

The Retail Media Wake Up Call

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10 minute read (it's worth it!)

TL;DR: Most retailers 'operate' retail media networks devoid of robust spend and the related profits that come with it. As a result, these retailers can't sustainably offer eCommerce at the very same time consumers are increasingly shopping online.

Making money as a retailer is tough.

Doing so in eCommerce is even tougher.

And it's impossible without a thriving ads business.

There's trouble brewing amongst retailers:

- Consumers are increasingly shopping online
- Retailers' eCommerce profitability is fleeting
- Brands are concentrating retail media spend with only a handful of networks

Let's dive in to explore what might be the most disruptive force to impact retail over the next five years.

Beyond Bezos' wildest dreams

In business, the longer you stay in the game, the more options arise that you never even considered.

This maxim holds true even for visionaries like Bezos.

For instance, he didn't dream of Amazon's cloud business AWS when he founded the company in 1994, but it pioneered cloud computing and now contributes \$100 billion+ (!) to Amazon's top line and nearly \$40 billion (!!) in operating income.

Just as important has been the development of Amazon's ad business, which we estimate raked in

\$56 billion in revenue in 2024 (+20% Y/Y) and will grow to \$67 billion this year (+18% Y/Y).

- Paid search serves as its foundation, strongly correlated to its quarterly gross merchandise volume growth, as 1P vendors and 3P sellers alike fight for visibility.
- It keeps advancing its programmatic capabilities and Amazon's investing billions into media and [upper funnel capabilities](#), giving advertisers unprecedented access to its data through [Amazon Marketing Cloud](#).

Amazon needs ads despite three-quarters of a trillion in GMV

According to Stratably's financial estimates, Amazon's retail business operating margins (including ads but excluding AWS) will reach 5.1% in 2024.¹ This is a comparable level of profitability to its major retail peers like Walmart and Target, and for Amazon, it's an all-time high.

To separate the financial results between core retail operations from advertising, we must make estimates for advertising operating margins as Amazon doesn't disclose this data. We view Meta's average operating margin over the last 10 years (40%) as the best comparable and a reasonable estimate to make for Amazon's ad business.

Using 40% as our operating margin assumption, Amazon's Advertising business contributes ~\$22 billion out of Amazon's \$27 billion in total retail profits for 2024. In other words, Amazon Ads amounts to 83% of total operating income, with the core underlying retail business generating margins of ~1%, contributing the 17% balance to total operating income.

Take a moment to think about the 1% figure...

After three decades of refining its model and generating three-quarters of a trillion in global gross merchandise volume (!!!), which is THE definition of scale, Amazon barely ekes out a profit.

What chance does an omnichannel retailer that's half-committed to eCommerce have at breaking even with eCommerce? Practically speaking, it will have been working on that challenge only since the pandemic and it will be dramatically sub-scale compared to Amazon such that its GMV would be a rounding error if Amazon ever acquired it.

The viability of eCommerce without ads might even be worse than this base case estimate as many ad industry vets tell us Amazon's ad margins are likely even higher, in the 60% range, maybe even 80%.

If we use 60% as Amazon's ad operating margin estimate, then that implies the underlying retail business lost \$6.5 billion in 2024, generating a negative 1.4% operating margin loss.²

Yikes!

One could argue that Amazon chooses to lose money in retail knowing it makes it up in the ad

business and thus it doesn't *have* to have ads to turn a profit.

That might be true, but would it have been able to become the juggernaut it is without the ability to take ad profits and invest into fulfillment capabilities enabling same-day delivery on massive selection? And if not, then would it even be in the position it's in as the largest retailer in the U.S., still outpacing market growth by 4x?

Probably not.

Plus, Walmart's trajectory further proves the point. [It has been very public about its ad and data revenue streams structurally changing its P&L](#), enabling it to become the omnichannel king. Like Amazon, Walmart features scale and high competition for visibility on their site, encouraging brands to spend money advertising with it.

Amazon (and Walmart) are proving that simply selling goods online is not a path to normal retail margins, even at enormous scale, which most retailers simply don't operate at anyways.

Thus, retailers NEED an ad business to make eCommerce profitable.

Brands are concentrating their retail media efforts on the same handful of networks

We benchmarked 92 consumer brand manufacturers that sell through major retailers in the U.S. Participants tended to be at the Director or VP level in their organization, working across a mix of CPG and non-CPG categories, and on average, did \$4-6 billion in annual revenue (i.e., larger sized brands that have sophisticated marketing and eCommerce capabilities).

The results indicate that the average brand activates on only five to six networks!

These networks tend to be the same within a given category. For instance, in grocery, this includes Amazon, Walmart, Instacart, Kroger, and Target. In Home Improvement it includes Amazon, Walmart, Target, Home Depot, and Lowe's.

We've seen [other studies](#) also echo this finding, and it was unchanged from our 2023 benchmark indicating brands have not expanded to more networks in any meaningful way over the last 18 months.

In fact, our research also revealed that [51% of brands plan to increase the share of their retail media budgets going to Amazon](#) this year compared to just 3% indicating Amazon would get less of their budget.

In other words, while dozens of retail media networks have launched, most are not getting much of any attention or budget dollars from brands, and that's not changing any time soon.

Uh-oh!

If these retailers don't have an ad business to fund eCommerce, they face a difficult path forward, attempting to balance meeting consumer expectations of a robust online shopping capability with the need to drive earnings growth.

These retailers can't magically manufacture online sales scale and it's difficult to drive a deep auction on their sites because of the lack of traffic and selection.

This is a growing problem.

Consumers are spending more of their wallets via eCommerce

While stores still account for 84% of sales, eCommerce is steadily chipping away:

- Digital penetration is [up 85 basis points Y/Y in the U.S.](#) market in 2024.
- Amazon, the poster-child for eCommerce, is [now the largest retailer in the U.S.](#), surpassing even Walmart by our estimates.
- [Digital's share of growth](#) at Walmart, Target, Kroger, and more omnichannel retailers is regularly surpassing 50% of their total growth, and our forecasts call for that to continue over our five-year forecasting horizon.
- We estimate [ALL of the growth in the CPG market](#) during 2024 came from online channels.

Our estimates may prove conservative too, especially considering the evolution of shoppable media. Shoppers are only spending more time with digital media and they're increasingly going to be able to buy directly from these ads, all powered by a select group of retail media businesses connected to eCommerce platforms. [TikTok Shop's rise](#) is a powerful example of what's possible and we expect [Amazon's streaming TV efforts](#) along with what Walmart will create with its [Vizio acquisition](#) to drive this trend further.

In addition, there's no clear catalyst coming to improve the in-store shopping experience. For instance, consider efforts to reduce shrink with retailers locking up more product. This adds friction and makes consumers question their decision of trekking to the store. [Numerator reported 60% of consumers have this experience](#) on a regular basis with 27% saying they plan to switch retailers as a result!

Without ads, retailers face a painful trade-off

Given shoppers' preferences are shifting towards online channels, retailers MUST offer eCommerce to stay relevant.

If they don't, they will have half the growth opportunity going forward. Imagine a retailer that typically guided investors to 5% annual growth. This growth now looks more like 2-3% without eCommerce.

If they do offer eCommerce, but they don't have a robust ad business because Amazon, Walmart,

and a few others are gobbling up that budget, then they'll likely face negative 1-5% operating margins on their digital business (at least), eroding their overall operating profitability. Further, this problem would only grow over time considering digital sales as a percentage of the total would be increasing. Instead of growing earnings faster than top-line growth, it would likely flat-line if not move structurally lower.

The investor reaction to either outcome would be swift and severe!

Talk about having to make a least-worst decision.

How we'll see this play out over the next three years

We equate the retail media industrial complex to [China's ghost cities](#).

These "cities" have been announced, and buildings were built, but they are devoid of activity, and no one is planning to move there.

Similarly, retailers have issued the press release, they've talked about their 'valuable' first-party data at the big conferences and sponsored products are available for sale, but there's no deep ad auction nor incremental funds flowing in, and brand partners aren't planning to change that any time soon.

We've been in this retail media honeymoon period since the pandemic. But the rubber must meet the road at some point, and it's becoming more obvious by the day (or research study!) that not every retailer is operating a robust network.

Here's what we expect to see as a result:

1. Retailer consolidation.
2. Retailers share fewer eCommerce metrics.
3. Retail media network divisions publish fewer press releases as there is less good news to share.
4. Retailers attempt to re-classify in-store activations as "retail media", with these efforts yielding no incremental funding.
5. Retailers will try to sell investors on the opportunity with non-endemics, which is a red herring for all but the biggest networks.
6. Instacart, Criteo, and now Amazon Ads ([Retail Ad Service](#)) will bring more retailers onto their platform in an attempt to make it easier for brands to activate.
7. (Maybe, just maybe...) Investors will start pushing retail executives for more detail on the size of their media business and their commitment to eCommerce.

Maybe brands see structurally lower margins

We may also see retailers lean on brands more, shifting at least some of the problem to other parts

of the value chain.

Most brands don't want a world dominated by a few big retailers and anecdotally we often hear about desires to diversify away from Amazon in particular.

But most brands, or at least their investors, also won't accept structurally lower margins. Instead, they'll continue to shift more of their efforts towards Amazon, Walmart, and the few others that don't charge them extra for every sale that happens online.

A wake-up call for consumer brand professionals

Retail media isn't as healthy as it seems, and the shift in consumer spending toward eCommerce is only accelerating. To stay ahead, focus on these critical actions:

Prioritize Winning Accounts

Diversification may sound appealing, but the reality is clear – Amazon, Walmart and only a few others dominate for a reason. Are you aligning your efforts and investments with the accounts that have the scale and robust ad businesses to sustain long-term growth?

Reassess Your Customer Set

Take a hard look at your retail partnerships. Where will digital and physical growth come from over the next five years for each of them? Are you positioned to maximize that potential, or are resources tied up in accounts that may struggle to remain viable?

Evaluate Retailers' Ad Viability

A retailer's ability to compete digitally depends on the strength of their retail media network. How does each partner's ad business factor into their ability to deliver sustainable eCommerce growth?

Prepare for More Disruption

The disruptive force of eCommerce is only getting started. Are your strategies adaptive enough to address the shifting competitive landscape, evolving consumer behaviors, and escalating expectations for digital integration?

Brands that align their focus with the right partners and take bold, strategic actions now will not only weather the disruption but emerge stronger in the years ahead.

Footnotes

- We'll know the final number when Amazon reports full year results in a few weeks.
- There's an inverse relationship in the financial model – as the ad operating margin estimate

increases, the implications for core retail margins decline.