Portage Investment Thesis: E-Commerce Enablement

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Portage

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Introduction

> The e-commerce enablement market is diverse, broad and evolving rapidly."

The e-commerce enablement market includes any fintech-pertinent services and tools that enable e-commerce transactions and the merchants and consumers behind them, from e-commerce platform providers like* Shopify *to more specific services, such as BNPL, recommerce, and fraud protection and risk management. In short, any tool that facilitates or enhances online transactions and the customer purchasing journey, including solutions that support the everyday operations of e-commerce businesses, falls within the realm of e-commerce enablement.

Despite the breadth of the market, the investable opportunities within e-commerce enablement, we believe, are limited. One constraint is the slowing growth of online retail sales. The "heyday" of 2020, when e-commerce boomed amid the disruptions of the COVID-19 pandemic, has stalled. E-commerce sales decelerated rapidly in 2021 and 2022; in fact, some countries in Western Europe and East Asia saw a decline in e-commerce penetration from 2021 to 2022—the first such decline on record.[1]

Another headwind: e-commerce enablement has become more competitive. Many new entrants emerged during and immediately after the pandemic. At the same time, established platforms like **Shopify** and **Amazon** have commoditized many features that vertical enablement firms sought to promulgate. Incumbent fintechs like **PayPal** and **Affirm** have also extended their e-commerce capabilities and offerings.

Even with those issues, however, there remain select areas of opportunity. E-commerce merchants continue to face real challenges and, we believe, meaningful market demand. The online retail marketplace is still expanding, albeit more slowly, and businesses are spending more on e-commerce applications as they look to adopt more modern solutions.

1. *Global Retail Ecommerce Forecast 2023*. eMarketer. February 21, 2023. www.emarketer.com/content/global-retail-ecommerce-forecast-2023

1. The e-commerce ecosystem: Past, Present, and Future

The foundations of today's e-commerce industry were laid in the 1990s with the launch of monolithic, feature-rich solutions that typically came with high upfront and ongoing costs, and as such, catered to large enterprises.

In the second wave of e-commerce, which began about a decade ago, growth has been driven not by large enterprises, but rather by small and medium-sized businesses, leading to the rise of SMB-focused platforms like **Shopify**, **WooCommerce** and **BigCommerce**. These have become dominant in the SMB merchant market: in the U.S., nearly one-third of all online businesses use Shopify to power their stores.[2]

In our view, SMBs and mid-market merchants will continue to be the fastest-growing segment of the e-commerce ecosystem, and their growth will be the driving force behind the adoption of new, innovative e-commerce enablement solutions.

Primarily for that reason, we are somewhat skeptical of two relatively new enablement models hailed as heralds of the "third wave" of e-commerce. One is so-called **headless commerce**, which separates the front and back ends of e-commerce applications and connects them through APIs. The second is **composable commerce**, which breaks down e-commerce solutions into individual services. Both models promise a level of customization and flexibility that monolithic legacy solutions cannot rival, and (theoretically, at least) they can make it easier for businesses to implement new e-commerce software.

However, whether startups in these spaces are viable investment opportunities is unclear. So far, such systems are often simply too complex for most smaller businesses, whose needs are already largely served by traditional e-commerce platforms. In short, our view is that merchants, and particularly SMBs, will by and large, opt for more full-fledged e-commerce systems. We do believe that composable commerce systems will eventually capture the enterprise level of the e-commerce ecosystem, but we doubt that these systems will be delivered by new entrants.

2. *eCommerce Usage Distribution in the Top 1 Million Sites*. BuiltWith. trends.builtwith.com/shop

2. What we look for

There are three main categories of businesses within e-commerce enablement: **platforms** *like* Shopify *and* BigCommerce; **middleware**, *which facilitates platform-to-platform connectivity; and* **applications** *that offer specific services.*

The **platform/back-end market** is relatively mature, dominated by go-to providers that have been aggressively expanding their functionality. A prime example is **Shopify**, which has grown its capabilities not just through organic growth but also through acquiring companies offering additive services and through strategic relationships, often solidified via equity investment.

Given incumbent platforms' market dominance and breadth of capabilities, we think it is unlikely that a challenger will emerge with a fully competitive offering. That means the primary windows of opportunity for new entrants are in the categories of **middleware** (now occupied by universal API firms like *Weav* and add-on marketplaces like *Mirakl*) and **applications** (now occupied by firms such as **Klaviyo**, **Loop** and **Chargebee**, for example). Our further view is that applications that are complementary to incumbent platforms can survive independently only if they cannot be easily absorbed into those platforms (platform risk).

When evaluating companies within the evolving e-commerce enablement space, we look for three potential indicators of success:

↘ **A long-term vision or product roadmap that evolves with its customer base and minimizes graduation risk.**

Successful e-commerce enablement is not a "one and done" proposition but rather depends upon the longevity of the merchant-customer relationship. A challenge to this relationship is graduation risk—the potential for merchants to eventually achieve enough scale to develop their own solutions in-house. Enablers' solutions need to be too operationally intensive to build in-house, capable of evolving with merchants as they mature into larger enterprises, or focused on specialized categories (for example, fraud) that are applicable to businesses of all sizes.

2. What we look for (cont.)

- **First-mover advantage in a space without significant platform risk.**

  Opportunities in e-commerce enablement are constrained by the presence of established enterprise solutions providers (e.g., **Oracle**, **SAP**) and platforms that already focus on SMBs (e.g., **Shopify**, **BigCommerce**), which have a track record of being able to quickly integrate new solutions. To mitigate against platform risk, new entrants must either be first to market with a feature-intensive product or build their product in a completely different space.

- **Intuitive and easy to integrate.**

  Most SMBs operate with limited resources, prioritizing solutions that can be implemented and maintained easily. E-commerce enablement products must avoid bloating or reworking SMBs' tech stacks—a compelling value proposition, especially given that many SMBs already find **Shopify** too complex and expensive to manage.

3. Fintech meets e-commerce

Among the most significant developments in e-commerce enablement today are occurring at the intersection of e-commerce and fintech. Increasingly, e-commerce platforms are offering financial services, along with transactions and payments services, to their enterprise and SMB customers. On the other side of the equation, some fintech-first companies offering banking, payments loans and other financial services to retail brands are looking to e-commerce enablement as an area of opportunity. Meanwhile, SMB-focused fintechs such as Intuit *and* PayPal *are also acquiring e-commerce capabilities.*

For new entrants, one key to success is data access to merchants and suppliers, which could potentially foster faster B2B payments. Among Portage portfolio companies, **Oatfi**, **Kontempo** and **Notch**, are exploring these functions to enable—and capture data from—B2B transactions.

Whether some of the newer lending/fintech solutions can successfully expand into enablement solutions remains to be seen. On the lending side in particular, there is strong competition from traditional banks and e-commerce giants, and financing-focused companies such as **Affirm** and **Klarna** also provide shopping platforms in partnership with brands and retailers.

In general, we recognize that there is reason for excitement in the proliferation of value-additive financial services for the e-commerce industry. There are a few caveats, however. One is that many merchants will always favour dealing with traditional banks, particularly larger merchants with the resources to oversee a banking relationship and the scale to benefit from favourable financing costs. A second is that merchants are subject to broader macroeconomic conditions, and many have faced challenges related to inventory backlogs, slow sales and cash flow in recent years. When evaluating fintechs in e-commerce, therefore, one must also evaluate the future state of the end customer. As well, given the cyclical nature of the e-commerce market, robust underwriting will be critical for any players offering financial services to merchants.

4. The opportunity landscape: key areas of interest

4.1. Pre-purchase and checkout

Our general view is that these stages of the consumer purchase journey (pre-purchase, purchase, checkout and post-purchase) offer relatively few compelling investment opportunities at the moment. In both pre-purchase and checkout, incumbent e-commerce platforms have become increasingly sophisticated, and new entrants' solutions often appear more viable as features than as standalone products—meaning they may be easily commoditized by bigger players.

In particular, it is unclear whether checkout facilitation as a standalone offering can deliver real return on investment. It's true that cart abandonment is an issue for merchants, but we question whether ease of checkout is a major contributing factor. Slow load times, surprise fees, over-long delivery times, and the simple fact that e-commerce will always attract a certain number of "window-shoppers" seem to be more significant drivers. And the reality is that checkout is already a very crowded space.

Companies that have attempted the "quick checkout" model—and attracted quite a bit of investor enthusiasm only a few years ago—have run into issues. Among them, **Fast**, which raised US$102 million in 2021, declared bankruptcy in 2022,[3] and **Bolt**, which raised US$355 million in 2022 at a valuation of US$11 billion,[4] has been burdened with management changes, layoffs and regulatory scrutiny.

One area that may offer more promising investment opportunities is checkout at the point of impression, which would bridge the gap between the consumer's pre-purchase and at-purchase experience. In this space, **Skipify** has integrated checkout links into marketing emails; **iFrames** refers to an HTML element that publishers can use to offer direct checkout for products mentioned in an article.

Another area of opportunity is—or should be—customer data collection and analysis. However, offerings in this space often fail to meet merchants' expectations in terms of meaningful insights and direction from data analysis;

3. *Fast, the easy checkout startup, shuts down after burning through investors' money.* Bobby Allyn. NPR. April 5, 2022. www.npr.org/2022/04/05/1091077398/checkout-startup-fast-is-shutting-down-after-burning-through-investors-money
4. *Online checkout firm Bolt valued at $11 bln after funding round – source.* Reuters. January 26, 2022. www.reuters.com/technology/online-checkout-firm-bolt-valued-11-bln-after-blackrock-led-funding-source-2022-01-14

4. The opportunity landscape: key areas of interest (cont.)

merchants often don't find the solution worth the time and expense required. So far, the most successful new players have been plug-and-play data model providers operating in the ecosystems of incumbent platforms. One example is **Klaviyo**, which has a strategic relationship (including revenue sharing) with Shopify; it went public in 2023 and has a current market cap of US$10 billion+.[5]

4.2. Fraud prevention and risk management

E-commerce fraud is a space rife with investment opportunities. Driven by the rise of e-commerce transactions in emerging markets and by increasing AI-based attacks, it is a pervasive and growing challenge to the industry, with merchant losses from online payment fraud expected to reach US$91 billion globally by 2028, up from US$38 billion in 2023.[6] Driven by AI, the complexity and speed of fraud attacks will likely increase in the future.

Many merchants today employ legacy fraud solutions and in-house/manual processes that are expensive, clumsy and often ineffective. Merchants will increasingly need to adopt a multi-layer and proactive approach to fraud prevention, deploying connected technologies that work with cross-channel data and perform relationship analysis at scale to better understand a purchaser's behaviour and screen out fraudsters. (The potential for false positives—and lost revenue—is of course a key caution.)

The global fraud detection and prevention market is projected to grow by 19% annually from 2023 to 2028, according to MarketsandMarkets.[7] There are a handful of leading players in the space, including **Riskified**, **Forter** and **Signifyd**. New entrants might face an uphill battle in earning the trust of merchants who might favour more established providers, and when it comes to all-important data, incumbents have an advantage over startups. Accordingly, consolidation in the fraud prevention industry may be on the horizon; some platform incumbents, such as **eBay**, have already started acquiring startups in the space.

5. *As of October 2024*
6. *Online Payment Fraud: Market Forecasts, Emerging Threats & Segment Analysis 2023-2028.* Juniper Research. June 26, 2023. www.juniperresearch.com/research/fintech-payments/fraud-identity/online-payment-fraud-research-report
7. *Fraud Detection and Prevention Market. MarketsandMarkets.* www.marketsandmarkets.com/Market-Reports/fraud-detection-prevention-market-1312.html

4. The opportunity landscape: key areas of interest (cont.)

That said, new entrants that address still-unsolved issues represent potential investment opportunities. Some names to watch include **Spec**, which targets payment fraud, account takeovers and loyalty program abuses; **Netacea**, which provides solutions to mitigate bot-attack risks; and **Darwinium**, which targets chargebacks, fraudulent accounts and other frauds.

4.3. Post-purchase

Of all the phases of the customer journey, we are most excited about the potential investment opportunities in post-purchase. Many SMBs do not have the resources to develop solutions in-house, creating a meaningful need for innovation by new entrants. Positive post-purchase experiences can aid merchants in customer retention and loyalty and, potentially, open up new revenue streams in the form of resale, loyalty programs, community, and so on.

4.3.1. Returns and recommerce

Sustainability and cost are key considerations among consumers, and merchants are increasingly exploring ways to reduce waste and improve the return and resale experience. In response, two new, related niches in the enablement space have arisen: returns and reversible commerce (recommerce), which facilitates brand-to-consumer sales of used goods and peer-to-peer (P2P) platforms that empower sales of goods between consumers.

Returns

Many e-commerce retailers use built-in platform features, such as **Shopify**'s in-house services, for returns. Entrants in the space offer more nuanced feature sets, such as automated return approvals, integration with logistics, exchanges and dynamic return policies. They may stand to benefit from the fact that a positive returns experience can help drive consumer purchase decisions. (More than 60% of consumers look at return policies, according to **Parcll**.)[8] **Loop** provides a good example of a multifunctional approach, enabling return surveys, configurable return policies and process workflows, as well as connections with logistics, platform and ERP systems.

8. *Ecommerce Returns Statistics That Will Blow Your Mind!* eCommerce Fastlane. https://ecommercefastlane.com/7-ecommerce-returns-statistics-that-will-blow-your-mind/

4. The opportunity landscape: key areas of interest (cont.)

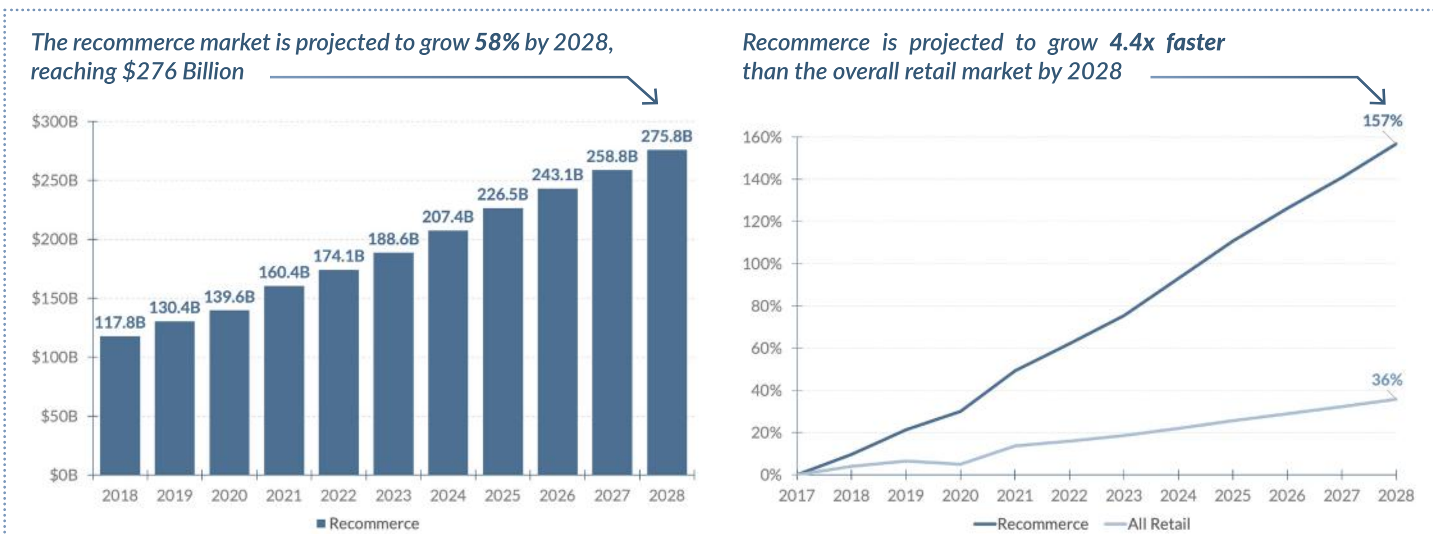
Another enablement bucket in this area is customer-facing return solutions, which encourage store-based credit or product exchanges over outright returns, reducing sales losses. Some of the notable names to watch are the aforementioned **Loop**, which offers an expanded suite of returns and exchange services; **ReturnGo**, which provides instant refunds through **Refundid**; **Happy Returns** (acquired by **PayPal**), which offers in-person and online return solutions; and **Sway**, a fully digitized return pickup service.

We believe that the clearest angles for fintech going forward lie in refund services, and the returns space is broad enough to allow for packaging of related features (e.g., reverse logistics, product exchanges) with core offerings. We note, however, that comprehensive solutions from well-resourced providers and partners already exist, somewhat limiting the opportunities.

Recommerce

We are more optimistic about the opportunities in recommerce, which includes business-to-consumer retailers as well as P2P marketplaces. Although nothing new—**eBay** was founded nearly 20 years ago—recommerce is expected to grow rapidly, driven by increased consumer demand for affordable options, rising interest among sellers, and the evolving convenience and ease of shopping on resale platforms.

Figure 1: Rapid growth in resale[9]



9. *Source: OfferUp*

4. The opportunity landscape: key areas of interest (cont.)

The rise of recommerce[10] has led to a proliferation of marketplaces (from digital classifieds platforms like **Craigslist** and **Facebook** Marketplace to more comprehensive offerings like **Depop**, **Poshmark** and **Thredup**) and marketplace aggregators such as **Beni** and **Gently**. We do not see any clear investable fintech ideas among these marketplaces and aggregators, however, largely because the space already has some clearly defined winners.

There may be greater opportunities in the retailer enablement space. These providers enable merchants to create their own brand-specific resale solutions, allowing them to recapture significant value by facilitating secondary sales and bringing revenue back into their ecosystems. For example, **Treet** allows retailers to offer an in-store credit for reselling a product rather than returning it. Meanwhile, **Croissant**, a Portage portfolio company, markets its product buyback service for merchants as a way to drive purchase decisions—research suggests that more than 80% of younger consumers consider resale value before buying.

4.3.2. Shipping and product protection

Improved shipping and product protection is one avenue towards higher customer engagement, and leading players in the space have approached it in a variety of ways. Some, like **Route**, offer shipment tracking and protection as complementary services; others, such as **Clyde** (acquired by **Cover Genius** in 2023), focus exclusively on protection. Most of these insurance plays are merchant-facing, and some provide a broad range of services. **Route**, for example, not only offers shipment tracking, but also enables carbon-neutral shipping, shipping protection and post-purchase engagement solutions. **SendCloud** provides merchants with shipping automation, returns, checkout, tracking services and shipping protection through **XCover**, a product from **Cover Genius** that provides protection for a wide range of products and services.

This market is still evolving, and one of our key concerns is how competitors can form moats. It is still unclear whether early successes for differentiated solutions (such as **Clyde** and **Route**) can continue over the longer term. If, as we suspect, the core offering in this space turns out to be product protection, then success will depend on high volumes in a low-margin business. While we think the space is worth monitoring, the potential for price competition and the potential inability of added services to mitigate against it are reasons for caution.

10. *Recommerce Report 2023.* OfferUp. about.offerup.com/recommerce-report-2023

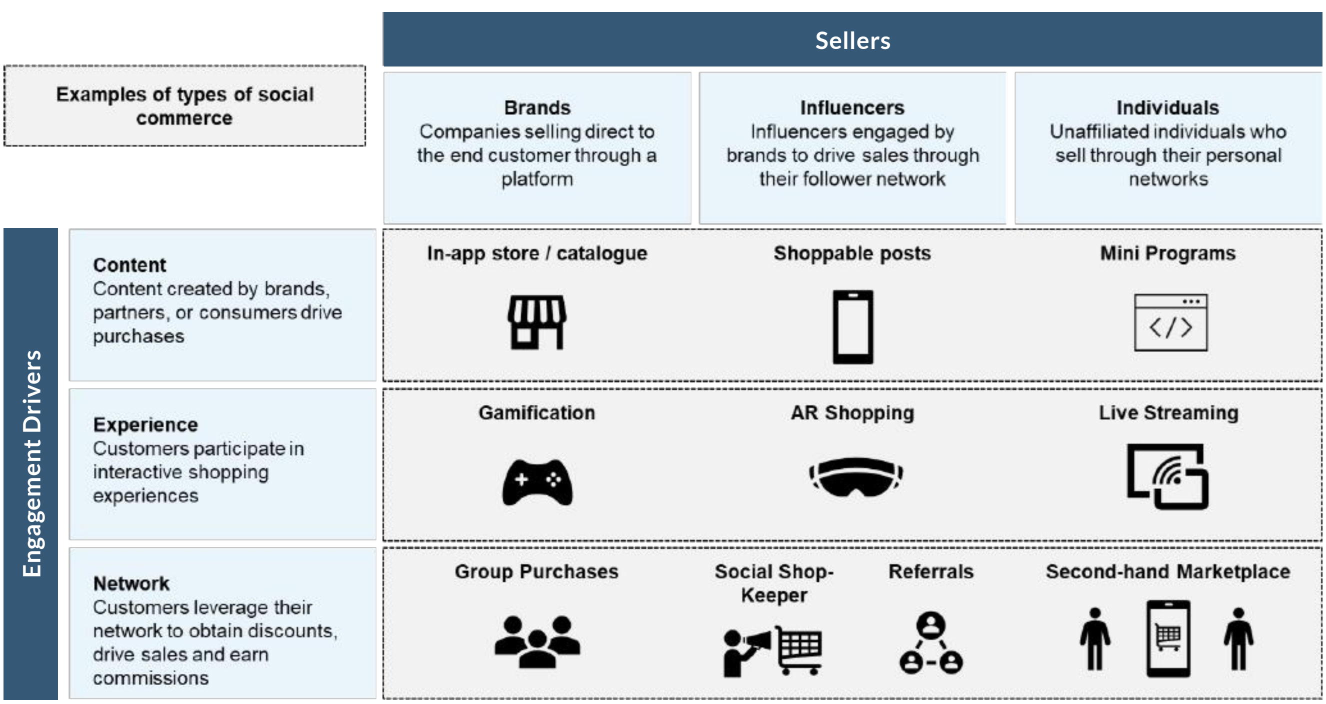
4. The opportunity landscape: key areas of interest (cont.)

4.4. Social commerce

Given that 90% of Internet users globally use social media, engaging with customers on this channel has become a priority for merchants. The U.S. remains a significant area of opportunity for social e-commerce transactions: fewer than half of American consumers have purchased goods through social platforms,[11] compared with more than 84% of Chinese consumers—the highest level of social commerce in the world.[12]

From an enablement perspective, the space includes solutions focused on brand-to-consumer, brand-to-influencer-to-consumer, and consumer-to-consumer transactions. There are a host of transaction models, from content plays like shoppable posts and experiential offerings like AR shopping to network plays (e.g., group purchases and referrals).

Figure 2: The social commerce landscape[13]



11. *Nearly half of US consumers say they have made a purchase through social media. Mintel.* April 20, 2023. www.mintel.com/press-centre/nearly-half-of-US-consumers-say-they-have-made-a-purchase-through-social-media
12. *Social commerce in China – statistics & facts.* Statista. www.statista.com/topics/6718/social-commerce-in-China
13. *Why shopping's set for a social revolution.* Accenture. January 2, 2022. www.accenture.com/us-en/insights/software-platforms/why-shopping-set-social-revolution

4. The opportunity landscape: key areas of interest (cont.)

This is a broad area, implying plenty of whitespace for new entrants. However, the universe of fintech-specific opportunities is constrained by large social media platforms that own the customer relationship and by established e-commerce players. We believe two specific areas are worth monitoring, however: influencer revenue/business management, as exemplified by **Skip**, and group purchases, which enable groups of consumers to split payments and pool funds, with **FEVO** being one example in the live-event and related merchandise space.

Live stream shopping, or simply "live shopping," is another area of interest. Several social media platforms and e-commerce marketplaces have already launched live shopping features, as have several brands (e.g., Macy's) on their websites and a handful of new live-shopping marketplaces (e.g., **ShopShops**, **TalkShopLive** and **NTWRK**). As well, some notable startups are helping brands launch live streaming capabilities on their social media or directly on their websites, including **eStreaml**y, **Bambuse**r, **Now Live**, **Livescale** and **Emplifi**. As the live shopping market evolves in the West (it is already a popular channel in China), these plays are worth monitoring.

4.5. Other e-commerce enablement categories commerce

4.5.1 Loyalty

The value of loyalty and rewards programs to merchants is clear: by driving repeat spending, the top loyalty programs can boost revenue by 15% to 25% annually, according to McKinsey.[14] Yet the space is already fairly mature. For enterprises, loyalty programs are table stakes, and enterprises that have not already launched loyalty programs are more likely to internalize than to outsource loyalty services (see PayPal's acquisition of **Honey** and Capital One's acquisition of **Wikibuy** and others). We see opportunities in the space as primarily being in the SMB B2B enablement space, although enablers targeting SMBs that cannot currently self-deploy still face the challenge of graduation risk.

14. *Next in loyalty: Eight levers to turn customers into fans.* José Carluccio, Oren Eizenman, and Phyllis Rothschild. McKinsey. October 12, 2021. www.mckinsey.com/capabilities/growth-marketing-and-sales/next-in-loyalty-eight-levers-to-turn-customers-into-fans

4. The opportunity landscape: key areas of interest (cont.)

Another, related area of note is e-commerce subscriptions, where enablers help merchants to implement product subscription options at checkout and to offer customers discounts. One startup of note is **Ordergroove**, which delivers and manages subscription programs for brands like l'*Oréal*, *Dollar Shave Club* and *G Fuel*.

4.5.2. "Shopify" for professional services

Several startups are seeking to replicate the success of **Shopify** within the SMB merchant market by developing all-in-one solution models for the services industry. Notable players in this space are **Copilot** and **Service Provider Pro**.

Although service providers do lack the kind of all-in-one solutions that merchant SMBs enjoy, our view is that a *Shopify*-style success in services is unlikely. Businesses that sell goods typically have the ability to scale and they deal with complex operational issues (inventory, marketing, and so on), while their support needs are similar enough that a core infrastructure like Shopify's is broadly applicable. In contrast, there is wide variance in service providers—a plumber, for example, is very different from a mental health therapist.

Largely for that reason, it is difficult to see how a single, broadly applicable platform '*à la Shopify*' could emerge. We find it more likely that there will be a winner in specific services segments, with the potential to expand its offerings in related segments over time.