Flywheel

The Big Shift

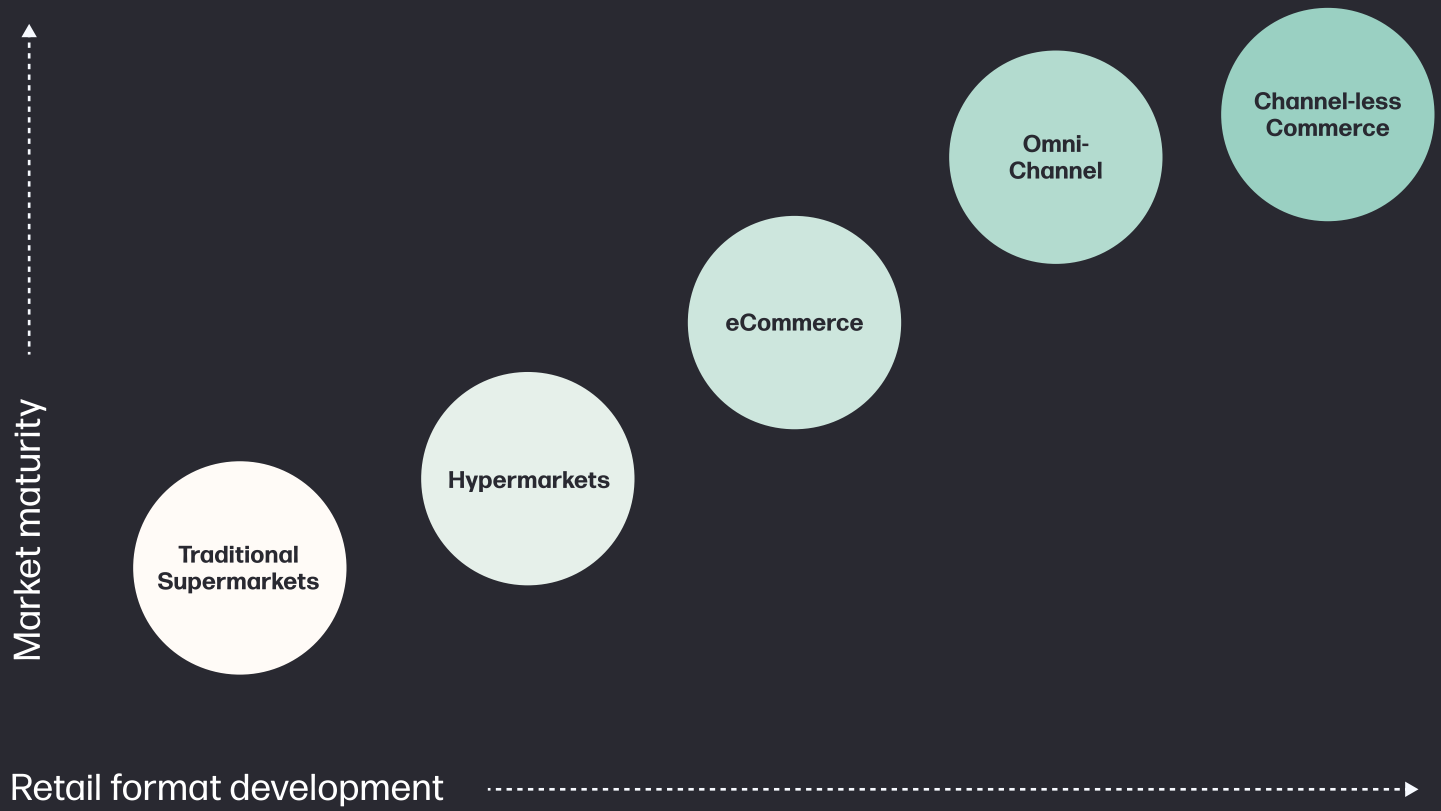
How brands tip the retail power balance

Since the beginning of commerce, brands and retailers have been locked in a dynamic power struggle.

Until the 1950s, big brands dominated the fragmented retail landscape, leveraging their scale to drive sales and profit across small, individual retailers. Independent stores clamored to carry reputable products and paid large brands a premium to showcase them. For brands, life was good.

As retail consolidated across a handful of national retailers, the power balance has steadily shifted to the retailers. Chain consolidation led to joint business plans (JBPs), and more direct (and expensive) relationships between brands and retailers became the norm.

Winning with retailers became a longitudinal game of trade terms and slotting fees that typically moved in one direction. Since stores are constrained by the physicality of space, retailers could simply swap out selection if a brand was not contributing on a trade, profit, and foot traffic basis. Brands negotiated and found opportunities to leverage their scale on different vectors, specifically supply chain and media.



This balance is starting to *shift*

Scaled media was once a source of strength for enterprise brands, but that power is diluted on digital marketplaces that value selection, not scale.

The smaller brands, not enterprises, drive marketplaces and digital platforms like Google, Amazon, and Meta. Second-priced auctions don't value scaled buys. Linear television is ideal for enterprise brands—the more you buy, the less expensive a gross rating point becomes. Second-priced auctions (common in retail media, search engines, and social media) are the opposite—the more a brand buys, the more it costs to reach, and there is no barrier to entry.

	No. of advertisers
Superbowl 2024	53
Meta	10 million

	Market cap
CBS Paramount	~$7 billion
Meta	$1.3 trillion

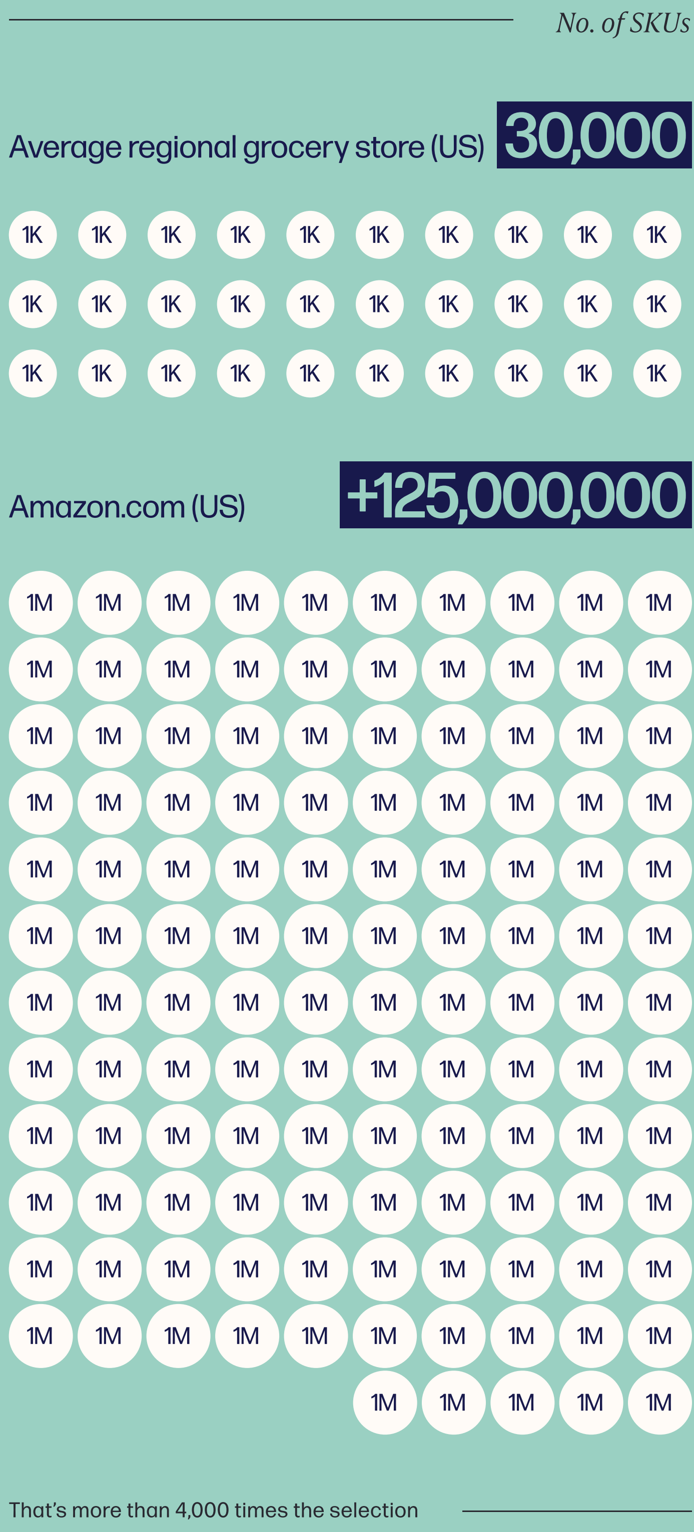
Marketplaces are not confined by the physicality of an in-store shelf.

Retailers want to list as many SKUs as possible on their marketplaces because it drives profit across their advertising and retail businesses. Lots of SKUs mean higher ad auction density (increasing the price paid for the advertising unit or as known, cost per click) and lots of units with higher gross margins than traditional retail (without carrying costs).

Smaller brands/sellers are willing to spend more on advertising as a percentage of total sales than enterprise brands as they recognize they have to invest more of their cost of sales to get consumer visibility.

Traditional retailers saw the combination of gross margins digital platforms enjoyed and the deprecation of the Cookie impacting traditional media companies. They decided it was a worthy aspiration to enter this market with more conviction. They invested in expanding their own media networks and platforms to provide opportunities for both small and large brands.

> "I can't remember a business with the margin structure of the advertising business here at Walmart"
>
> – Doug McMillon, 2022



When it comes to shifting the balance of power — the more brands understand about retailers, the more they can demand.

Retailers now own marketplaces, ad platforms, robust customer insights, and consumer relationships, but winning brands can turn this on its head, leveraging marketplaces' consumer infrastructure to their advantage.

Data is power. If retailers want to differentiate their position, they will be forced to give this data away.

Before brands can craft winning negotiation strategies, they must understand the role advertising plays in retailer growth and have context for the competitive retail landscape.

How retailers approach advertising growth

Consider what independent analyst Benedict Evans wrote in 2021: “Are Amazon ads worth more than AWS? Does Amazon make more money from ads than AWS? Quite possibly.” In the subsequent years of sustained double-digit growth, that hypothesis is likely even more true today.

Leading retailers follow a similar playbook, focusing on each end of the purchase funnel. This funnel consists of three types of media. Upper-funnel (traditionally considered TV-based advertising), mid-funnel (internet-based display advertising), or lower-funnel (on the actual retailer's site most commonly referenced as search).

They start at the lower funnel, selling brands based on deterministic measurement with actual sales. However, paid search inventory growth is constrained by onsite traffic. So if advertising drives a retailer’s share price and market cap (assuming they are building, not borrowing tech), how does a retailer keep growing an ads business after they hit saturation on this lower-funnel advertising product?

They first move to the mid-funnel, focusing on owned & operated (O&O) and offsite display. There’s a significant performance gap between retailers’ owned display inventory vs offsite, with their own inventory delivering far better conversion, albeit typically at a higher cost. If owned inventory performs better for brands and is cheaper for retailers to execute, why would retailers ever do off-site? It's simple—they need to demonstrate advertising growth to investors. While offsite may be profit-dilutive to their advertising business, it still can be an improvement vs. traditional retail margins (and no retailers break out the split between offsite and on-site advertising). There are vast levels of low-quality, low-priced inventory available on the internet that, when enhanced by the retailer's knowledge of the consumer, becomes higher value.

This classic arbitrage play presents retailers with huge revenue and profit opportunities, particularly with more established media companies unable to create this with the erosion of the cookie. Cash is no longer king and has been usurped by First Party Consumer Data knowledge. Retailers have found their new oil.

As retailers' advertising businesses evolve, they continually evaluate what they will build, buy, or lease. In the case of offsite display, retailers have mainly been happy to let more traditional ad tech companies like the Trade Desk own this market.

Why? There are several reasons. The first is the task of building and creating this inventory. It is vast, sold across thousands of sites and vendors, and has a vast quality scale. They also know this type of inventory doesn't perform as well as their own and that brands are becoming more aware of its associated challenges (e.g., brand safety and MFA sites). Using this approach, they can monetize their First Party Data but not incur the costs of building, managing, and governing the quality of this product for their brand clients.

With brands putting pressure on display advertising units, leading retailers are doubling down on above-the-line advertising (Connected TV) as the upcoming driver for their ad businesses. TV advertising is a high-quality and traditionally high-margin business.

Amazon has invested heavily in building Prime Video, and Walmart recently acquired Vizio for $2.3 billion in an attempt to match this scale. This trend will continue as retailers recognize that traditional media companies' margins are their opportunity.

In December 2023, the **Association of National Advertisers** analyzed:

$123,000,000 of ad spend with

35,500,000,000 impressions

"Our research found that only 36¢ of every dollar that enters a DSP effectively reaches the consumer."

Source: Association of National Advertisers

Retailers have a conundrum. They know providing significant levels of data empowers brands in the long term. However, their business model is now dependent on the high margins of their media operation.

Simply put, they are willing to trade more core retail performance data to keep growing their new high-profit advertising business.

Retailers used to attract brand partners by adding stores—more stores meant more distribution opportunities and, therefore, more sales. Now, they add data sets to prove the power of their sales channel combined with the value of their advertising, investing heavily in their own clean rooms and closed-loop measurement capabilities. To gain market share, they must demonstrate that they offer the highest quality, sustainable sales channel for a brand to demand the highest prices for their advertising.

Brands used to wait months for probabilistic MMMs to say what media drove sales. Now marketers can see deterministic sales data in near real-time, and they aren't looking back. This retailer investment coincided with the impending demise of third-party cookies, strict privacy regulation, and Apple's ATT efforts, which further increased demand for first-party data. Data availability is quickly becoming a primary differentiator for retailers. A core capability to win consumers has become a potential profit and growth opportunity rather than a cost.

Data availability is quickly becoming a primary differentiator for retailers.

How Chinese entrants are increasing competition for Western retailers

For China to have long-term economic prosperity, it must drive two fundamental macro changes. The first is to become a creator of global brands rather than the world's manufacturer. Secondly, as its internal market growth slows, it needs to expand its manufacturer's ability to take these new brands and ship them to win consumers overseas, where they expect more robust demand and higher margins. A Chinese manufacturer can invest double the level of a Western manufacturer to win market share through advertising while maintaining healthier margins.

Pinduoduo (who owns Temu) is seizing this opportunity by addressing an untapped US market. They've made significant media investments (almost $2 billion on Meta advertising in 2023 and three 2024 Super Bowl ads) and are focusing on less affluent, likely rural shoppers.

Jeff Bezos said, "In our retail business, we know that customers want low prices, and I know that will be true 10 years from now. They want fast delivery. They want vast selection."

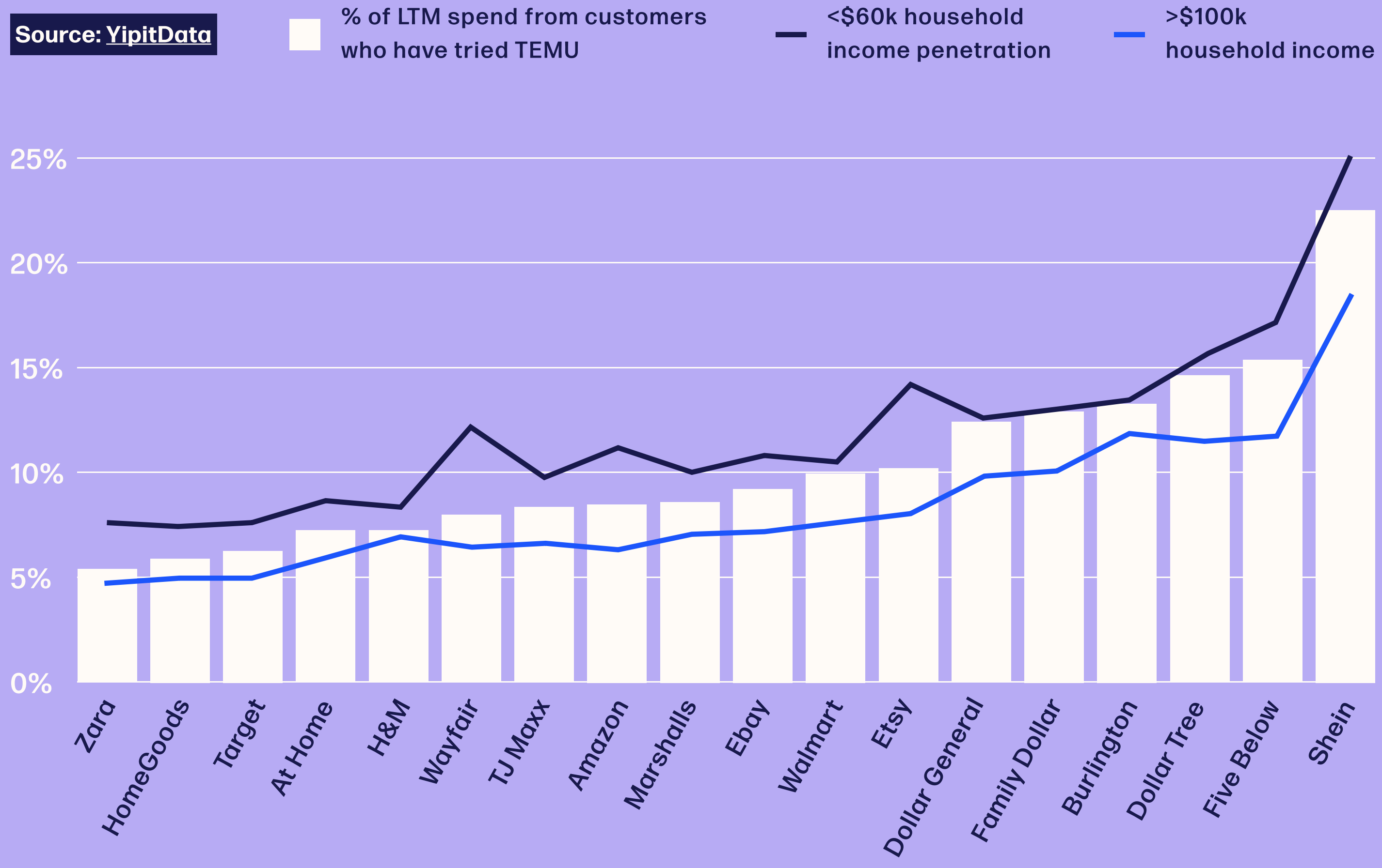
Temu and Shein (the two leading Chinese players in the US today alongside TikTok) have already replicated two of the three critical elements highlighted by Bezos required to win–and note that Bezos lists price first. We all want cough syrup fast, but consumers can wait a week for a t-shirt (especially one whose price is less than half of the cost on Amazon). Suddenly, slow shipping becomes a feature, not a competitive weakness, within the context of price. For now, Temu has even found an exemption from tariffs via the *1938 De Minimis provision, allowing them further competitive advantages. A key ingredient in the business model of technology platforms has always been their ability to be two steps ahead of regulators.

** The De Minimis Tax Exemption*

Allows shipments bound for American businesses and consumers valued under $800 (per person, per day) to enter the U.S. free of duty and taxes.

Nearly 100% of Temu's inventory is below this threshold.

Share of LTM sales from customers with a Temu purchase as of August 2023



Their presence is being felt in the market, as they are taking share from non-discretionary retailers, particularly apparel. While Temu isn't yet relevant for all categories, its tactics may change. It recently announced a "local warehouse" badge that US sellers can use to show customers faster delivery times.

In the new world order of retail success, the more competitive a retail environment becomes, the more data retailers will give brands to compete with and the more comparisons brands can make between them. Retailers need to empower brands as partners for their success, giving away even more insights. Brands will only be able to take advantage of this new world order if they have properly invested in their own real-time platform capabilities.

Brands can leverage their power over two things retailers need to survive

Product Selection

In the infinite online shelf, whichever retailer has the most significant or unique selection wins the consumer. This is why Walmart actively encourages brands to list as 1P and 3P sellers, and Amazon's planograms are not a handful of six-foot sets but millions of unique queries. However, winning brands realize that product allocation should be in their hands, not the retailers'. Consider Apple's exclusive M1 Macbook Air at Walmart for only $699. The least expensive (excluding refurbished) Macbook Air on Amazon + Apple.com is the M2 at $999.

While marketplace retailers may ask for a brand's complete selection (remember the days of Amazon Vendor Managers roaming the halls of trade shows asking for price lists and offering to list all of a brand's items), brands need to think through how selection impacts various classes of trade. They need to determine if the selection can be profitable, especially considering the increased cost to serve, both ship-to-home and click-and-collect. This is a game of unit economics and SKU offerings to drive differentiation. Brands can now assess the best channel to market in real-time.

Media Spend

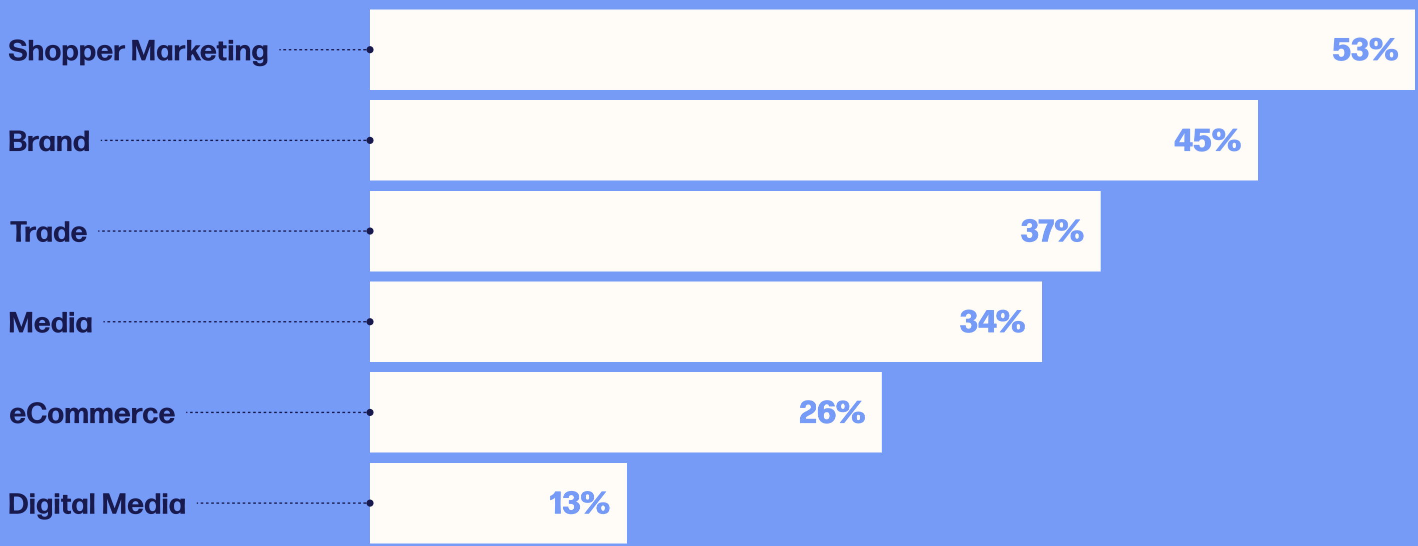
Retailers rely on retail media spending from brands as a profit growth engine. As closed-loop measurement grows, brands invest from trade and traditional above-the-line media budgets.

At first, most retail media funding was taken from existing budgets. However, as brands tested the impact of their investments, they have increasingly opened up above-the-line budgets

There is an exciting sub-thread on the cost of targeting related to a brand's Household penetration to determine if a CPM premium is worth it, but that's for another day. By 2026, the majority of retail media investment (60–70%) is expected to be net-new, in part due to organic growth in digital revenue and shifts from other digital channels/traditional media. By 2025, retail media budgets are estimated to eclipse linear TV. Retailers are eager to seize this opportunity.

Funding source for retail media networks for ANA members

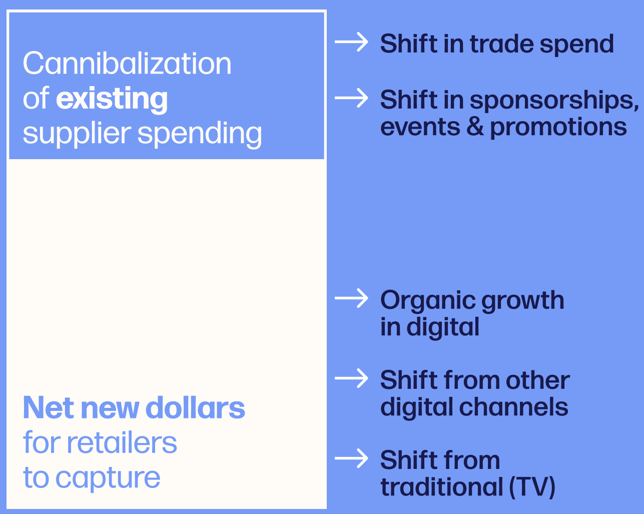
Source: Association of National Advertisers



In 2022 retail media funding was often taken from existing budgets for surveyed ANA members

Source: Association of National Advertisers

By 2026, the majority (60–70%) of retail media budget will be net new dollars



Source: Insider Intelligence, eMarketer, Boston Consulting Group, Google

As more retailers create RMNs and clamor for brand funding, brands quickly realize that not all RMN data quality is equal and consolidation has its benefits. Georgia Pacific recently announced a consolidation of investment in 40 RMNs down to seven.

Unlike traditional media buys, which lock weeks or months in advance, retail media budgets can shift in real-time, forcing retailers to demonstrate that their platforms continually present the most significant opportunity for growth. Again, for brands to make the right choices, they need to invest today in having the right platform driving their real-time decision-making.

Winning brands know how to pick winning retailer partners

All brands have the same goal—sell the right products in the right place, with the best experience to the highest long-term value consumers. Brands win if they have the best data and use the insights to most effectively allocate media investment, retail resources, and product distribution between retailers to maximize sales, share, and profit.

They must have an in-depth understanding of retailer ecosystems and motivations.

This means:

Harnessing the power of closed-loop media measurement systems and clean rooms, using retailers' first-party data to increase personalization and consumer targeting

Capitalizing on the infrastructure built by large retailers to empower real-time retailer allocation decisions, both in supply chain and media spend

Shifting retailer prioritization from being relationship-based to performance-based while creating constructs around fair and equitable to support retail media

Simple, right? Well, not really. These media networks are fragmented and complicated and require domain expertise from partners like Flywheel to take full advantage. For brands to make the right allocation choices, they need to invest today in having the right platform and partners driving their real-time decision-making.

Flywheel

Flywheel has spent the past 10 years building our proprietary tech. Our platform (Flywheel Commerce Cloud) is powered by the industry's biggest marketing data asset.

The sheer scale of what we've built is unparalleled:

#1 user	of AMC worldwide
+4 billion	daily updates/bids
$10 billion	in annual media spend
+330 million*	products tracked
+400	marketplaces

*Active products only. Flywheel tracks an additional 640 million that are inactive.

By combining Flywheel Commerce Cloud (product-level sales) and Omnicom's Omni (audience) data sets, Omni is taking sales signals from FCC and finding/driving audiences that tie to true sales performance. This is a net opportunity for enterprise brands, who can dive deep and invest in the upside, just as the retailers are.

While brands and retailers will always have their interests at heart, they're approaching unprecedented symbiosis and equilibrium. To thrive, the question for brands isn't how to dominate retailer relationships; it's about picking the best possible retail partners to give brands the opportunity to win... ***together.***

Contributors

Patrick Miller

Co-Founder
Flywheel

Katie Box

Vice President of Brand Marketing
Flywheel

The

Big

Shift

Flywheel