure	2010	% Change
Dollar Circulated	$451 billion	17.1%
Coupons Dropped	291 billion	7.2%
Pages Distributed	212 billion	4.5%
Face Value (average)	$1.55	9.2%
Fuse (weeks)	8.5	-8.9%

Source: Kantar Media

We experienced another new phenomenon sweeping the world in 2010 and 2011, when Groupon completely bypassed the established infrastructure for coupon distribution. In under three years, Groupon grew to over one billion dollars in revenue.

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What Was the Technical Innovation that Allowed This Disruption? None!

Groupon simply moved the point of payment from a traditional post-paid coupon transaction to a prepaid online transaction. Groupon does not carry any inventory. They simply changed the commerce payment flow and moved the payment to the place where intent for a purchase was initiated.

Groupon went further to make their model work: they created an artificial scarcity, time limitation and social dynamics to push the purchase intent to a fast-close online.

As Groupon and similar deal companies lack innovation, you will not find any economies of scale in their model or technological advancements that would benefit the merchant and allow them to part ways with products and services at half price, plus the insertion of a new middle man, charging another 50% of the already discounted sales price.

Though we see Groupon as a true disruptor, there is no economical foundation to justify the insertion of a middle man at this level, and we expect this phenomenon to gravitate over time to consumer categories where merchants fill excess capacity without any additional per seat costs. This would mean as well a much smaller market share for Groupon style offers, compared to the overall market size for online-to-offline commerce.

What is interesting is that Groupon chose a retail category that was not organized with an established incentive system, but was rather fragmented with local focus and single locations.

Comparing Groupon's sales numbers now to the total incentives circulated that are organized by large manufacturers, CPG companies and retailers, Groupon still seems small in comparison to the overall incentive market.

When you compare historically disruptive developments, you can often see early entrants creating awareness with a simpler model, while the true disruption comes from successive technological innovation and more complex replacements of an existing structure.

Groupon was the early catalyst whose new awareness will enable deeper innovative developments in the coming years on all levels of the retail commerce chain.

2010 – 2020: The Decade of Retail Commerce Disruption (Online & Offline Convergence)

We believe there will be two main drivers for future disruption in retail commerce, and both of them are closely tied to more mobile adoption:

· the payments process and

· capturing data of the consumer at the time of the purchase intent.

We have seen with Groupon that by simply moving to a prepayment of discounted goods and services, the power shifts from the retailer to the “advertising” agent.

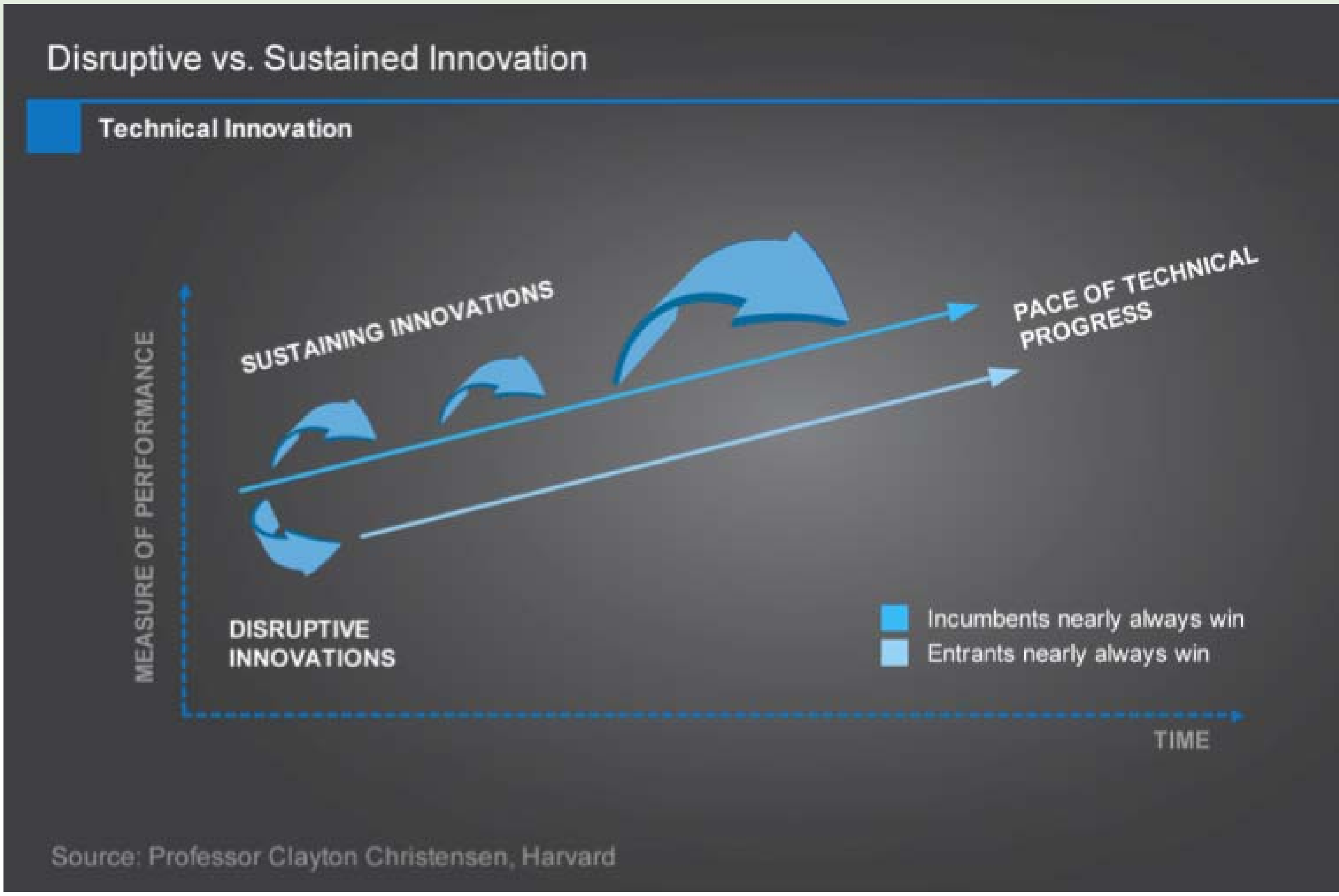
The “agent” now controls consumer data and the payment to the retailer or merchant. The concern we have with this model is that while the “agent” may contribute initial value to the consumer, he is not adding similar value to every retailer or merchant.

Quite to the contrary, they marginalize the merchant by shielding off valuable consumer data, keeping it for themselves to present the next discount from another merchant or retailer to the same consumer.

Payments

Google, PayPal, Square, First Data, Visa and many other online payment companies have rolled out a first version of digital wallet applications for mobile devices. Groupon has changed the dynamics by moving the payment from the merchants to themselves, and we do see wallets having a similar impact and potentially disrupting traditional retail. For established card networks, we expect that their wallet offerings will become simply a smarter extension to the plastic card without a change in the established business model and without true disruption.

The disruption may seem more likely to come from fairly new entrants like Google or PayPal, and not the traditional card networks Visa or Mastercard, but we believe that retailers ultimately will endorse only those technologies that support them. The Google wallet product is built on top of the Firstdata infrastructure that today already handles 50% of US credit card payments.



Players like Google and PayPal have the advantage of controlling the consumer (if they choose) and can influence them at the time of purchase intent. The only other traditional card network that has this distinct advantage is American Express, as it has direct relationships with consumers. Visa, Mastercard and Discover utilize a bank issuing partner system and do not have direct agreements for the most part with consumers.

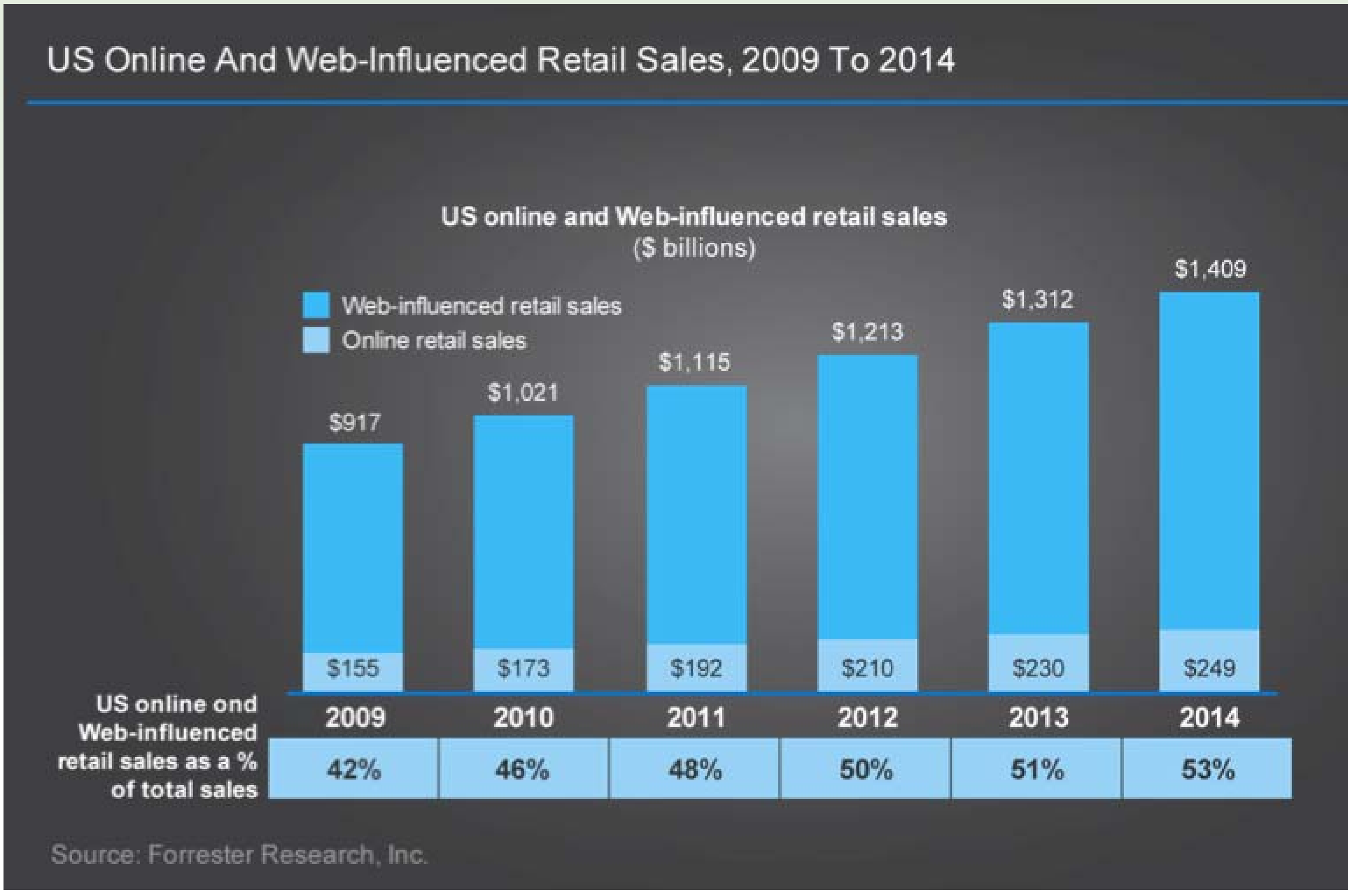
There are other, more retailer focused partnerships on the way. One example is the white label solution for a mobile wallet product introduced with a recent announcement between Corfire and Incomm to market the Corfire mobile wallet platform to Incomm's retailers.

Understanding the revenue force Groupon has become in just 36 months, we should be prepared to see more revenue shifts, but not necessarily as a result of new payment form factors, but as a consequence of the App Economy, an ever evolving ecosystem around the consumer that understands the consumer's interests and needs at the time of purchase intent.

Purchase Intent

In our opinion, the main disruption during the next years will be providing information to the consumer when he needs it at the point in time when the consumer is formulating a purchase intent. Our worldwide population is seven billion, and the number of mobile phones worldwide is five billion. 50% of new phones are smart phones (general purpose computing devices). This trend will bring the power of mobile discovery of your offline surroundings to every person on the planet.

Google claims that already 50% of offline retail sales are influenced online. Forrester has similar predictions and numbers.



The companies that will influence the purchase intent are many, not just one. Reviews, search results and other information available on any device at any time will influence the purchase intent of the consumer. Application developers will have a unique opportunity to serve relevant content that allows the consumer to discover their offline surroundings. While doing this, applications will have the ability to insert themselves into the commerce transaction. There will be a new, symbiotic relationship between retailers and Internet companies that serve content or applications that help to manage consumers' lives and retailers.

Our offline lives are complicated and diverse; the same will remain true in the future when Internet technology will help to organize our offline lives. Today we already see a flood of new applications and tools for consumers that will make local offline information more accessible online. With new monetization options these will only increase in numbers.

Assuming that Google's estimate that 50% of online retail is Web influenced is accurate, over 50,000 restaurant visits per minute are Web influenced in the US alone! This figure reflects the enormous market size of moving purchase intent online.

There is a need in the market for a commerce network that acts as a proxy in that process to harmonize analog and fragmented data points and turn them into a digital, consumable feed to provide to app developers, enabling them to present and match consumer intent with offline venues.

While many retailers still need to connect their legacy systems to this kind of backend infrastructure, the current innovative cycle connecting online and offline is truly helpful. The future we see in this development will create ultimately an ecosystem of app developers, retailers, brands and other technology partners driving the local offline GDP.

The US GDP was $14.7 trillion in 2010, and nearly $3 trillion, about 20%, are retail sales. How does this impact the already projected increase to 8% of retail sales in ecommerce? We believe that we will see an unexpected acceleration and larger numbers with the connectivity that is currently built enabling online-to-offline commerce.

We could see potentially hundreds of billions of dollars in retail commerce be accounted for via an online-to-offline connection, and we will need to define a new category "online- to-offline commerce" aside from ecommerce. This category will include commerce where the consumer will identify a product or service online and either prepay or be provided with a unique redemption code that will be stored in the consumer's mobile wallet for redemption (pick up) at the retail location.

Only a small transaction fee will be charged in the future for these online-to-offline transactions, similar to a credit card transaction (compare this to the current misaligned and unsustainable merchant tax of 30% – 50% from Groupon). The charge may be inserted into a wallet payment product or will be charged as standalone marketing/advertising costs.

We will see companies flourish that move the payment transaction into their books; these will be the new Groupon-comparable app “success” stories, and we would not be surprised to see shortly another company cracking the nut and moving billions of dollars into their books within just 24 months in business. The difference to Groupon will be the alignment of those companies with the retailer's needs. Therefore the financial transaction in the books of the online partner will equate more to a settlement role similar to traditional card networks and processors and should see similar valuations.

Other applications will leverage mobile wallets and established payment methods or will simply leave the payment transaction to the retailer but will have accountability for online-to-offline transactions with point of sale, SKU-level integration. The “commerce network” will now hold the consumer data and make it available to a retailer as a supporting infrastructure and not a competitor.

There is a quiet race for connectivity shaping up right now from major players like Google and PayPal. Traditional payment companies do see changes coming but have a hard time establishing disruptive movements as they disrupt their traditional business. From time to time we can read about acquisitions. Some will be larger, like the Google acquisition of Motorola, and some will be smaller, like the Google acquisition of Zave Networks or PayPal's acquisition of Where.com.

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Major disruption is coming with the move of our offline retail purchases to the point of thought and intent online. Considering the shift in control of the consumer's wallet, this trillion dollar opportunity may deliver the next Google or Facebook in the process, but ultimately we see this as a sustained innovation where the retailers will have and maintain control.

Today we are just in the early beginning. Groupon compares in this coming evolution to maybe Infoseek, Altavista or Lycos in the search category in 1996. At the core is the merchant, and the business will flow towards an aligned and sustainable model between purchasing consumers and the merchants providing the products and services.

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For the latest information about our product and services, please see the following resources:

Reference websites

http://www.adility.com

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Products

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