

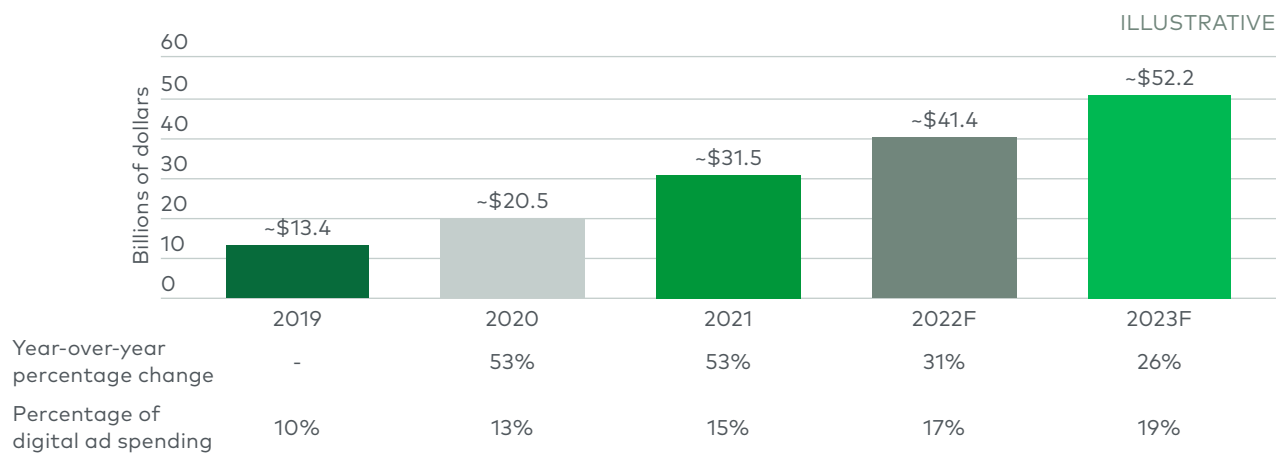
EXECUTIVE INSIGHTS

The Retail Advertising Boom: Time for Retailers and Advertisers To Take Action

Retail advertising is projected to surpass \$40 billion in 2022, representing some 17% of overall digital ad spend in the U.S. (see Figure 1). If you're a retailer or ecommerce platform, you're likely trying to determine how you can and should participate in the retail advertising boom. And if you're an advertiser, you may still be figuring out how to execute and optimize digital retail media as part of your marketing mix.

Building a winning advertising business is far from straightforward. To be successful, retailers probably need to make changes to the online and in-store shopping experience. They likely need to make long-term investments in technology and data infrastructure. And they will

Figure 1
US digital retail media ad spending, 2019-2023F



Source: eMarketer; L.E.K. research and analysis

inevitably need to closely coordinate their customer experience, advertising and merchandising functions. In this *Executive Insights*, we will outline the retail advertising opportunity and suggest the key elements of an action plan for retailers to capture it.

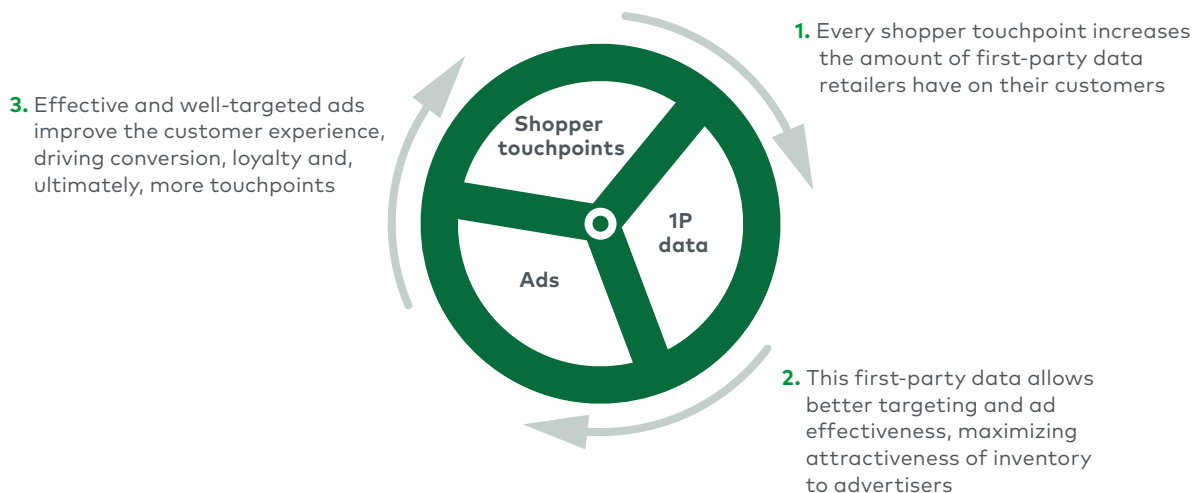
The promise of digital retail media

For retailers, digital advertising solutions represent an incremental, high-margin revenue stream. For shoppers, advertising can provide an improved experience, with ads that are relevant to their needs and content that enhances the overall customer journey. For advertisers, it offers unique opportunities to target and engage shoppers when they're in the shopping mindset.

Furthermore, by leveraging their first-party (1P) customer data, the level of targeting, attribution and ultimate return on ad spend (ROAS) that retailers can achieve is unmatched compared with virtually any other medium. As an example, an L.E.K. Consulting client typically delivers marketers a measurable ROAS of 10X or more on its ecommerce sites. What enables this exceptional performance? Our client is able to dynamically serve users a product suggestion (paid for by the advertiser) that is tailored to their demonstrated interests and behavior — directly within the shopping process — whether as a suggested search result, a native ad or a standard display ad unit. Retailers can leverage frequent shopper touchpoints and 1P data to enhance the shopping experience and build an advertising business as part of a reinforcing cycle (see Figure 2).

Figure 2
First-party data used by advertisers to increase ROAS

The massive volume of customer touchpoints that retailers have results in better first-party data that is valuable to advertisers aiming to improve ROAS



Note: ROAS=return on advertising spend; 1P=first-party
Source: L.E.K. research and analysis

Benefits to shoppers

Search and display ads on ecommerce sites can inform, inspire and win shoppers in a way that enhances the shopper journey. For example, a well-targeted and relevant search-results ad improves the shopping experience by enabling the retailer to present a more targeted selection of products to the consumer, which both drives incremental sales and establishes an advertising revenue stream.

To the shopper, digital retail media in many cases doesn't (and shouldn't) feel like advertising at all. A successful digital retail media offering begins with effective engagement and personalization while integrating "organic" and promoted (paid advertising) messages, suggestions and information into the experience in a nonintrusive way. As digital retail media networks mature, advertising integration will extend beyond search and display ads into more engaging ad formats, including "content-to-commerce" (publishing helpful or valuable content as a conversion-driving strategy) and video livestreaming on both retailer sites and social platforms.

The value to advertisers (suppliers)

The majority of retail advertising spend comes directly from suppliers, be they leading national brands or one of the thousands of smaller suppliers seeking to be discovered. Digital retail media networks enable advertisers to benefit from extensive 1P data that leading retailers have amassed through years of loyalty programs, credit card use and online transactions. The precision that this data can provide in delivering highly targeted ads nearest to the point of transaction has advertisers clamoring. The value of this 1P data is further increasing with the sunset of third-party (3P) cookies on browsers, which is driving advertisers to seek new solutions for acquiring, retaining and engaging customers.

Also important to advertisers is retailers' unique ability to "close the loop," mapping both online and in-store transactions directly to digital retail media investments in ways that even leading digital platforms such as Google and Facebook cannot. Leading brands have a strong desire for retailers' 1P data, shopper relationships and unique inventory to drive marketing ROI (see Table 1).

Accelerating retailer advertising efforts

In February 2022, Amazon announced that it had generated \$31 billion in 2021 advertising revenue, an increase of 48% over 2020. Recognizing Amazon's success, other leading retailers and ecommerce sites are moving faster than ever to compete for their share of the digital retail advertising pie. Walmart, Target and Kroger in particular have been amassing powerful 1P data and are rapidly scaling up their respective advertising capabilities and technology.

Table 1

Motivations for US CPG brands to work with retail media networks (2020 and 2021)

	Percentage of respondents in each group	
	2020	2021
Gain access to a retailer's 1P data	33%	62%
Build stronger partnership with the retailer	49%	51%
Better understand the shopper at the retailer	19%	51%
Leverage owned and operated retailer inventory	29%	49%
Open cobranding opportunities	38%	37%
Deliver more personalized communications	43%	34%
Access reporting tied to sales (closed loop)	48%	28%
Oblige merchants as part of negotiations	48%	14%

Note: 2020 N=100; 2021 N=100; CPG=consumer packaged goods; 1P=first-party
Source: Merkle, "The Evolution of Retail Media Networks," conducted by Ugam, Oct. 11, 2021, eMarketer

So, while Amazon has been a leader in harnessing data and personalizing every aspect of its business, the gap is starting to narrow as leading retailers invest in the technology, machine learning and advanced analytics needed to exploit their customer data.

Meanwhile, growth in ecommerce shopping (and revenues) among traditional retailers is providing increased scale and "digital supply," allowing them to benefit from advertising technology investments. There is a rapid proliferation of retailers ramping up their digital advertising businesses (see Figure 3).

Challenges and opportunities for retailers

With the promise of dramatic revenue growth and attractive margins come a number of challenges — and opportunities — for traditional retailers as they seek to develop their advertising solutions:

Online scale constraints. Digital retail media networks are ultimately constrained by the scale of a retailer's ecommerce businesses. Working with third-party publishers and other partners to link data and leverage off-site inventory can partially overcome this issue, but many retailers are still limited by the fact that most sales occur in-store.

Underpowered technology and capabilities. Most retail advertising is programmatic and requires deep data, targeting, optimization and attribution capabilities. To build and refine in-house capabilities requires substantial investment, scale and time. While in-house development may be the best path for a major retailer, accessing solutions from vendors and partners may be more realistic and economically attractive for many midsize or smaller retailers.

Figure 3
History of US digital retail media offerings



Note: 1P=first-party; 3P=third-party; SSP=supply-side platform
Source: L.E.K. research and analysis

Lack of 1-to-1 shopper engagement. Despite efforts of leading players like Kroger and Best Buy to drive engagement and establish loyalty programs, many retailers still lack repeat engagement, identity and behavioral/transaction data from the majority of their shoppers.

Inability to "close the loop." The ability to directly link digital advertising (and in-store) media exposure with sales transactions provides a critical benefit to advertisers. Offering this capability is relatively straightforward when it comes to ecommerce sales but remains a challenge for in-store purchases. While retailers have a range of solutions for linking ad exposure with purchases (e.g., credit card data), a large percentage of in-store transactions typically cannot be linked. A critical aspect of closing the loop is being able to engage shoppers in-store and providing incentives/programs (e.g., loyalty rewards) for sharing identity information.

Opportunities to "activate" physical stores for advertising. Most retailers have in-store signage and advertising inventory. But for the most part, in-store advertising remains nonprogrammable and disconnected from online and ecommerce advertising businesses. In many cases, merchants still control in-store advertising inventory and manage it separately as part of the merchandising buying process. Advertisers, on the other hand, are increasingly seeking an integrated omnichannel offering and the ability to more precisely target and optimize placements across ad types.

An action plan for retailers

Based on the success of Amazon and other retail leaders, marketers and suppliers increasingly expect effective advertising solutions from their retail partners — and the shopper engagement and targeting/attribution capabilities that come with those solutions. So as

marketers boost advertising spending in retail channels, share and profits may shift to the retailers that can deploy those ad dollars most effectively and deepen supplier relationships while also enhancing the shopping experience.

To win in this environment, retailers must take the following six steps:

1. Integrate advertising seamlessly into the shopping experience. Advertising needs to enhance the experience, not compromise it. Retailers need to determine the types of messages and suggestions that can inform shoppers, enhance their experience and drive incremental transactions (e.g., search results suggestions, product videos, shopping lists), and then personalize the experience with optimized ad placements based on shopper history/behaviors, minimizing clutter and boosting response.

Retailers also need to ensure that the advertising is boosting engagement — if it's not driving click-through rates and increasing incremental sales, it's not working.

2. Deepen customer touchpoints and harness data assets. Retailers need to track customer preferences, shopping history and click behavior to further personalize the ecommerce experience and build tools to directly link media exposure to sales transactions, both online and in-store. To enable this, identity and customer information needs to be for all channels, including pursuing a "logged-in" ecommerce and store experience (e.g., apps, loyalty programs, special offers, in-aisle promotions).

Also, integrate all cross-division shopper data (break down any silos) and seek opportunities to link to/onboard additional partner data to better understand shoppers.

3. Leverage third-party technology platforms to get up and running fast. Launch and learn; don't try to do it all in-house. Build an internal team to drive ad solution strategy, manage direct sales/operations and guide technology strategy. Leverage third-party retail ad platforms/data enablers to accelerate progress and reduce initial investment needs and reevaluate the mix of insourced versus outsourced activities over time.

4. Pursue ad inventory expansion. Seek off-platform partner collaboration and/or the acquisition of complementary media properties. Leverage customer and transaction data to establish a broader, integrated media network. Also, enable advertisers to extend and deepen customer reach via additional touchpoints, powered by 1P retailer data.

- 5. Digitize and modernize the in-store advertising experience.** Leverage learnings from the out-of-home advertising industry, where the shift to digital billboards has yielded 6-8X greater ad revenue per board. Shift in-store signage and media placements from static to digital and make placements dynamic, with the ability to be changed based on numerous triggers, including time of day, weather, special events, etc. Enable sharing of (and bidding for) locations across multiple advertisers, effectively increasing "occupancy" and yield. Finally, accelerate the development of tech-enabled ads/placements such as in-aisle, on-shelf messaging, promotions, etc.
- 6. Integrate all ecommerce and in-store advertising placements under a coordinated business team.** Remove any legacy advertising separation between ecommerce and merchant teams. Build an omnichannel advertising offering, leveraging common customer and transaction data, and pursue cross-platform bundling. Also, enable programmatic buys (alongside direct buys) for in-store inventory in addition to direct sales, enabling more demand sources and optimization in order to drive yield.

The retail advertising boom presents an enormous opportunity for retailers, advertisers and, by extension, shoppers themselves. But getting the most out of this opportunity is no small task. It requires that retailers invest in every level of the advertising experience, from the technology infrastructure that underpins it to the environment in which shoppers are exposed to it.

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