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Silicon Valley Bank

The Future of Retail

An exploration of emerging trends
redefining the retail industry

2022



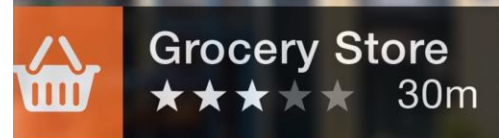
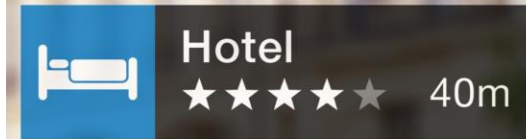
The Future of Retail 2022

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Introduction

The COVID-19 pandemic brought lockdowns and social distancing which changed consumer behavior, perhaps indefinitely. This forced conventional retailers and brands to rethink their go-to-market strategies to sustain and improve customer engagement.

Over 18% of US goods are now purchased online, over a 10 percentage point increase since 2012. The merging of the online and offline worlds has brought new challenges for retailers, especially brands – reintroducing “omnichannel”. The term is over a decade old, but changes in consumer behavior accelerated by the pandemic have increased the importance for brands to provide customers a seamless shopping experience from their computer, mobile device, telephone or in-store. Similarly, e-commerce companies recognize the value in physical locations as a sales channel and to capture behavioral data.

All this change has caught investors attention. Venture investment in commerce companies increased over 100% in 2021. On the exits front, highly anticipated IPOs like Warby Parker debuted with even more likely to come based on the number of commerce “Unicorns”. Finally, 2021 saw an uptick in acquisitions as retailers looked to bolster their omnichannel capabilities.

All the findings in this report suggest that retail is at the forefront of a significant reimagination and primed for innovation.

Alicia Fuller

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Spotlight

The Rise of Omnichannel



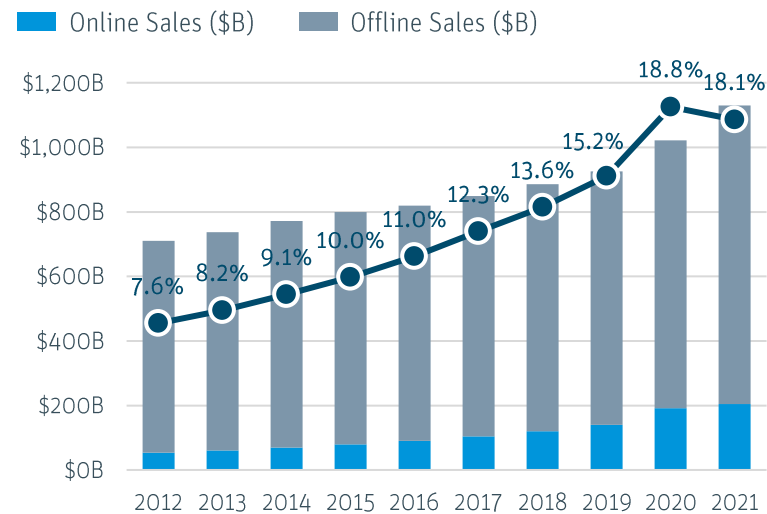
Omnichannel the Future of Retail?

Retail is embracing digital commerce, with brands recognizing the need to engage with customers whether they are scrolling or strolling. Accelerated by the COVID-19 pandemic, US online sales in 2021 reached more than \$200B, representing 18% of all retail sales. Globally, 2.1 billion people shop online. Traditional brick-and-mortar stores are quickly adopting digital commerce strategies, as a growing proportion of consumer purchases switch from offline to online.

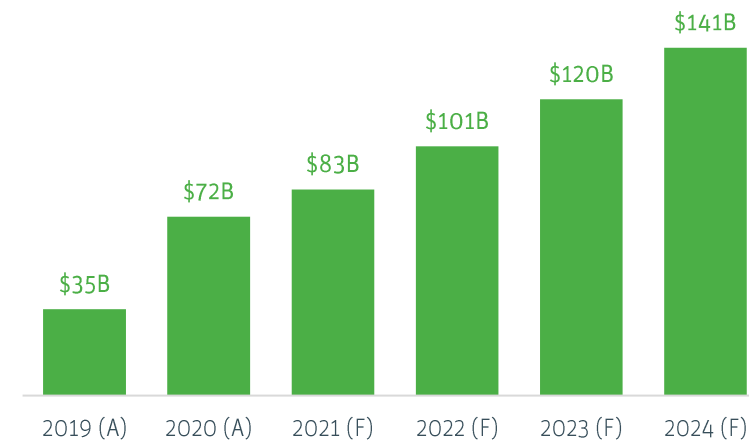
As COVID-19 uncertainty continues, more of our lives will be behind a screen — a worrying trend for brick-and-mortar retail. The emergence of omnichannel is changing things. Omnichannel, a multichannel approach to coordinate a consistent, seamless shopping experience across channels, is not new. Starbucks' loyalty rewards program is a great example of connecting the digital and physical realms.

What is new is the evolution of physical retail spaces as part of the omnichannel experience. The in-store retail experience is a meaningful part of the customer journey. In 2021, new store openings were greater than store closings for the first time in five years. Macy's paused several planned store closings when they realized they had higher e-commerce sales in markets where they have physical stores. Brands selling through their own channels can control the end-to-end experience and gain higher margins, vs. selling through a third-party platform. Amazon's \$13.7B Whole Foods acquisition gave the e-commerce giant instant access to 450 physical locations to complete the missing piece of its omnichannel strategy. With ad costs rising and privacy concerns mounting, a physical retail presence is becoming a more effective and affordable strategy to market to customers.

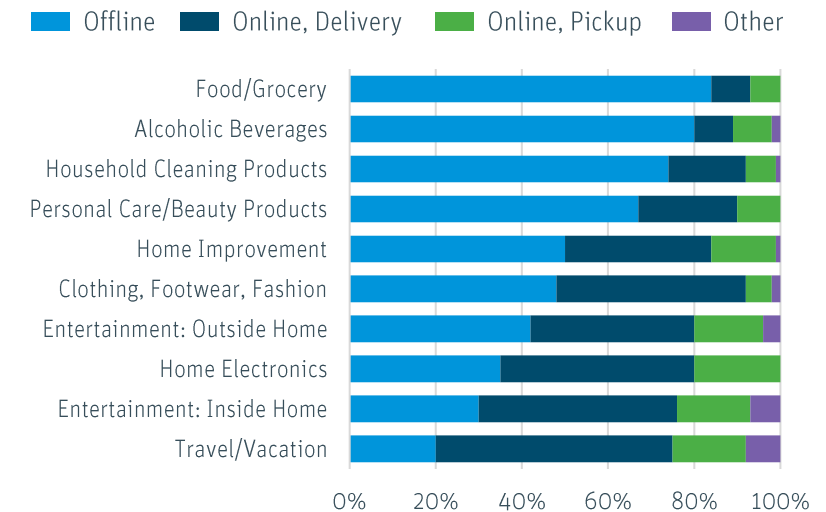
Breakdown of US Retail Sales by Channel¹



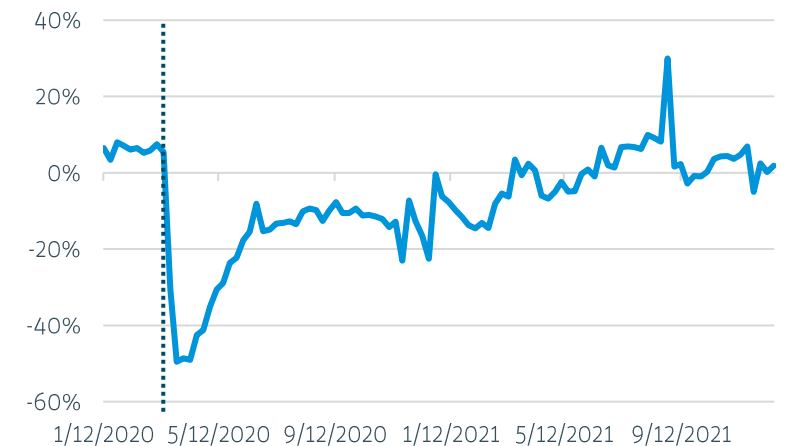
US Click-and-Connect Sales²



Transaction Channel by Last Purchase Type



US Foot Traffic Yo2Y Percentage Change



The Evolution of Omnichannel

1.0: Dawn of E-commerce

It's not an experiment if you know it's going to work.

– Jeff Bezos, Amazon

2.0: Clicks to Bricks

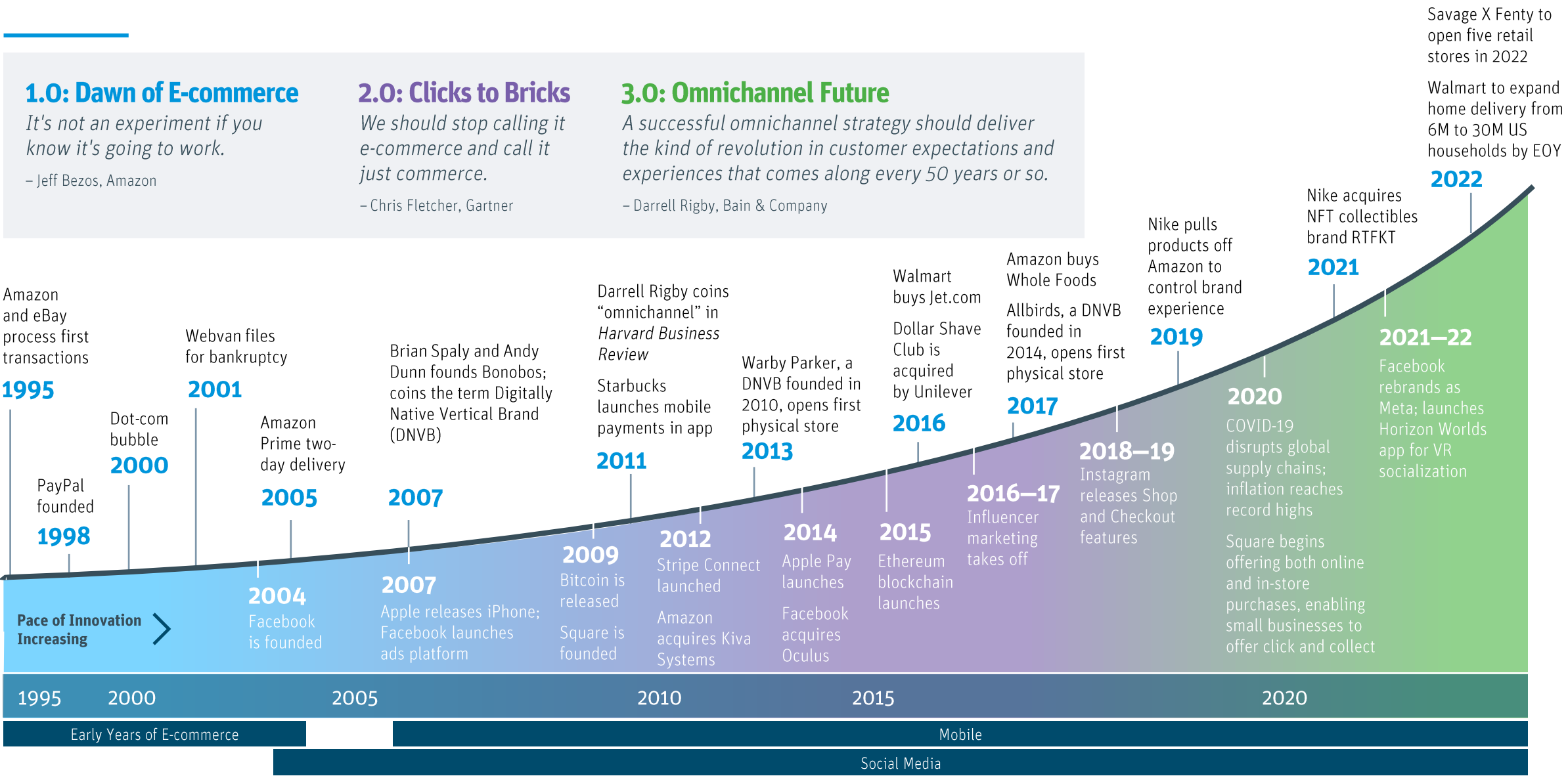
We should stop calling it e-commerce and call it just commerce.

– Chris Fletcher, Gartner

3.0: Omnichannel Future

A successful omnichannel strategy should deliver the kind of revolution in customer expectations and experiences that comes along every 50 years or so.

– Darrell Rigby, Bain & Company

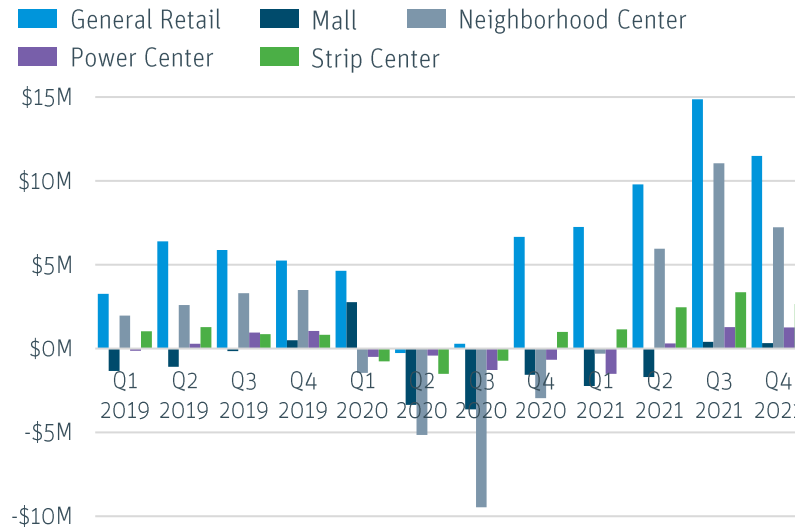


A Brand-New World

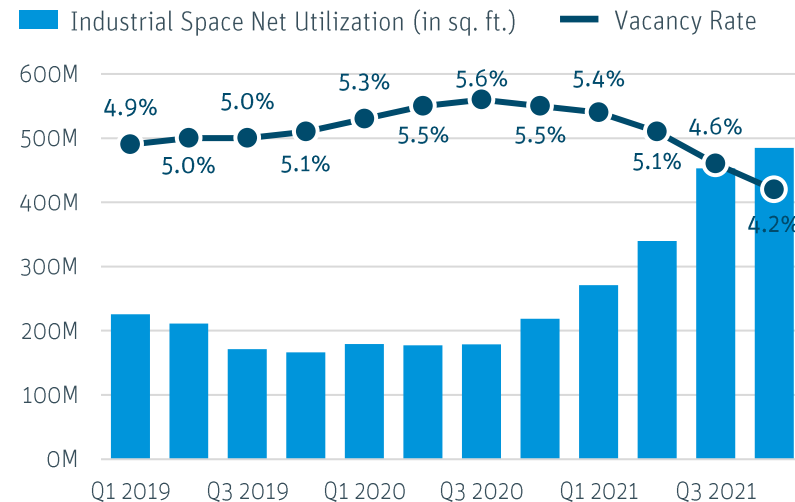
After taking a hit early in the pandemic, the retail sector has recovered – posting substantial increases in occupancy – especially for general retail and neighborhood centers (aka the high street). The rise of omnichannel will have a big impact on the retail real estate industry. With the rise of in-store pickup and curbside delivery, brick-and-mortar locations have to accommodate distribution and fulfillment operations, which means new processes, layouts, inventory management systems and staff. By 2025, Colliers predicts 31% of online commerce will be fulfilled by omnichannel in the US (vs. 22% in 2020). Investors can see this trend emerging, as indicated by the significant jumps in investment for both last-mile delivery and warehouse technology startups. Retailers who move quickly to improve logistics could cut costs by 15%, inventory levels by 35% and service levels by 65%.

Demographics are a key factor for any omnichannel strategy. Based on survey data, 54% of consumers are likely to look at a product in-store and buy it online—giving rise to the term “showrooming”. Brands know this and are finding new and creative ways to draw in customers. For example, Zara hired digital artist Shane Fu to produce a virtual storefront at its Soho location, which was tied to a TikTok campaign. Although the storefront only existed in the digital world, the store saw a noticeable rise in foot traffic. Physical stores are critical touchpoints to convert customers when deploying an omnichannel approach. The shopping experience becomes an extension of the lifestyle brands are trying to portray. Technologies – including beacons, mobile apps, self-service kiosks and virtual mirrors – are used to build consumer profiles from data to enhance their brand affiliation and shopping experience.

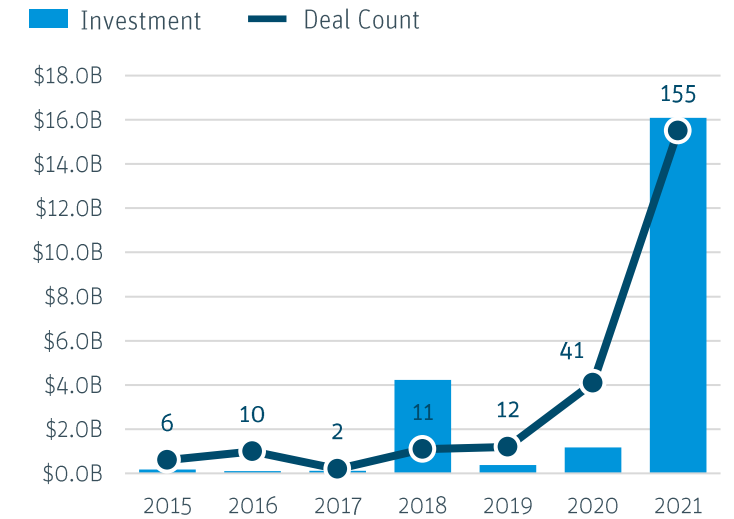
Retail Utilization Trends (in Sq. Ft.) by Type¹



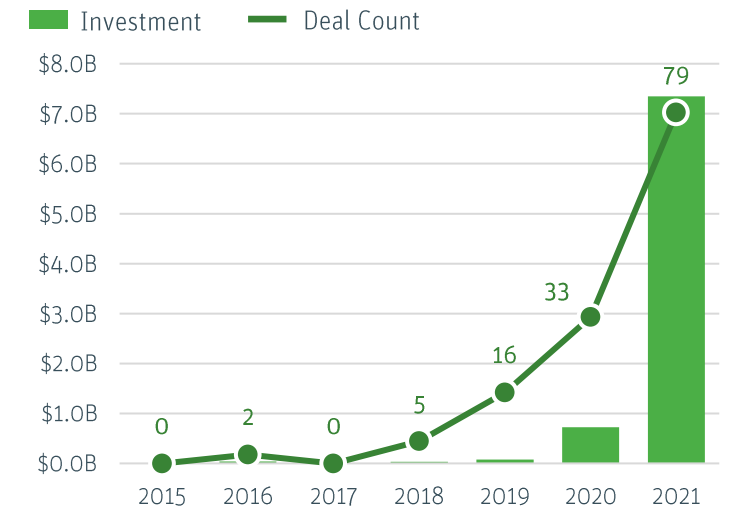
Industrial Utilization Trend and Vacancy Rate



Last-Mile Delivery Global Venture Activity



Warehouse Tech Global Venture Activity



Notes: 1) Definitions by Colliers: General Retail refers to the sale of goods individually or in small quantities direct to consumers. Mall refers to a designed center which includes retail stores, experiences and restaurants. Neighborhood Center refers to a location with one anchor tenant plus convenience retailers and local businesses. Power Center refers to a large outdoor shopping mall with multiple big box stores. Strip Center refers to any shopping area, generally with common parking, comprised of a row of stores. Source: Forrester, McKinsey, Colliers, PitchBook and SVB Analysis.

Fundamentals

Considerations for Commerce Companies

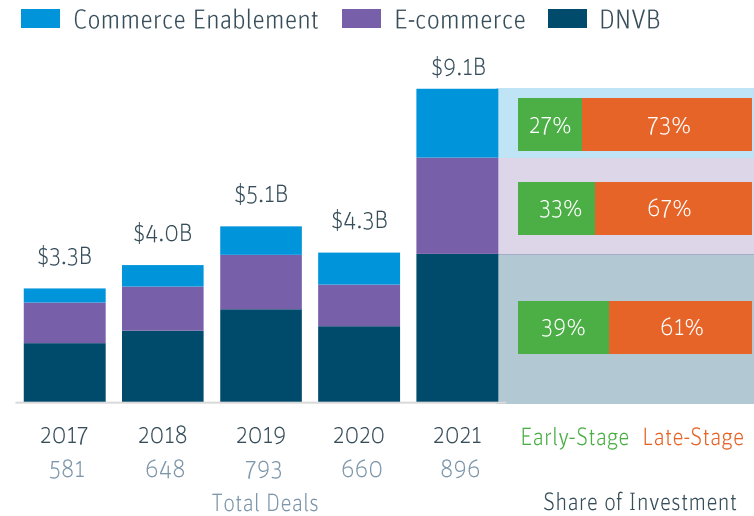
Venture Goes on a Shopping Spree

Unlike many tech subsectors, commerce saw a slowdown in venture capital (VC) investment in 2020 as the pandemic hit. With shutdowns and job losses causing uncertainty, followed by a stimulus-boosted switch in consumer spending and subsequent supply chain issues, the retail environment was thrown for a loop. Online shopping spiked 36%, a previously unheard-of increase. This put pressure on an already at-capacity logistics infrastructure — with container shortages, warehouses at capacity and a lack of workers.

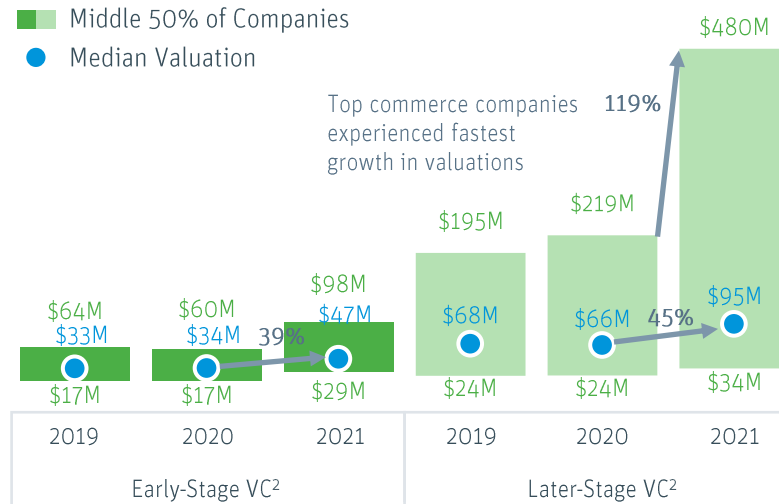
Investors took note and jumped into investing in new ideas and solutions. In 2021, investment in just e-commerce startups alone was higher than most of the prior years for the entirety of commerce. Not surprisingly, the influx of capital — particularly at the late-stage — has seen valuations spike in 2021. The median post-money valuation increased 45% between 2020 and 2021, while the 75th percentile company experienced a valuation increase of nearly 120%, as competition for the best deals intensified.

This competition appeared most intense for e-commerce and commerce enablement companies. While the median gross profit multiple for DNVB companies increased 48%, the e-commerce and commerce-enablement multiples increased 179% and 252%, respectively. Investor interest has piqued for a number of reasons. With challenges presented by the pandemic, entrepreneurs are coming up with increasingly innovative solutions. These expand beyond the traditional commerce space as Web3 and the metaverse emerge as exciting new opportunity landscapes. Recent privacy changes have forced direct-to-consumer companies to rethink customer acquisition along with the expectation of a seamless, personalized buying experience synonymous with an omnichannel strategy.

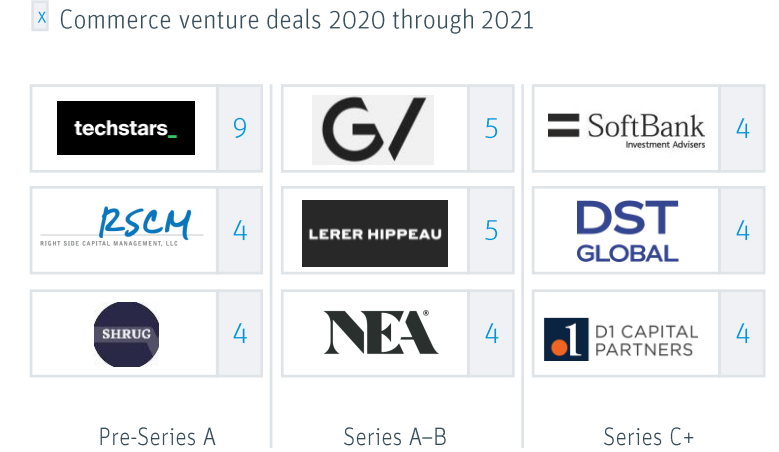
US Commerce VC Investment by Subsector



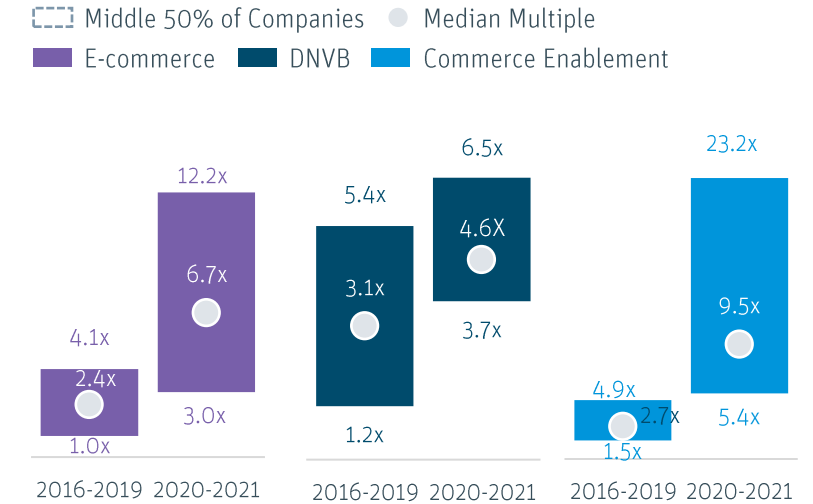
US Commerce Valuations by Company Stage¹



Top VC Investors in US Commerce Companies



Gross Profit Multiple for Late-Stage Cohort^{2, 3}



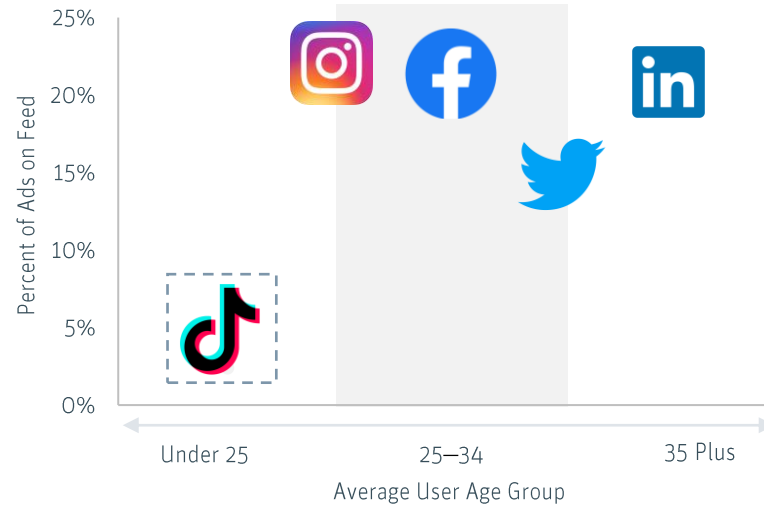
Notes: 1) Based on post-money valuation. 2) Early-stage is defined by PitchBook as Series A to Series B financing deal and occurred within five years of the company's founding date. Late-stage is defined by PitchBook as Series B to Series Z+ rounds and/or occurred more than five years after the company's founding date. 3) Post-money valuation divided by gross profit. Source: PitchBook, SVB Proprietary Taxonomy, SVB Analysis.

Ads Rack Up Screen Time

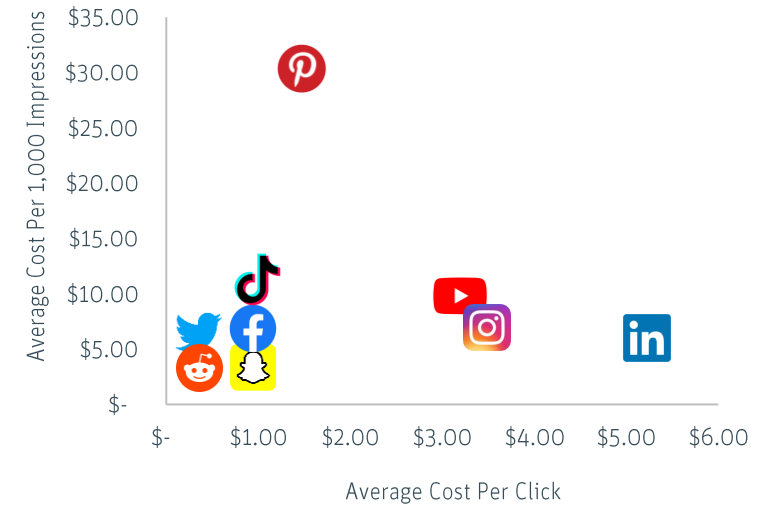
People are spending increasingly more of their days (and nights!) scrolling social media, to the tune of 2 hours and 41 minutes in 2021, up from 1 hour in 2012. It should be no surprise that brands are turning to social media as a primary marketing channel. These channels are pretty suited to their own unique user demographics, giving the ability to target specific groups. While variable, the cost to advertise on social networks more suited to brands — such as Pinterest and Instagram — is on the rise. Looking at cost-per-click (CPC) and cost-per-impression (CPM), emerging (TikTok, Snap) and nontraditional (Reddit) offer an affordable alternative as well as access to the next generation of customers. Another consideration is the role of search giants like Google. Just like Facebook (Meta) dominates for social, Google (Alphabet) for dominates search ad spend. However, when it comes to products Amazon is actually the leader, worldwide, accounting for 38% of product searches, compared to 40% for all search engines. This is poignant, as retailers make decisions on where to spend their ad dollars.

“We need to start thinking about a world with no ads.” Said by Marc Pritchard in 2019, P&G’s chief brand officer, was a vision for today. Consumers don’t like advertising and newer platforms, where consumers live, have reduced exposure and/or real estate available to ads. Recent changes to Apple’s operating system (iOS) and Google’s proposed ban on third-party cookies have forced companies to reevaluate their marketing strategies. Commerce companies should take note, especially brands (who rely on ads to create prestige and demeanor). One solution is organic content. Working with influencers, brands can access audiences with specific interests and garner a higher rate of engagement. Another is reclaiming their user data and embedding the feedback loop directly into the products themselves — an approach P&G have demonstrated.

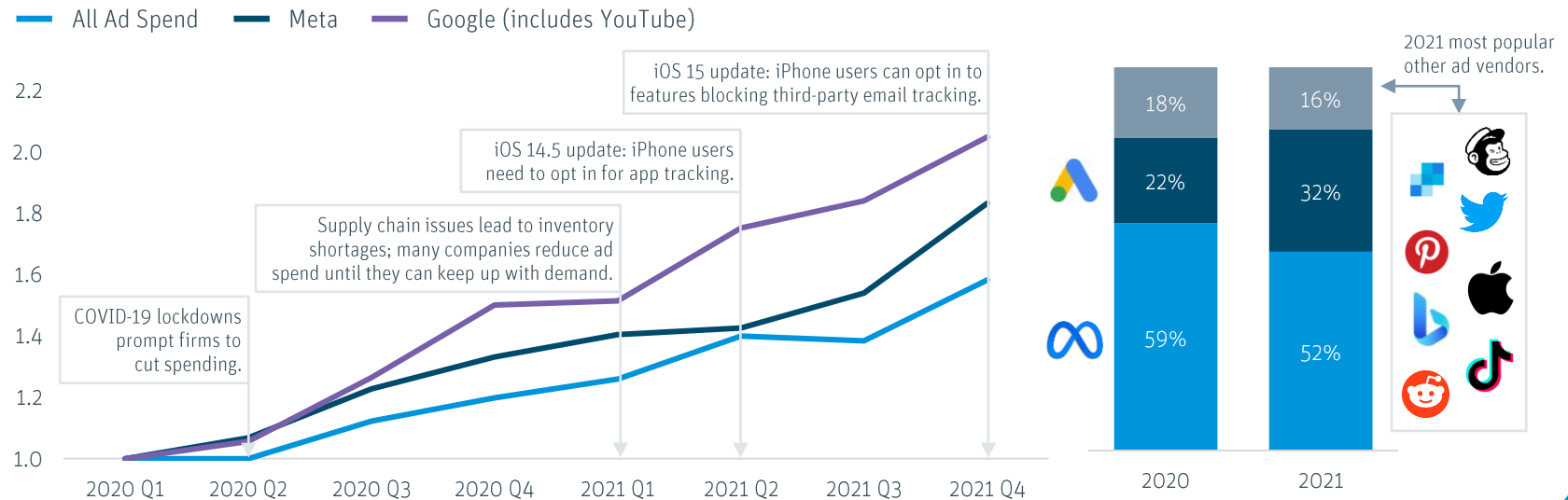
Social Media Segment Marketing¹



Average Social Media Ad Costs 2021²



Median Advertising Spend Index²



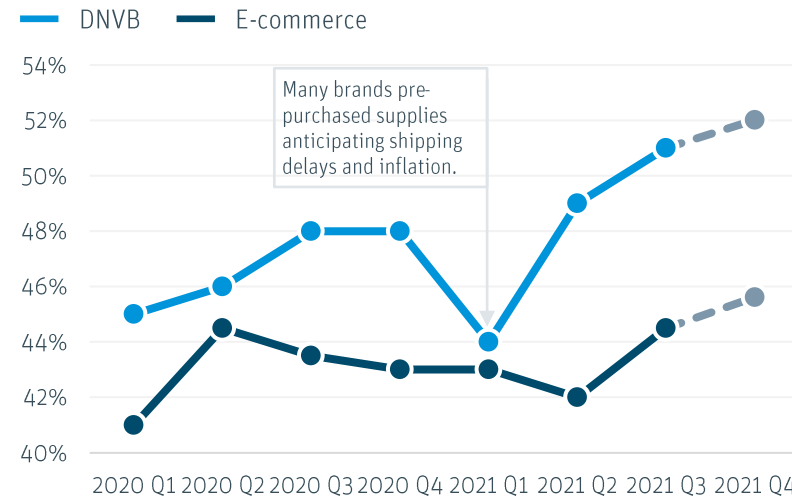
Bolstering the Bottom Line

To provide a closer comparison between DNVB and e-commerce companies, we look at gross margins. It's clear that DNVB, which typically have physical retail locations, have struggled to stabilize their margins with the various waves of COVID-19, whereas e-commerce margins have remained fairly flat. The good news is both are trending up. Changes in the ad spend-to-sales ratio can be a proxy for customer acquisition cost. It is interesting to see a divergence in ad spend between DNVB and e-commerce companies, as one group benefits from a spike in demand while the other contends with reduced foot traffic.

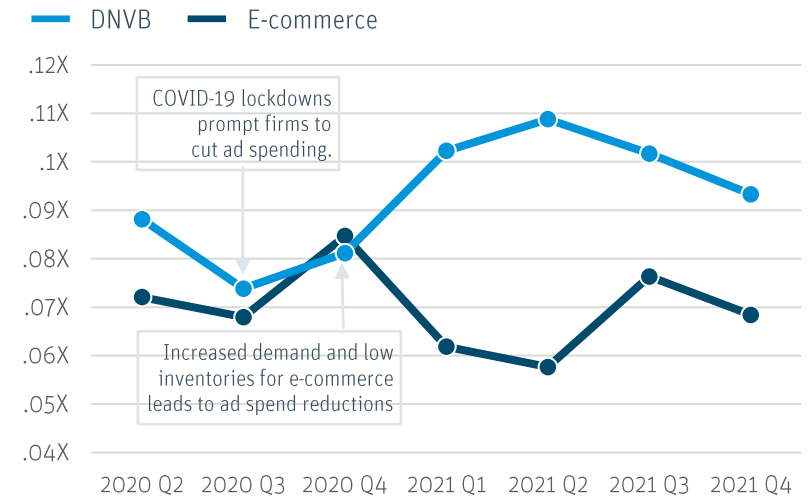
Partnerships have been a key way for many retailers to keep up with the rate of change. From accessing various social audiences, getting merchandise to customers or reorienting the in-store experience, partnerships can be quick to implement and avoid upfront investment. Fintech technologies like contactless payments, buy now pay later, and payment facilitation have improved the customer experience. For example, Olla partnered with Aeripay to leverage their frictionless payment API for their retail partners, mobile delivery app, and brick and mortar dispensaries. Walmart teamed up with Mashable to push the frontiers of digital experience by creating a virtual 3D home, featuring shoppable content from Walmart.

Not by definition a "partnership", but the emergence of Shopify as a solution for small businesses to easily get up and running should be acknowledged. Shopify provides an affordable way for businesses to connect social media channels and online market places with marketing campaigns and payment solutions. The number of stores using the Shopify Plus product has grown from 4,373 in Q1 2017 to 23,468 in Q4 2021.

Cohort: Median Gross Margins¹



Cohort: Median Ad Spend-to-Sales Ratio^{1, 2}

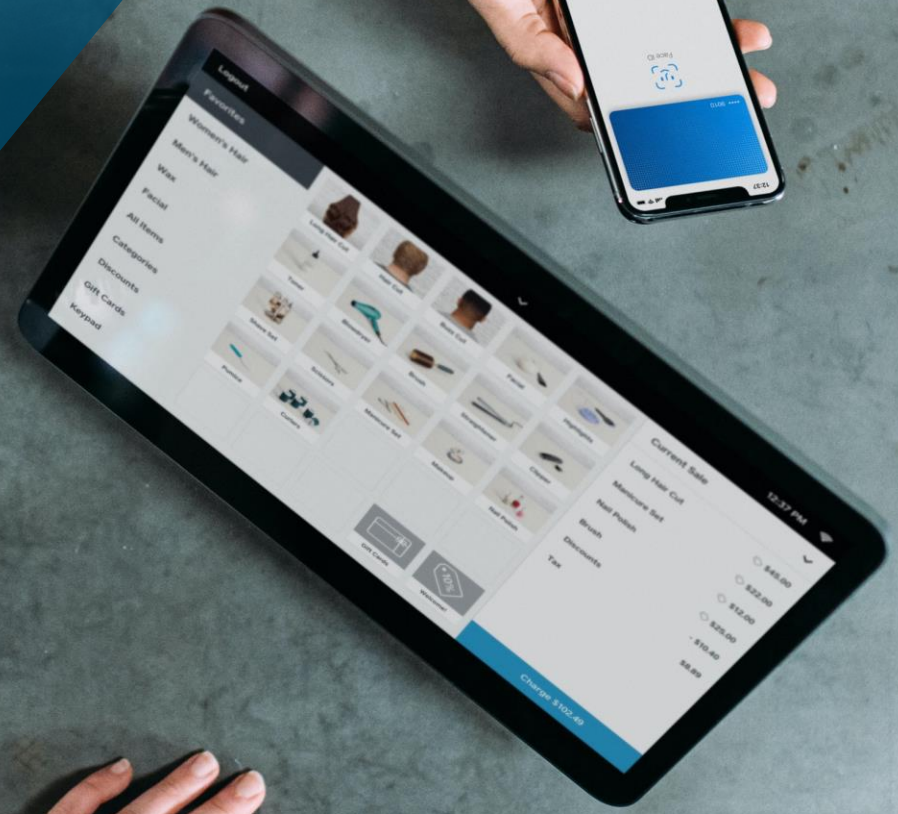


Omnichannel Partnership Landscape and Select Partnerships

Online Experience	Direct-to-Consumer Channels	Last-Mile Logistics	Physical Store Experiences
aeripay + olla	BigCommerce + TikTok	Walmart GoLocal + Home Depot	JCPenney + thirteen lune
Mashable + Walmart	Target + Pinterest	DoorDash + Albertsons	IKEA + Uppercase
Verishop + Snapchat	lululemon + Trove	Delivery Solutions + Sephora	Nordstrom + Fanatics

Exit Environment

M&A and IPOs



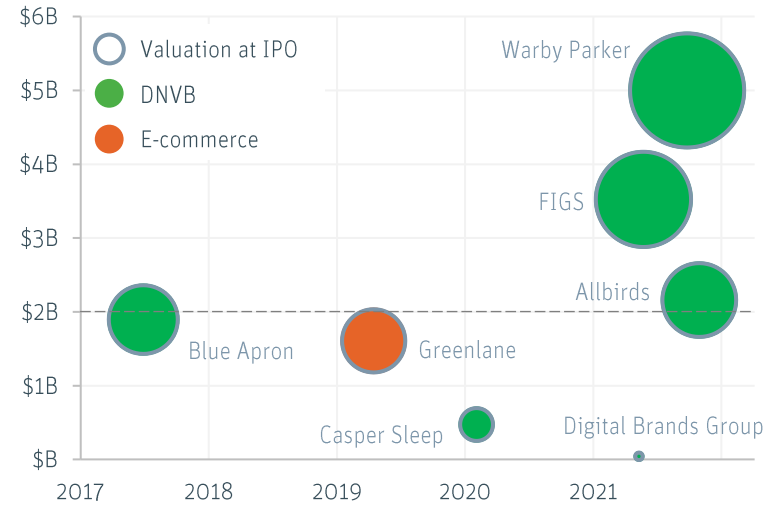
Brand-New Exits

The banner year for US tech IPOs did not leave the commerce sector behind, with four VC-backed commerce companies going public (on major US exchanges) in 2021 valued at over \$11B in total. Even with the rapid rise of online shopping during the pandemic, only DNVB went public, with the last e-commerce IPO in April 2019. This is notable, as the likes of Warby Parker, Allbirds and FIGS are omnichannel leaders.

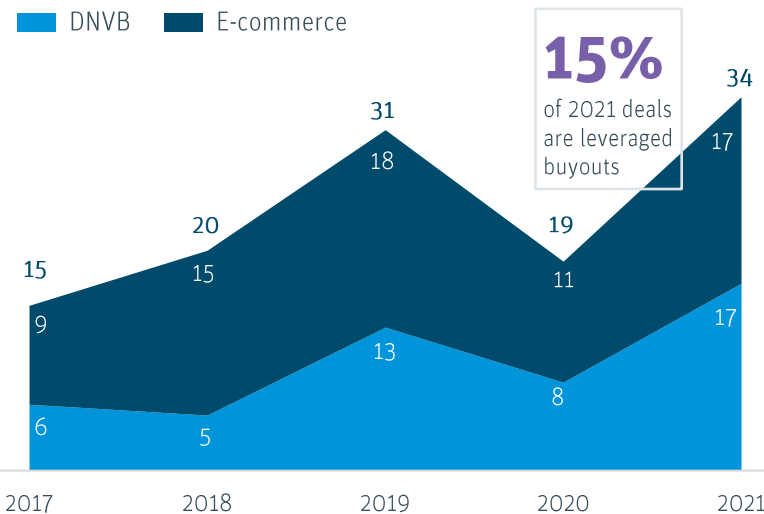
However, the backlog – based on the number of commerce unicorns – of IPO candidates is healthy for both DNVB and e-commerce companies. Eight commerce companies achieved unicorn status in 2021. For M&A activity, DNVB and e-commerce deals were evenly split in 2021, recovering from (an expected) lull in 2021 – similar to the broader M&A market. Looking at major retail brands, a pattern of omnichannel-themed acquisitions emerges. These themes include building a brick-and-mortar presence, technology to precede or tie in the physical store experience, and accessing new communities by being where they reside.

The most interesting example of this is Nike's acquisition of RTFKT (pronounced "artifact"). On the face of it, the company could be bucketed under the "non-fungible token (NFT) mania." However, as the online world meshes more with our everyday lives, having a stake in the digital world could be supremely important to the continuance of the brand. According to the U.S. Patent and Trademark Office, the brand has filed multiple applications, including ones for the slogan "Just Do It" as well as the Swoosh and Jumpman logos.

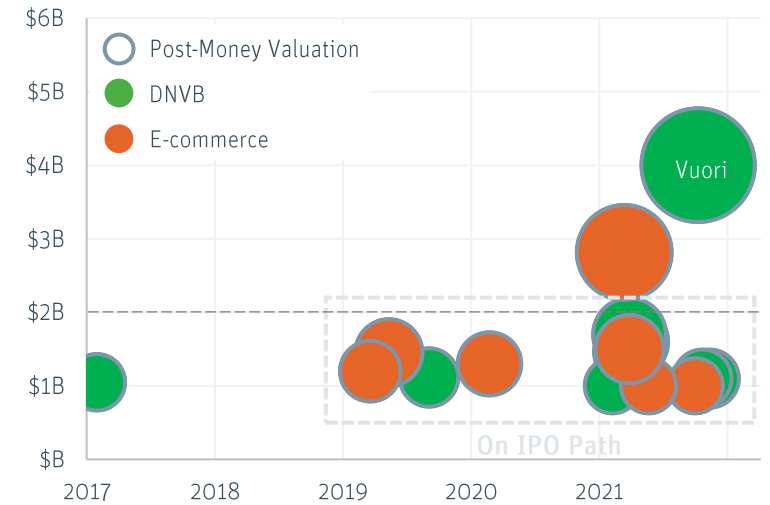
US VC-Backed Commerce IPOs by Type¹



US VC-Backed Commerce M&A by Type³



US Commerce Unicorns by Type²



Notable Omnichannel Acquisitions

Buyer	Target	Rationale
		Access a seamless and convenient shopping experience for pharmaceuticals
		Expand into grocery, access to physical stores and a customer base to sell Amazon Prime and loyalty programs
		Acquire 3D technology for customers to virtually try on clothes
		Access a fitness community and a channel to sell apparel
		Provide Nike access to an emerging market for virtual apparel
		Acquire proprietary technology to batch and route orders

SVB Perspective

Predictions for 2022



Predictions for the Future of Retail



All-Out Omnichannel

To compete with increasing digitization, retailers need to be everywhere the customer is. Omnichannel will become the prevalent strategy for brands.



Personalization

We expect more partnerships, investment and M&A by commerce companies to tie online and offline experiences to meet customers personalization expectations.



Data Gathering

In a cookie-less world, commerce companies need to develop new ways to gather data and apply offline to enhance sales conversions, product development and customer relationships.



Digitization

With the real and digital worlds blending, brands will launch physical stores, with physical environments transitioned to showrooms directly connected to online platforms.



Channel Optimization

Optimizing media spend will be a big focus in 2022, with companies reducing their dependency on Google and Facebook, with influencer networks and physical stores an affordable alternative.



The metaverse

Not to miss the next big thing, commerce companies will explore emerging Web3 and metaverse trends through partnerships and acquisitions.



Payments

Enabled by fintech innovations, consumers and merchants will have access to an expanded array of payment options. From buy now pay later to one-click or facial ID checkout.



Customer Communication

To fully realize an omnichannel strategy, all forms of customer communication must be covered. Expect more SMS, in-product and bot outreach.



Logistics

Burned by supply chain chaos, more commerce companies will vertically integrate into last-mile delivery and “near-housing” solutions.

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