EVALUATING A COMPANY'S ECOMMERCE CAPABILITIES DURING M&A

Global M&A activity is picking up thus far in 2024, and several factors are prompting this increased activity. We're seeing stabilizing interest rates, efforts to fortify supply chain resilience, industry consolidations, and rising demand for digitization and technological innovation being among the key drivers of the increased activity as compared to 2023.

Enter eCommerce – consumers are increasingly prioritizing convenience and an easy shopping experience, and the eCommerce market is growing significantly as a result. As companies continue to invest in brands that are delivering on consumer trends that they believe will sustain over the long term, it's no surprise that they're increasingly evaluating eCommerce businesses and businesses with well-functioning eCommerce capabilities as potential additions to their portfolio.

Areas of focus for eCommerce are not strikingly different from diligence that would be conducted for a brick-and-mortar store; however, diligence is conducted through a different lens and distinguished metrics for an eCommerce target. From our experience, the buyer should keep the below eight considerations top of mind throughout the M&A lifecycle while also keeping in mind the impact on both the evaluation and the investment decision overall.

THROUGH THE CUSTOMER'S EYES

1 PRODUCT

Part of diligence is reading product reviews and understanding the value proposition of each product of interest in order to gain critical insight from the eyes of the consumer. A key factor to watch out for when assessing an eCommerce platform is review manipulation – inflated reviews or the deletion of negative reviews should be a red flag for the buyer. In addition to reviews, *how does the product rank against its competitors*? You may consider comparing metrics such as quality and price. A strong brand can command higher prices, foster customer loyalty, and act as a barrier against competitors.

2 UNIT ECONOMICS

Buyers should dig deeper into eCommerce brands' marketing campaigns to analyze unit economics: how much profit a company makes from each consumer over its "lifetime" (*Lifetime Value, LTV*) compared to how much it costs to acquire the consumer (*Customer Acquisition Cost, CAC*). Unit economics will reveal more about the type of consumers the brand attracts as well as the staying power of the product in the market. We know that eCommerce brands often lend themselves to subscription services, which can be a good sign when it comes to LTV.

Let's say the CAC for a company is $10: a $1,000 marketing campaign yields 100 new consumers. This can be considered a one-time investment for the company; however, the profitable results will vary based on consumer churn rate and LTV. Ideally, eCommerce would have growing repeat orders over the long term. Decreasing order frequencies/value coupled with increasing consumer turnover is a signal that the company is attracting fewer valuable consumers. A best practice is to analyze LTV and CAC for the past 24 months on a monthly or quarterly basis for cohorts of consumers, i.e., groups of new consumers acquired in a specific month or quarter.

THE “DAY-TO-DAY”

3 CUSTOMER SUPPORT

The customer support structure and burden for eCommerce can vary depending on the company size, service area, or product offering; however, having a firm understanding of the nature and volume of consumer queries will give additional insight into how the brand is experienced and viewed by the customer.

We know that for eCommerce, the consumer experience is about speed and convenience. We recommend reviewing the target’s response time to customers and determining if there are multiple avenues that customers can use to get assistance (*e.g., phone call, chat forum, FAQ page, etc.*). Also, consider the nature of questions asked by consumers. *Are they quick to answer and effort could be reduced by using AI, or are they more complicated questions that require an employee to be with one customer for an extended period?* Ideally, ~80% of customer inquiries are easy to answer, which cuts down on time and leads to a more scalable operation.

4 INVENTORY AND SUPPLIER MANAGEMENT

Consider the distribution model of eCommerce– *are they dropshipping, or do they have an outsourced fulfillment or wholesale model?* This will impact the kind of vendor relationships expected as part of the supply chain. Not all businesses have physical products, but if they do, then a buyer will want to analyze components like supplier diversity, logistics lead times, SKU breakdown, inventory level, etc.

Companies selling a physical product should have a reliable supply chain that can fluctuate and meet market demand. This includes having trustworthy vendor relationships and a diverse network to be able to procure materials if there is a delay or out-of-stock scenario. Also, inventory level should be evaluated; if they have insufficient inventory, they’re at risk of being out of stock, but if they have too much inventory, then they’re taking up space and freezing cash. Finally, consider how the business’s operations are standardized and how they might meld into the buying company’s ecosystem.

HOW THE MONEY MOVES

5 REVENUE

When it comes to revenue, it's important to recognize how past events can help predict future top-line growth drivers. Buyers should understand the potential seasonality of the target company – *how do sales ebb and flow?* We know the majority of eCommerce revenue often comes from several key events throughout the year. *What is the impact of one-off events like large sales or out-of-stocks?* It's also key for investors to dive into revenue concentration and understand the composition of those sales – looking at things like the breakdown of revenue by customer, product, supplier, etc. *Is a large portion of the target company's revenue coming from a single geographical area or a single specific product?* High concentration of revenue can often create risk for eCommerce businesses especially and is something to be on the lookout for.

6 COST

On the cost side, businesses typically want to have a solid understanding of the target company's recurring business expenses, such as Cost of Goods Sold (COGs), eCommerce platform subscription fees and support, ad and digital marketing spend, etc. *Is your target company currently using an eCommerce marketplace (e.g., Amazon) or are they a direct-to-consumer (DTC) business?* The target company's type of business model will heavily impact its profit and loss (P&L), which is something to keep in mind. Organizations that work through marketplaces will typically have a lower percentage of COGs but also have the addition of marketplace fees, which often can make up 30-40% of revenue. DTC sellers will have a higher percentage of COGs, and marketplace sellers will often use the costs put into fees for things like marketing and fulfillment.

DIVING INTO TECHNOLOGY STACK AND REACH

7 IT INFRASTRUCTURE

It's critical to investigate the target's software stack and IT Infrastructure as a whole. *What do their security protocols look like? Are they regularly providing performance enhancements?* When it comes to specifically their eCommerce tech stack if they're not utilizing a marketplace, *have they invested in* *a [traditional or headless platform]?* It's common to underestimate both the financial and time burden that incompatible technologies can have when evaluating a potential target.

8 TRAFFIC PATTERNS + SEARCH

When we think about when the traffic profile of the target comes into play, it's important to ensure the eCommerce platform that they've invested in can scale based on the amount of traffic they currently have. A tool like Google Analytics can help you analyze and observe trends on a regular cadence as well as notice overall ups and downs.

Further, when it comes to search, for many eCommerce businesses, organic search makes up the bulk of their traffic. A couple of questions for buyers to keep in mind – *does the target have a high number of ranking keywords? Is there consistency in their keywords?*

WRAPPING UP

Our eCommerce retail consultants and M&A consulting team continue to have a pulse on the latest trends, insights, and capabilities required by due diligence teams and executives alike when progressing through the deal process. To better understand how these factors impact your business, reach out to us.

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