Rise in e-commerce increases need to consider ESG impacts

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Over the past decade, digitization has revolutionized the consumer goods industry. While technology has touched many parts of the value chain, consumer-facing capacities have seen the most pronounced changes, as evidenced by the estimated 11% compound annual growth rate (CAGR) for e-commerce retail sales in the U.S. over the last 10 years.[1] According to the US Commerce Department, at the current rate of growth, 1 in 3 dollar sales will be online by the end of the next decade and that share could be even higher if changes in consumer behavior catalyzed by COVID-19 prove to be permanent. To keep up with e-commerce growth trends, most consumer goods retailers have been investing in e-commerce capabilities while also enhancing physical store offerings and experience.

Not all retail segments have seen the same pace of e-commerce growth. Consumer discretionary products – such as apparel and luxury products – have seen their e-commerce businesses grow faster than companies that produce and sell food or household goods. For example, discretionary sales excluding automobiles and part dealers, and gasoline made up a little over 50% of the total sales, but over 90% of the e-commerce sales.

Grocery sales, on the other hand, made up less than 2% of total e-commerce sales. Despite investments in technology, in the U.S. online penetration in grocery sales at an estimated 6%[2] lagged online penetration for total retail. Many traditional brick-and-mortar retailers have invested in online ordering, delivery and store pickup capabilities, but despite this adoption in the US for online grocery sales has remained relatively low compared to other countries such as South Korea, China and the UK.[3] However, the industry has experienced a rapid increase in demand due to shifting consumer behavior during the COVID-19 pandemic.

[1] As of 12/31/2019.

[2] Digital Commerce 360, "2019 ecommerce in review: Online grocery sales," December 24, 2019. https://www.digitalcommerce360.com/2019/12/24/2019-ecommerce-in-review-online-grocery-sales/.

[3] Kantar, "Share of online sales of FMCG will double by 2025," June 14, 2019. https://us.kantar.com/home/business/retail/2019/share-of-online-sales-of-fmcg-will-double-by-2025/.

The COVID-19 effect

Pandemics have impacted customer behaviors before. For example, when the SARS outbreak occurred in 2003, it contributed to the acceleration of the adoption of e-commerce in China. The COVID-19 quarantine has had parallel effects in the short term, forcing many consumers to make most purchases online as physical storefronts remained shuttered for an extended period. Some of these habits will likely persist beyond the crisis.[4]

For instance, public health concerns regarding COVID-19 have changed both consumer behavior and food retailer operations, resulting in an acceleration of e-commerce penetration in food retail. In an effort to abide by social distancing recommendations, many consumers have made an effort to reduce prolonged outings, including grocery shopping. Companies have taken action on this front as well in order to help address employee and customer safety. In particular, many retailers have limited the number of customers allowed in a location at a given time. This has resulted in long lines and wait times for stores, which is likely to prompt even more grocery purchases to shift online.

A portion of this demand shift may be permanent. Many customers who resisted trying this online ordering technology under normal circumstances may appreciate the newfound convenience of delivery and pickup and wish to incorporate this into their overall routines. Given low industry operating margins, there is little room for companies to drastically invest and quickly scale to meet this demand in the short term. Therefore, companies that have been steadily investing in e-commerce capabilities over the last several years will be best positioned to benefit. Not only will this shift have financial implications that may impact the ability to address existing ESG issues, it will likely bring new ESG considerations to light.

The ESG perspective

It is crucial to understand how a company's business model is changing, as it may introduce or eliminate financially material ESG risks. The acceleration in e-commerce may intensify labor, digitization, environment and data privacy issues.

Changes in labor management

Advances in technology and automation driven by e-commerce can help workers by reducing monotonous and physically strenuous activities. However, according to the Center of Urban Economic Development at the University of Illinois at Chicago, automation can also reduce job quality. Technological systems can track worker productivity and may inadvertently put more pressure on workers to work harder and faster. Consequently, it could affect the health, safety and morale of workers, and hasten the rate at which employees must be replaced. From a financial angle, this could result in higher health care costs, litigations due to injuries and unsafe work environments, or high employee turnover.

Job shifts have already begun and seem likely to increase over the coming decade. For example, demand for warehouse jobs has increased in tandem with the acceleration of online sales. From 2013-18, employment in the warehousing industry in the US rose 43%[5] (vs. all nonfarm employment growth of 9.8%), attributed mainly to e-commerce. The US Bureau of Labor Statistics expects warehouse employment to continue growing and anticipates 21% growth from 2018-28[6], versus all nonfarm employment growth of 15%.

Other shifts seem likely to accelerate in the near future. There may be less need for employees within the stores due to a decrease in customer traffic, but an increased need for employees who can address logistical challenges and perform deliveries. Companies that invest in training employees to be adaptable to these changes will better ensure the availability of workers in these new roles as they evolve.

Companies not adequately prepared to adapt to these changes may turn to third parties and contract workers who are not offered a set wage and benefits and, instead, receive compensation per delivery. This may result in employee, and in some cases, consumer backlash. As use of contract workers becomes a bigger focus of governments and the general public, the status quo may prove to be unsustainable. Retailers will need to adequately incorporate these labor management concerns into their business models.

[4] According to a study done by the University College London, on average, it takes a little more than two months before a new behavior becomes a habit, 66 days to be exact.

[5] UC Berkeley Center for Labor Research and Education, "The Future of Warehouse Work: Technological Change in the U.S. Logistics Industry," October 22, 2019. The Future of Warehouse Work: Technological Change in the U.S. Logistics Industry.

[6] U.S. Bureau of Labor Statistics, Employment Projections, https://data.bls.gov/projections/nationalMatrixHome?ioType=o.

Digitization

In-store retail sales still account for 89% of retail sales and even with accelerated growth of 15% in the next 10 years, compared to 11% growth in the preceding 10 years, brick-and-mortar would still make up a little over 50% of sales. This means that brick-and-mortar retail is not dead; it is changing, and the retailer of the future will likely be a retailer of the past – just a more efficient version. The successful retailer of the future will need to operate either as an optimized logistics machine, an ultraconvenient shopping option or an optimized showroom, and strengthen customer relationship and data analytics. Some retailers have already achieved – or are close to achieving – these milestones. One of retails' big ideas is the cashierless system pioneered by various companies and startups for supermarkets. In the likelihood of another pandemic, the technology would come in handy in protecting employees and minimizing customer contact. Going forward, retailers could also use the technology to track inventory or customer habits, though there are still questions about whether the cost of deploying and running the technology for a typically low-margin industry is worth it. The unfavorable economics may delay the implementation, but in the long term, this may be where the industry is headed.

Environmental effects

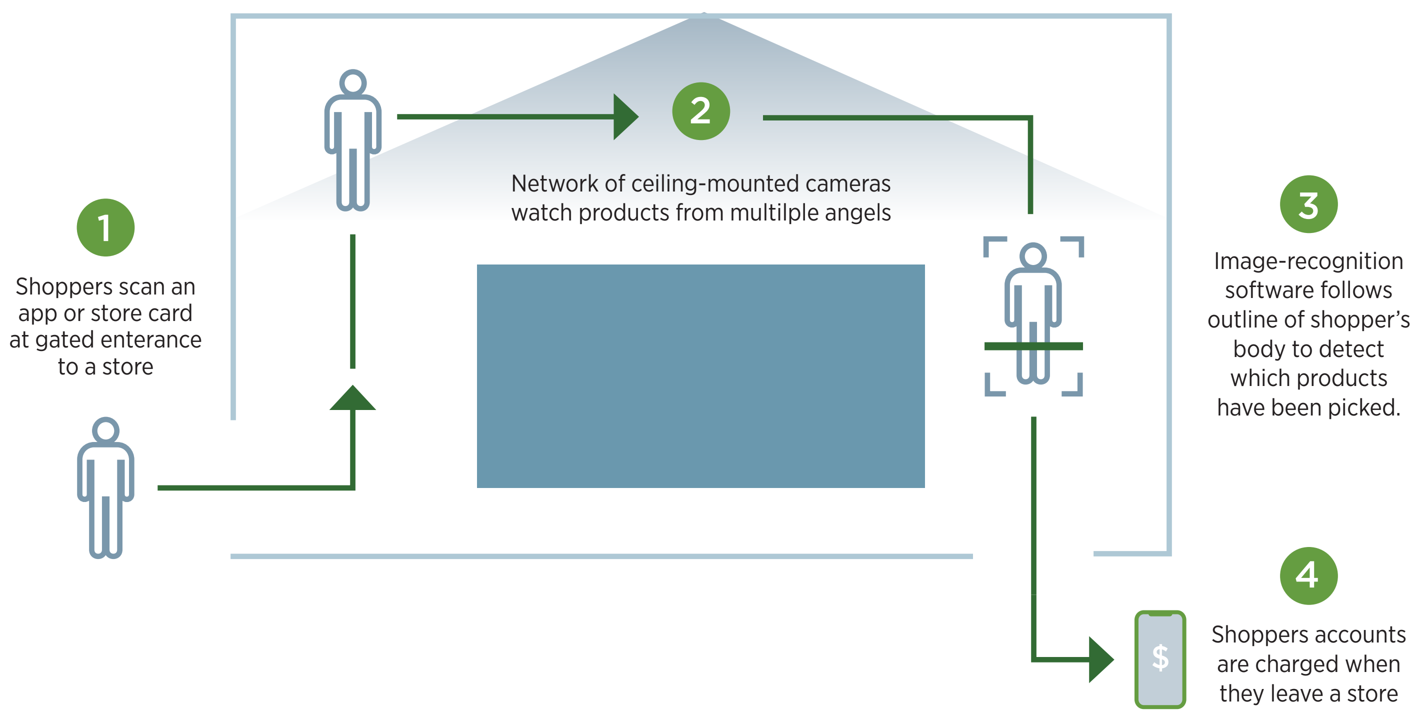
In isolation, compared to traditional shopping, online shopping is more environmentally friendly because it eliminates consumer travel to brick-and-mortar stores and resulting greenhouse gas (GHG) emissions. However, studies show that when consumers leverage several conventional brick-and-mortar alternatives in their online buying behaviors, some of the environmental benefits quickly erode.[8]

Some research argues that the increased packaging and shipping associated with online shopping has a 60% larger negative environmental impact than mall shopping. To stay competitive, some retailers have been ramping up same-day delivery, which exacerbates this phenomenon. Same-day delivery encourages more repeat shopping and results in customers ordering individual items instead of consolidating them. Therefore, as consumers pile up on rushed delivery, the result is an influx of delivery trucks on the road and need for additional packaging, further exacerbating climate change issues. From an ESG perspective, this could become a financially material reputational or regulatory issue as customers and governments look to reduce CO2 emissions in vehicles or face penalization.

Exhibit A

Pick and Go

Retailers are testing technology that would allow them to do away with cashiers.



Source: Adapted from an article in The Wall Street Journal by John Murawski, "Cashierless Stores Make Inroads in U.S.", August 12, 2019

[7] 15% versus the last 11% growth over the past 10 years.

[8] MIT Center for Transportation & Logistics, "Environmental Analysis of US Online Shopping, 2013 "https://ctl.mit.edu/sites/default/files/library/public/Dimitri-Weideli-Environmental-Analysis-of-US-Online-Shopping_0.pdf

Data security

Increased online sales will create an opportunity for retailers to more effectively capture and aggregate customer data. This has the potential to provide improved consumer insights that may lead to more effective marketing and sales. However, this also increases the need for adequate data privacy and security measures and it will be important for companies to continue to invest in related technology to safeguard consumer data.

Cybersecurity presents a high degree of material financial risk. Data thefts of customer information can erode consumer trust in the company, triggering interruption of services and loss of sales while the data breach is diagnosed. Data breaches could also introduce litigation costs to affected parties, which can be financially material. While companies can take out cyber insurance policies to cover some of these costs, a breach can lead to significantly higher premiums. Regulatory challenges include the EU General Data Protection Regulation, which requires businesses that collect the personal data of EU citizens to meet certain standards of data security or face fines. The California Consumer Privacy Act which creates new data privacy rights, became effective in January 1, 2020. Further, many US states have enacted "data breach notification laws," obligating companies to publish the details of security breaches, with negative reputational effects.

Calvert's approach to e-commerce

The continued growth in e-commerce is a welcome development for the consumer goods industry and the economy as a whole. Nevertheless, from an ESG perspective, it is vital to understand how this shift stands to influence labor management, digitization, environmental impacts and data privacy.

Among the specific indicators that Calvert looks at and acts upon when evaluating companies are:

- Monitoring each company's management of its workforce throughout its entire supply chain, looking to ensure that workers are treated in a fair manner, adhering to international laws and standards.
- Ensuring that companies with access to consumer information take safeguards to protect that information – failure to do so increases reputational risk in addition to the financial and legal concerns.

Calvert believes companies that balance all stakeholder interests over the long term will likely generate long-term value.

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