ESCUELA TÉCNICA SUPERIOR DE INGENIERÍA (ICAI)

ALTERNATIVES & IMPLEMENTATION OF DTC STRATEGIES FOR CPG MANUFACTURERS

Autor: Albert Macarrón Fabregat
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Madrid
Agosto 2018

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Madrid
Agosto 2018

ALTERNATIVAS E IMPLEMENTACIÓN DE ESTRATEGIAS DTC PARA PRODUCTORES DE CPG

Autor: Macarrón Fabregat, Albert.

Director: Gopal, Gurram.

Entidad Colaboradora: Illinois Institute of Technology.

RESUMEN DEL PROYECTO

Introducción

El mercado de bienes de consumo envasados (CPG por sus siglas en inglés) ha venido sufriendo un cambio drástico durante la era de la revolución de Internet. A medida que la tecnología avanza, los consumidores tienen mayor variedad a la hora de escoger a través de que canal prefieren comprar productos que anteriormente sólo se podían adquirir en establecimientos físicos. Los productores CPG pueden decidir no embarcarse en vender Directo al Consumidor (DTC por sus siglas en inglés) o enfrentar el cambio masivo que vender DTC requiere y aprovechar todos los beneficios que ello conlleva.

Planteamiento del problema

No obstante, cada compañía tiene sus características únicas y, sumando a las distintas variantes DTC (*click-and-collect*, entrega a domicilio, entrega en un día, …), hace que desarrollar una estrategia ganadora específica para ir DTC sea una difícil tarea que consume mucho tiempo. Adicionalmente, grandes *retailers* como Amazon o Mercadona se están convirtiendo en productores, añadiendo presión sobre los grandes gigantes CPG como Unilever o Johnson & Johnson. Los productores están viéndose forzados a buscar distintas

fuentes de ingresos si quieren sobrevivir a largo plazo. Las compañías CPG tienen que correr antes que aprender a andar y los productores "tradicionales" ven como pequeñas *startups* consiguen cuotas de mercado considerables. En conclusión, los productores CPG tienen que interiorizar cuál es su situación actual para ser capaces (y dispuestos) para embarcarse en un cambio de modelo de negocio arriesgado, y aquí es dónde entra este proyecto.

Estado de la técnica

El objetivo de este Proyecto es identificar las características más importantes que una compañía y/o producto tiene para así poder categorizarlo en grupos que deben seguir estrategias DTC específicas para triunfar. Una vez las compañías saben que quieren obtener de vender DTC y de cuales son sus necesidades, pueden evitar malgastar recursos en tareas, colaboraciones, recursos, … que no añaden valor y empezar a centrarse en conseguir un elevado retorno de la inversión. Los elementos que definen una estrategia DTC se han categorizado en 6 categorías con subdivisiones internas:

- *Marketing*: incluyendo marca y producto, valor, precio, implicación del cliente, gestión de los canales y promoción
- Ventas: incluyendo predicción de la demanda y modelo de venta
- *Supply-chain*: incluyendo producción, logística y posicionamiento del inventario
- IT: incluyendo factoría de *insights*, visibilidad extremo a extremo, ecosistema *IoT* y experiencia interactiva
- Atención al cliente
- Colaboración

Objeto del proyecto

Distinguiendo entre los distintos elementos DTC, algunos son considerados *inputs* específicos de cada compañía y otros, *outputs* determinados por una combinación de ciertos *inputs*. Además, algunos elementos son más relevantes que otros y tiene un impacto directo en los *outputs* más importantes. Los *inputs* más importantes son: rol DTC, presencia de la marca, tipo de compañía, tipo de producto, valor intrínseco del producto y consumidor objetivo. Por otro lado, los *outputs* más importantes son: modelo de venta, producción, logística y diferenciación del producto. Para relacionar *inputs* y *outputs* se han desarrollado un total de 2+4 matrices para poder decidir que tienen que perseguir las compañías (dadas sus características) en términos de modelo de venta, producción, logística y diferenciación del producto, los 4 *outputs* más importantes para convertirse en un *ganador* en el mercado *e-commerce*. En la Ilustración 1, las dos matrices superiores ayudan a determinar el tipo de emprendedor (arriba a la izquierda) y el tipo de consumidor (arriba a la derecha), mientras que las otras 4 matrices establecen para la compañía involucrada los *outputs* anteriormente mencionados.

Cada participante DTC tiene que estar preparado para adaptar su organización entera a las exigencias de los consumidores y ser capaz de anticipar cambios para poder aprovecharse de ello. Para ese fin, es necesario el desarrollo e implementación de herramientas analíticas avanzadas para que los productores puedan monitorizar los parámetros claves para conocer tanto que quieren sus clientes como si están en la senda correcta.

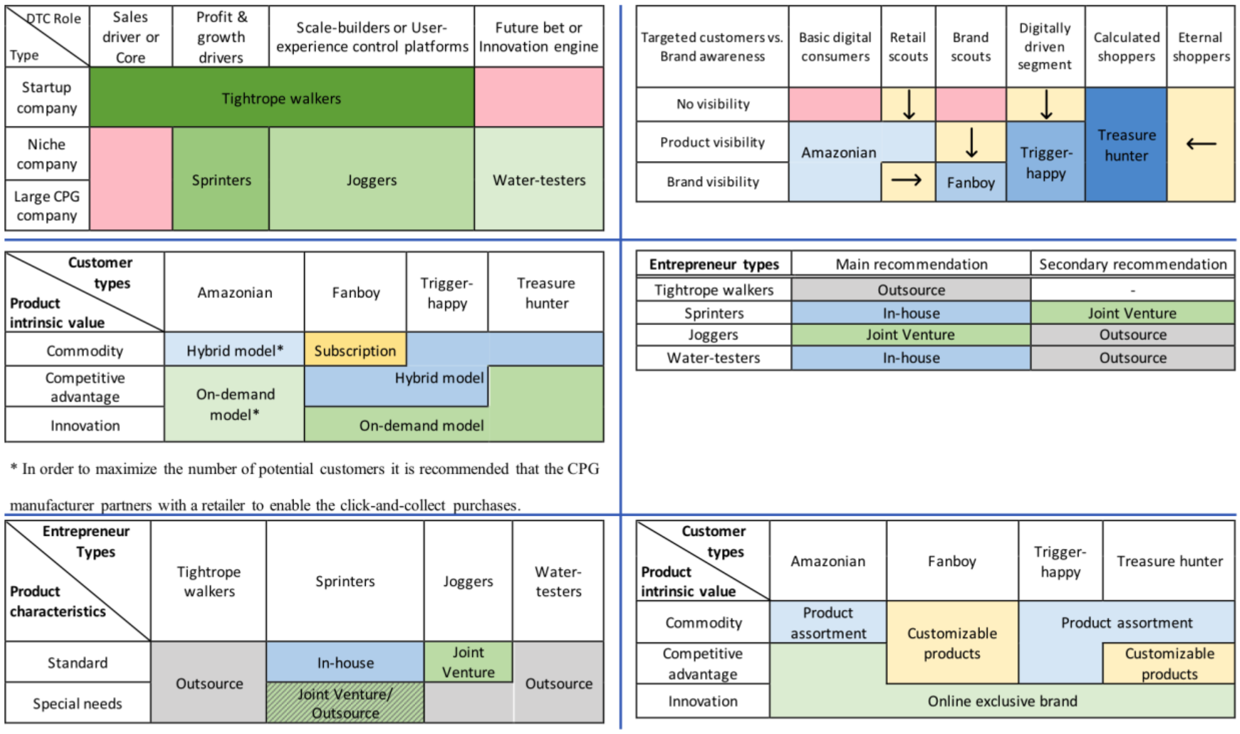

Ilustración 1: Matrices de estrategia DTC.

Para monitorizar correctamente el progreso de la implementación DTC, se han identificado parámetros clave para que los productores CPG puedan validar la efectividad de su estrategia. Tales parámetros son cruciales para poder conocer cuando desinvertir (o continuar invirtiendo) en una apuesta DTC.

En resumen, vender DTC proporciona una oportunidad interesante para incrementar la cuota de mercado y desafiar a los productores CPG tradicionales. Gracias a una relativamente baja inversión inicial y riesgo también bajo (a través de un modelo prueba y aprende los productores pueden evitar pérdidas significativas si la iniciativa no funciona) las empresas de bienes de consumo envasados, grandes y pequeñas, pueden dar rienda suelta a la creatividad y convertirse en líderes (online) de su categoría de la noche a la mañana.

ALTERNATIVES & IMPLEMENTATION OF DTC STRATEGIES FOR CPG MANUFACTURERS

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Collaborating Institution: Illinois Institute of Technology.

ABSTRACT

Introduction

The Consumer Packaged Goods (CPG) market has been suffering a drastic change during this era of the Internet revolution. As technology advances, consumers have an increasing number of options when it comes to purchasing packaged goods that were previously only available in traditional brick-and-mortar stores. CPG manufacturers can decide not to embark on Direct to Consumer (DTC) selling or face the massive change that going DTC requires and seize all the benefits that come along.

Problem statement

However, every company has its own unique characteristics and, in addition to several DTC variants (*click-and-collect*, doorstep delivery, *same-day* delivery, …), makes the elaboration of a specific DTC strategy to achieve success a time-consuming and difficult task. In addition to that, big retailers such as Amazon and Walmart are becoming manufacturers, putting even more pressure on "legacy" CPG manufacturers like Unilever or Johnson & Johnson. Producers are almost being forced to seek new income sources if they want to survive in the long-term run. CPG companies are expected to run before they have learned to walk, and big

manufacturers see how smaller startups grasp considerable amounts of the *e-commerce* market. To sum up, CPG manufacturers must acknowledge their current situation and be able and more importantly willing to embark in a risky venture, and here is where this project comes to place.

State of the art

The aim of this project is to identify the relevant characteristics that a company and/or product has so that it can be categorized into groups that should follow certain strategies to succeed when going DTC. Once companies know what they want out of DTC and what their needs are, they can avoid wasting resources in non-value adding tasks, partnerships, assets, etc., and start developing those capabilities that are going to provide a high return on investment. The elements that define a DTC strategy have been categorized in 6 groups with internal subcategories:

- Marketing: including brand & product, value, pricing, engagement, channel management, and promotion
- Sales: including demand forecasting and models
- Supply-chain: including manufacturing, logistics, and inventory positioning
- IT: including insights factory, end-to-end data visibility, IoT ecosystem, and interactive experience
- Customer service
- Partnership

Project purpose

Distinguishing between the DTC implementation elements, some are considered inputs of a specific company and some others, outputs determined by a combination of certain inputs. Moreover, some elements are more important than others and have a direct impact on the most relevant outputs. The most important inputs are: DTC role, brand awareness, company type, product type, product intrinsic value, and targeted customers. In the other hand, the most important outputs are: sales model, manufacturing, logistics and product differentiation. To link inputs and outputs, a total of 2+4 matrixes have been developed in order to decide what must companies pursue (given their characteristics) in terms of sales model, manufacturing, logistics, and product differentiation; the 4 most important outputs to be a *winner* in the *e-commerce* market. In Illustration 2, the two top matrixes help determine the entrepreneur type (top-left matrix) and customer type (top right), while the other four matrixes give the involved company the outputs mentioned above.

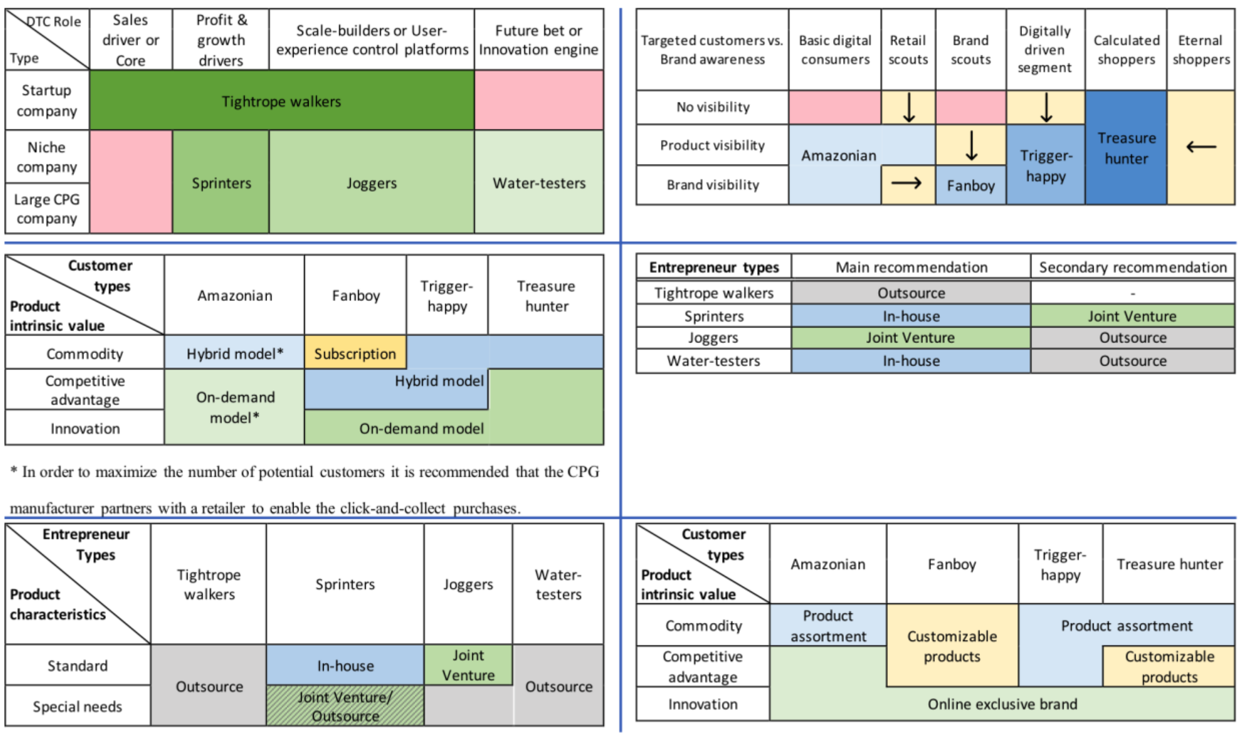

Illustration 2: DTC strategy matrixes.

Every DTC player must be ready to adapt their entire organization to consumers' demands and capable to anticipate to changes and take advantage of it. For that purpose, advanced analytic tools must be developed and implemented so that manufacturers can track key parameters to know both what their customers demand and if they are staying in the correct path.

In order to track the adequate progress of each DTC effort, key drivers have been identified so that each CPG manufacturer can validate the efficiency of its strategy. Such drivers are crucial in order to know when to divest (or continue investing) in a DTC effort.

Overall, DTC commerce provides an interesting opportunity to increment market share and to challenge old consumer goods players. Due to relatively low initial investment and risk (through a test and learn enterprise manufacturers can avoid huge losses if the initiative does not succeed) CPG players, big or small, can become creative and become leaders in their (online) category overnight.

Acknowledgements

This work has been possible thanks to the financial and moral support of my parents, Enrique Macarrón and Ángela Fabregat. I am truly grateful for the opportunity they have granted me throughout all my studies, without them I would have not become the person that I am today, and I would not have reached this far.

I would like to thank Dr. Gurram Gopal, who has guided me since we first met. His help, reflected in this project, has not limited to my academic life. I would also like to thank him for helping me decide how I want to focus my career.

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1 Introduction

Nowadays the world is immersed into automation and data exchange due to the vast penetration of the internet. This current trend, also known as Industry 4.0, and the increasing number of internet-connected devices has changed drastically consumer habits.

The previous generation of commerce is getting obsolete and a bunch of old and new brands are trying to bypass traditional retail channels by selling online, directly to their customers (DTC). Winning in the *digital battleground* has become exponentially more difficult but the huge success of online giants (mainly *Amazon*) has forced traditional consumer packaged goods (CPG) companies to act if they still want their piece of a billion-dollar cake.

Retailers like *Nike* have seized this opportunity (From 2016 to 2020 the multinational plans to grow DTC sales by a factor of seven – from the current billion-dollar level to over $7 billion (Leonard, n.d.)), proving to huge players such as Unilever or Procter & Gamble that succeeding is possible and profitable.

During this project we are going to analyze why and if CPG manufacturers should start selling DTC (some benefits of going direct to consumer may not be obvious), which factors distinguish "winners" from the rest of companies and what strategies can companies implement depending their goal.

2 Distribution and Sales Channels

2.1 Introduction

Before the introduction of online buying, customers went to a physical retailer to purchase any item. For consumer packaged goods one had to go to stores such as *Walmart* (the world largest retailer) or *Costco* for example (that forced CPG manufacturers to sell their products to retailers through wholesale channel, lacking bargaining power or insight of their own products).

However, with e-commerce introduction, manufacturers no longer have to rely exclusively on brick-and-mortar retail stores and conventional wholesale channels (Figure 1). CPG brands can decide whether to sell only in physical stores, direct to consumer or to combine both methods.

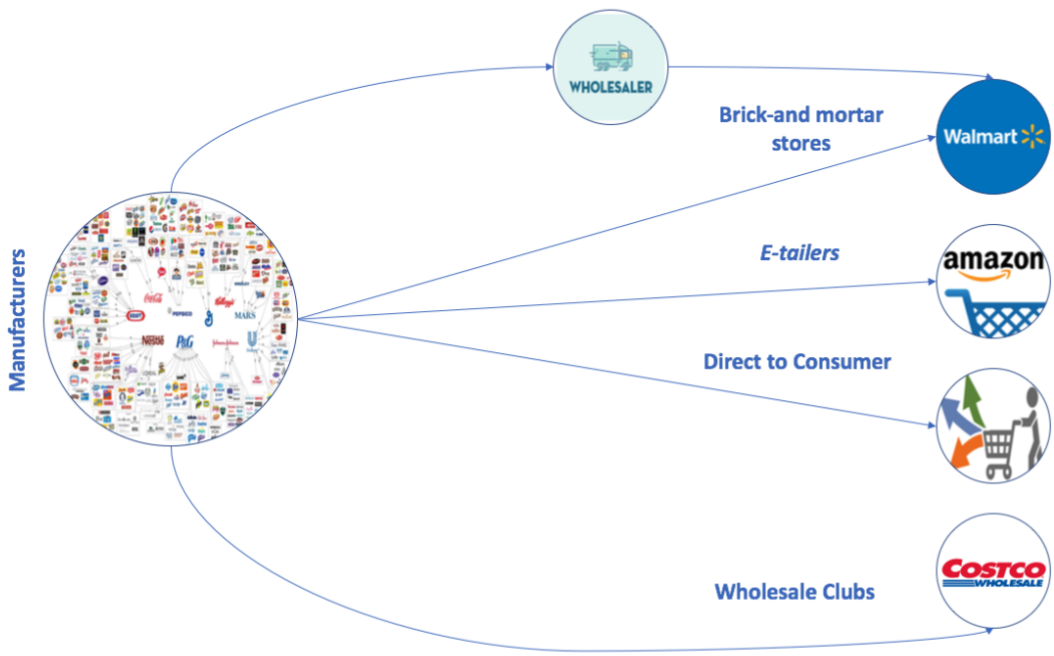


Figure 1: Distribution channels.

2.2 Wholesale channel

Traditionally, the main way customers bought products was through a retailer. Before that could happen, a manufacturer had to supply its products to the retailer or to a middleman. In that era of mass production and marketing, the distribution and sales channels were the ones shown in Figure 2.

As the internet era began, large retailers like *Walmart* or *Target* were forced to adapt and develop online stores to battle against digital retailers like *Amazon*. However, large CPG manufacturers didn't have to face such big shift since they represented almost the entire market.

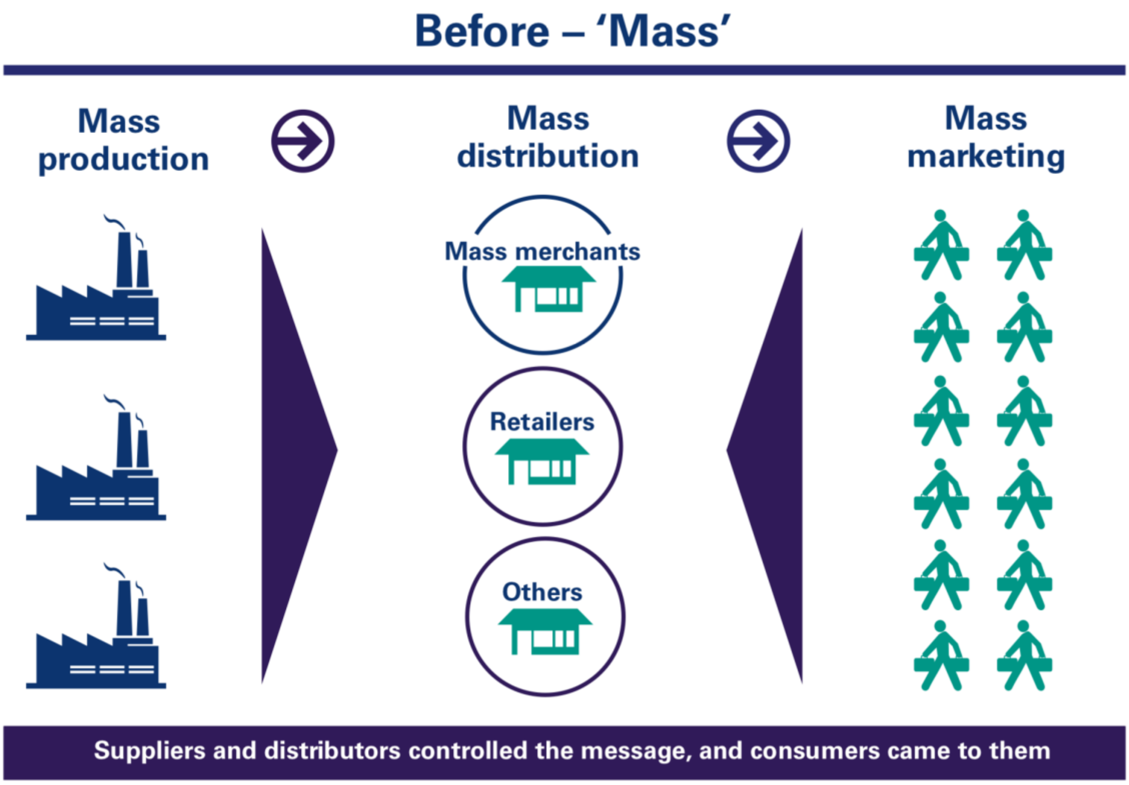


Figure 2: Traditional demand and supply chain. (Hamory, Rankin, Drummond, & Upreti, n.d.).

2.3 **Direct to consumer channel**

The entry of new CPG players like *Harry's*, *Dollar Shave Club* or *The Honest Company* (Jessica Alba's nontoxic-household-products company) has started to challenge the oligopoly of "Legacy" CPG manufacturers.

These new players differ from traditional manufacturers because they are capable of developing the value chain and creating high-power brands with less time and money than established marketers by focusing intensely on specific categories. The cost of materializing a new idea, to launch a start-up, has dropped from $5 million in 2000 to less than $5,000 in the past decade according to CBInsights data (November 18, 2015).

The most interesting part is that the new entrants accomplish that by selling their products direct to consumer only and using, in the majority of cases, *e-commerce* only. Even though brick-and-mortar DTC stores not only exist but are also successful (Apple stores or Nike stores are clear examples), CPG stores mostly are for testimonial purposes.

As new players continue to cut and threaten CPG giants' income, these giants will engage new moves and strategies in order to protect their position. A clear example of such strategies is the $1 billion acquisition of *Dollar Shave Club* by Unilever. In the future we can expect an increasing number of going DTC attempts by legacy and new CPG players. And with every player trying to succeed over the others, the world is going to see different strategies, some of which may be more effective.

2.4 **Omnichannel**

But why do manufacturers have to decide between DTC channel or the traditional wholesale channel? If manufacturers want to have the power and capabilities to drive the entire path to purchase, they need to build both strong digital capabilities and enhance collaborative relationship with online and physical retailers. Pursuing all the possible channels that will eventually lead to a customer, manufacturers commit to an omnichannel strategy.

Focusing on both channels allows to pursue the growth *e-commerce* presents and, in the same time, foster relationships with the main income source for top CPG manufacturers, retail stores purchases.

Additionally, an omnichannel approach offers synergies and access to potential clients married to one retailer only. *Amazon* for example has over 132 million active customers (Veldhoen et al., n.d.) and manufacturers could use *e-tailers* to lift brand sales and ROI.

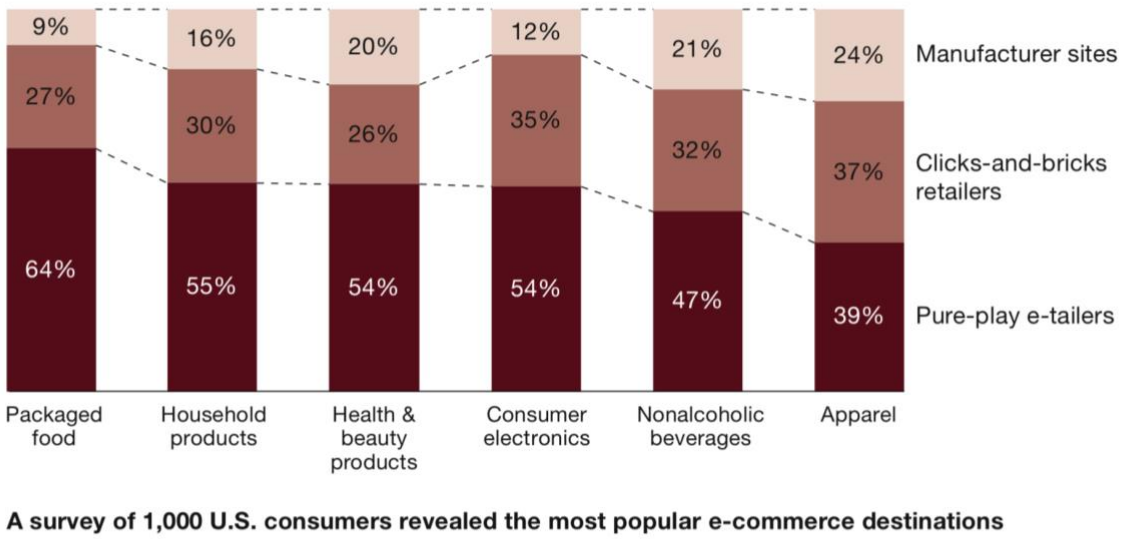


Figure 3: Consumers' online shopping behavior. (Veldhoen et al., n.d.).

Consumers prefer to buy in places with the widest selection (Figure 3) and not placing products inside retailer stores (physical or online) is the same as not being invited to the party at all.

3 Selling Direct to Consumer

3.1 Why do brands hesitate to shift to DTC?

Although going DTC benefits seem to outscore its drawbacks; companies, primarily large consumer goods producers, are still reluctant to take that leap. In the Food and beverage category, Top 26 companies only accounted for a mere 3% of growth even though their market share was 45% of the total (Figure 4).

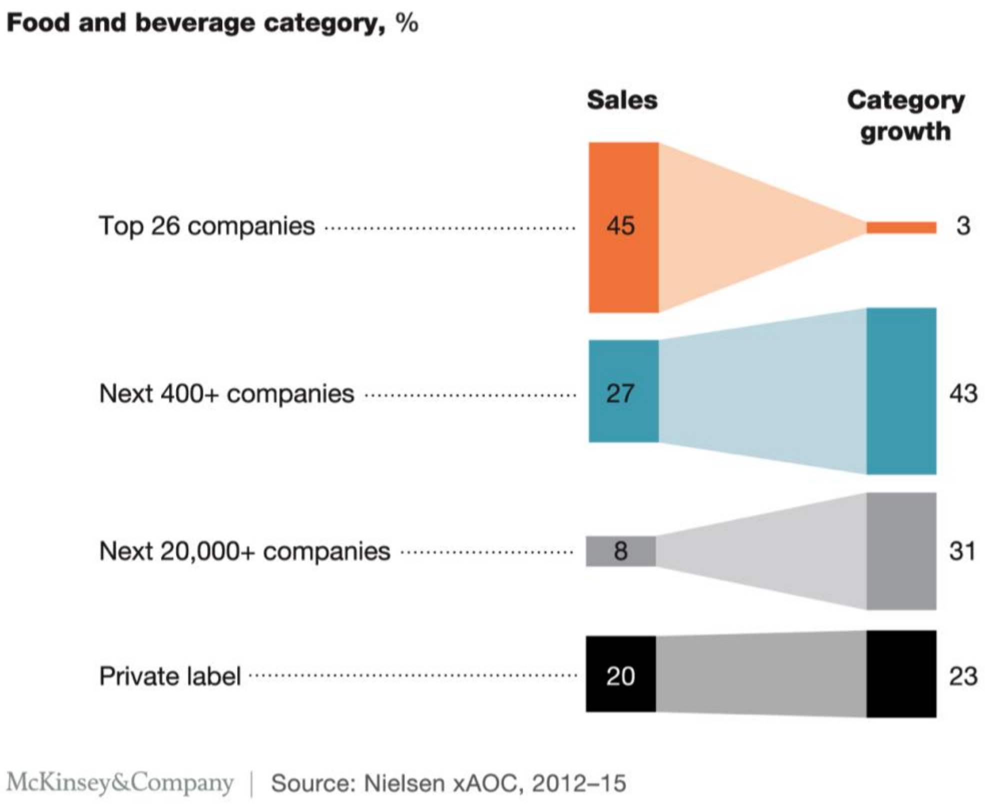


Figure 4: Food & Beverage manufacturers % of sales and category growth (Alldredge, Brown, & Magni, n.d.).

The main CPG companies, giants such as *Mondelez*, *Unilever or Kraft-Heinz*, see a risk in adopting an aggressive DTC marketing campaign. E-commerce market is still relatively small and damaging retailer-supplier relationships can threaten to reduce the primary income source. Companies are also worried about shelf-space domination in brick-and-mortar stores when they have been investing billions of dollars to gain and retain the most profitable in-store spots.

Moreover, what if an online retailer like *Amazon* ends up having the same or even more control than a traditional retailer? Even though online retailers promise CPG Brands to give them a direct customer-brand relationship, manufacturers are still reluctant to make that move, involving technical challenges such as rethinking package design to favor shipping instead of producing old bulk sizes which favored discount prices.

3.1.1 Cannibalization

Cannibalization is another major issue that CPG companies consider before going DTC. It is very dangerous to focus on *e-commerce* only and to overlook where does the new income come from. Companies have to focus on incremental revenues rather than on DTC revenues only because instead of attracting new customers, their previous customers might be shifting from brick-and-mortar stores to online shopping.

Going DTC requires a massive shift and a huge investment in order to be ready to fulfill customer desirers. In a world with *free two-day shipping* (thanks *Amazon*), being able to move tons of inventory from one part of the country to another from scratch is not only challenging but also costly.

3.1.2 DTC margins

Additionally, DTC margins are lower than wholesales, diminishing the interest a "legacy" manufacturer may have in going DTC. *E-commerce* is more of a long-term play and large Consumer Goods companies hesitate to shift focus from their *cash cows* to promising opportunities.

3.2 Benefits of selling DTC

3.2.1 Give customers what they want

It is a common business nature that the customer is always right. Nowadays, according to The Digital Consumer Preferences Survey from *BrandShop* ("Brands need a DTC strategy | WARC," n.d.), 90% of consumers visit a brand's website to shop. Consumers seek easier ways to purchase, and if for example they want goods delivered monthly to their homes, manufacturers should be ready to fulfill their needs.

3.2.2 Deeper insights

Additionally, having a company's own website allows it to have a better understanding of consumer behaviors and preferences. Also, it opens a mailing list goldmine that provides the means for customer engagement. DTC forces companies to handle every step of a transaction thus owning the complete customer experience and allowing it to collect unbiased insights.

Going DTC, also diversifies the income sources, broadening the base and avoiding relying exclusively on retailers. Moreover, it allows brands to retain control of brand image. For example, even though *Amazon* is not a traditional retailer, some brands have had complaints due to copies of their own products being sold on Amazon. *Birckenstock*, a footwear maker, stopped selling in 2016 its products there because the presence of fakes on *Amazon* contributed badly to its image.

As contradictory at it may seem due to a reduction of product placing fees, retail partners also want that CPG companies go direct to consumer. Fast delivery is a feature that consumers are increasingly demanding, and retailers could benefit from working with manufacturers to drop-ship online orders.

Finally, companies should always try to force the competition out of its comfort zone. Competitors can rise quickly and being two steps ahead of them is an excellent way of getting protected against any rival move.

4 Elements of DTC: Implementation

Half of all growth in the consumer packaged goods industry is taking place online and opportunities in e-commerce are rising. The number of US consumers purchasing online is expected to double within a year, and already 25% of US households buy CPG online. But how do companies act to be able to seize market share in a winner-take-all world?

According to a 2013 *Deloitte* survey (Conroy, Nanda, & Narula, n.d.), although 92% of CPG executives agreed with the idea that e-commerce is a strategic channel for their companies, only 43% thought that their companies were well prepared for a digital strategy implementation.

Moreover, a 2017 *Boston Consulting Group* report (von Koeller, Dawe, & Pittman, n.d.) showed that only 34% of the most important CPG companies are extra prepared for DTC (Figure 5).

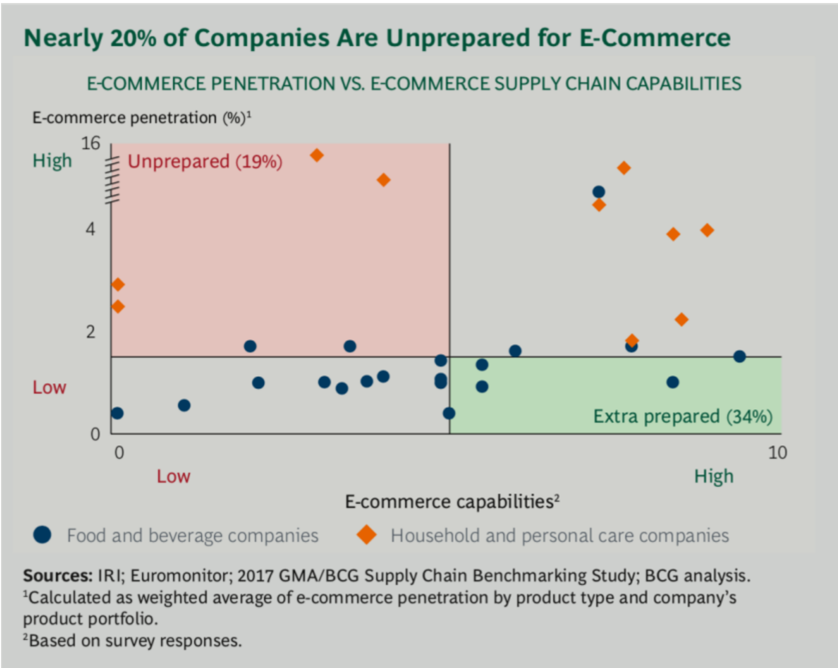


Figure 5: CPG e-commerce capabilities vs. penetration (Hadlock et al., n.d.).

In this section the key elements of a DTC implementation are going to be discussed. Each CPG company is unique and the consumer packaged goods industry provides a huge variety of different products ranging from household cleaning supplies to food and beverages. Every product has its own unique set of characteristics and there isn't still a universal strategy for going DTC that works with every product and company that manufactures it.

Nevertheless, if companies understand each element of a DTC implementation and how it connects to the others, they will be able to tailor-make a strategy and manage efficiently the demanding requirements imposed by consumers and retailers, and also the trade-offs imposed by the available technology.

4.1 Marketing

4.1.1 Brand & Product

CPG companies have to think carefully whether to introduce an already existing brand to the DTC universe or to distinguish branding between online-only and brick-and-mortar products once they have decided to sell directly to the consumer. Moreover, as DTC consolidates, brand loyalty decreases, emphasizing the importance of securing a strong brand image and position. Consumers can now search and learn about as many brands as they wish, so brands should focus on differentiating from the crowd by providing personalized engagement practices.

Customers' expectations when purchasing from the manufacturer's own website are higher than when consumers buy from retailers' websites with a variety of brands. Since the brand's website only offers its own products, consumers expect to find every product, cheaper, and every variant of it (color, size and style) and, more important, accurate and comprehensive information regarding the product (Figure 6). Content management such as imagery and product information while providing an excellent service level is a key factor for consumers' evaluation.

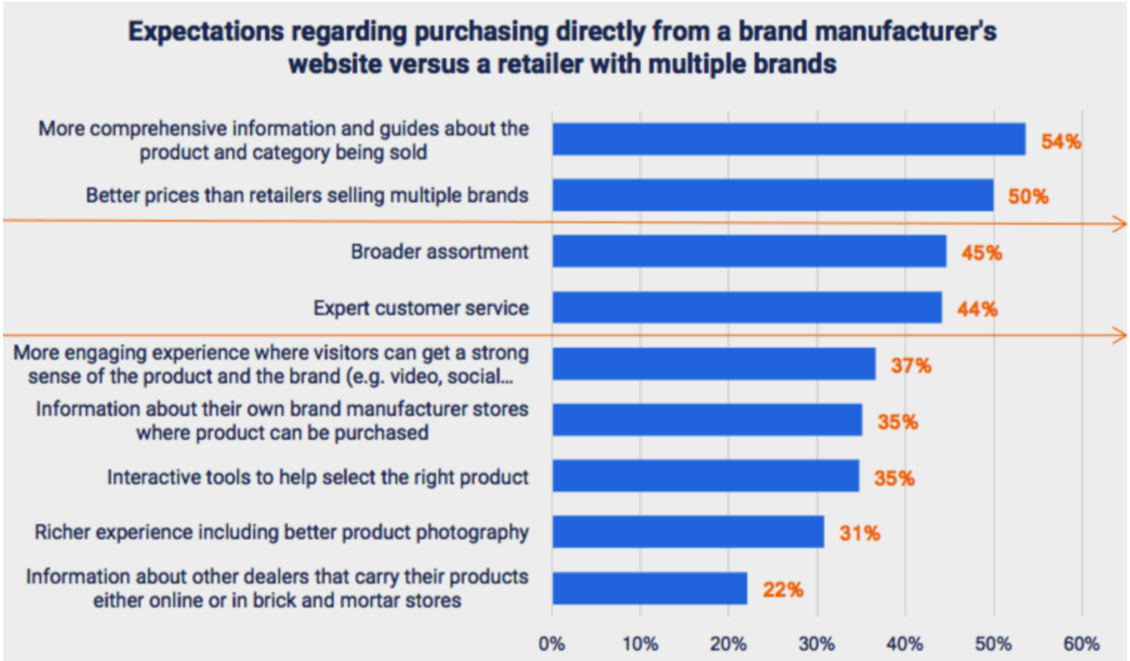


Figure 6: Consumers' expectations when purchasing from a brand manufacturer's website. (Sterling, 2017).

But how exactly should manufacturers build their brand image in the DTC space? Do they extend existing brands, or do they create new ones? Unless the existing brand addresses a highly defined pain point, most manufacturers decide to **create a new brand**. In the majority of cases, channel partners perceive conflicting objectives and, moreover, potential consumers are not convinced of the value of the existing brand now being available online. For example, even CPGs giants such as Unilever, when they acquired Dollar Shave Club, they recognized the need for distinct branding and maintained the *e-commerce* brand even though Axe is a well-known razors brand. Unilever decided that Dollar Shave Club and Axe shaving products should coexist in the online marketplace since the acquired brand had a huge and loyal customer base.

Once a manufacturer has acknowledged that there is a need for building a new brand, it has to decide how the company wants its product to be perceived. Should it create a product price based, convenience based, or even category focused brand?

Manufacturers must evaluate who their consumers are, and which category do they fall into. Some consumers prefer to pay less for the same product they can buy in brick-and-mortar stores while others may prefer to pay a premium because they may not have enough time or access to buy at traditional stores. If traditionally a brand is perceived as a premium or well-established brand a convenience or category focused product makes more sense. In the other hand, the disruptive power of *e-commerce* presents an advantage for small companies when it comes to price-based products. For such companies, sacrificing absolute-dollar margins can lead to a total volume sales increase. And while a 5% price reduction has a huge impact on CPG giants due to its high volume, for new players the sales boost makes up for lower profit margins.

4.1.2 Value

This category is crucial if CPG companies want their DTC strategy to succeed. Companies need to sell their product, fighting against traditional channels while also facing a harsh competition in the online world. In short, manufacturers need to offer a product with a clear consumer benefit, a product that provides a certain value.

As discussed in Brand & Product sections, there are different successful DTC value propositions that can create an attractive consumer offering. In this section we are going to delve into these winning value propositions.

First of all, *e-commerce* enablers are improving while obstacles are decreasing. A combination of these factors will result in a product with consumer value. Figure 7 and Figure

8 include the most important enablers and obstacles that manufacturers must consider before creating a new product.

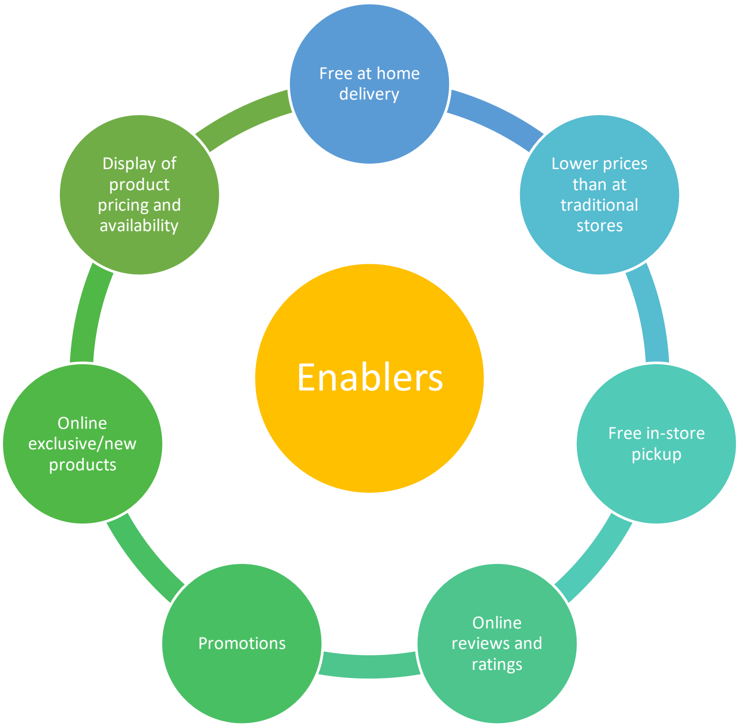


Figure 7: Most important E-commerce enablers.

Figure 8: Most important E-commerce obstacles.

Not every product can add value in the same way and there is more than one combination of the propositions that manufacturers can pursue to persuade consumers into buying their product online. If we consider both consumers' enablers and obstacles we can bring to the forefront several value-adding propositions (Figure 9):

Figure 9: Value-adding propositions.

- Offer a money-saving solution: Consumers seek prices that are not higher than retail prices. Consumers want more affordable prices for quality products.
- Offer a time-saving solution: Some consumers do not care about paying a premium for a product (because they don't have nor the time or access to conventional retail stores) if the way they buy it makes life more convenient for them.
- Present a unique product, not available before: Companies such as Harry's or The Honest Co. have changed the game in previously existing categories. Creating a product that wasn't available before doesn't mean that a new category has been invented but that new characteristics or technology has been added.
- Create an enjoyable and surprising experience: The company may want to provide, on a recurring basis, a positive experience so that its customers can get to know the company's products and help develop a strong brand image.

- Offer customized products: Every customer has different preferences for a certain product. However, a brick-and-mortar store cannot store every combination of flavor, size, color or formulation, for example. Manufacturers can satisfy these preferences with DTC sites and charge a premium because customers might be willing to pay more for a product that they like but is no longer available in a retailer's shelf.

4.1.3 Pricing

E-commerce has had a huge impact on pricing. Since consumers now have plenty of options regarding where to buy and enough price-comparing tools, pricing power is now shifting towards the consumer.

Companies that develop a DTC strategy must be familiar and capable of dealing with dynamic pricing (Figure 10). **Dynamic pricing** has introduced high volatility to the marketplace, squeezing margins for DTC players. Dynamic pricing offers many advantages because, thanks to database mining, sellers can measure customers' desires. For example, the price of a four-pack breakfast cereal on Amazon, increased threefold (from $6.68 to $20.14) in a single week (Hadlock et al., n.d.). Additionally, manufacturers need to enforce MAP agreements. Minimum Advertised Price (MAP) is the minimum price that resellers are allowed to sell a product for. Below that price, companies could suffer from bad brand perception and channel or partnership conflicts.

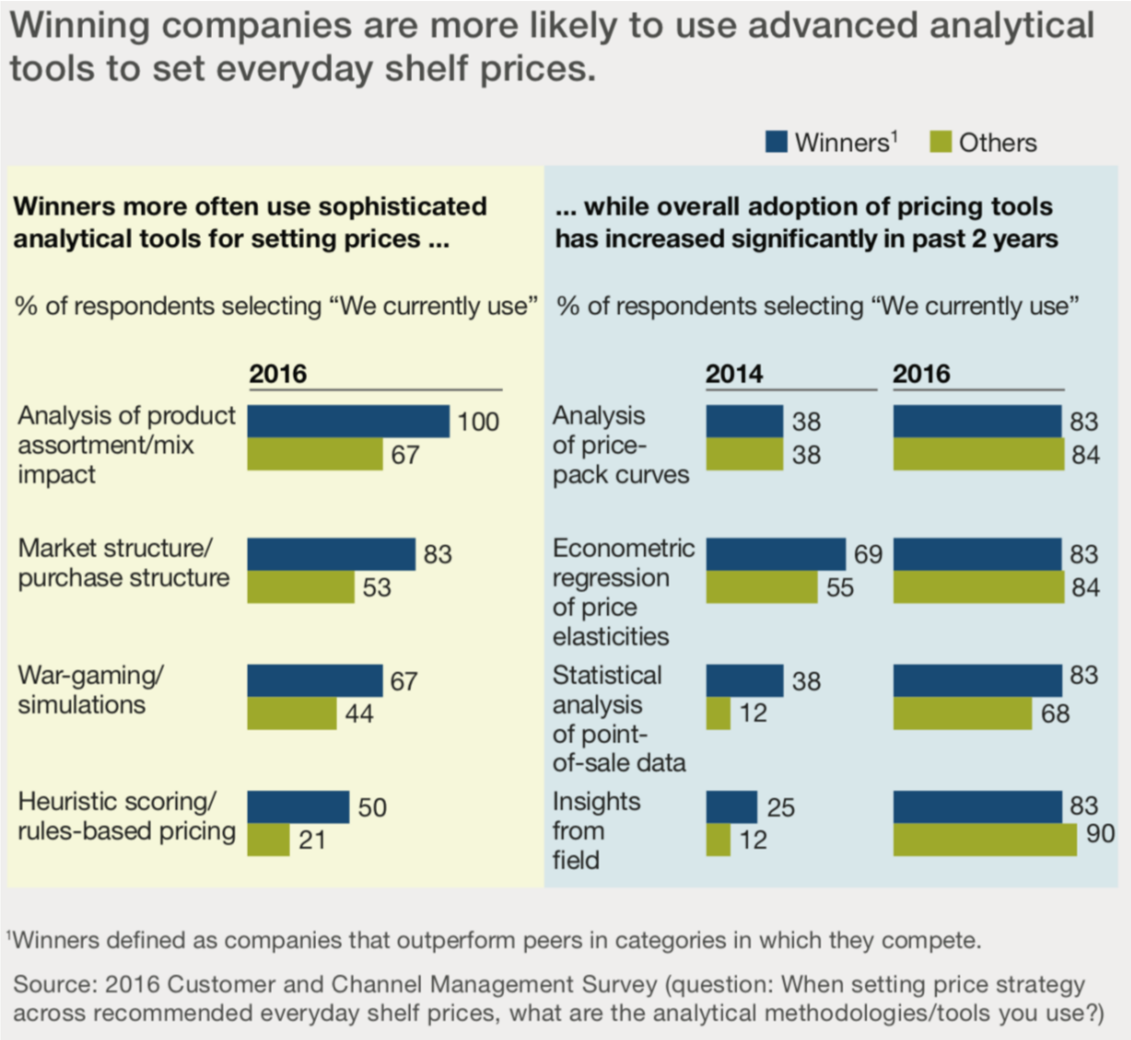


Figure 10: Tools used by leading DTC companies (Alldredge, Henry, Lowrie, & Rocha, n.d.).

4.1.4 Engagement

Once a CPG manufacturer has thought of a product/s to sell DTC, there are two questions that need to be answered. Which customers should it target? How does the company engage and maintain those customers? Manufacturers are well aware that not all customers are the same. Going DTC is a tough movement for every company, and wasting resources trying to engage with every possible customer is the same as boycotting your own venture.

The 80/20 axiom of business management (Marshall, 2013) tells us that 80% of sales come from 20% of clients. Companies must ignore customers that are costing money to them and rather focus on that 20% of gold-mine customers. Which tools can be and are used to find them is going to be discussed later on (IT).

Given that *E-commerce* is in an early stage (but growing rapidly), there are still plenty of customers who are not attached to the physical purchasing experience. Such customers can be persuaded into buying DTC products if they are approached properly. Table 1 helps explain which customers a company should invest money in to try to capture.

Table 1: Customer Relationship Groups. (Armstrong & Kotler, n.d.).

Potential profitability		Short-term customers	Long-term customers
	High profitability	Butterflies: Good fit between company's offerings and customer's needs; high profit potential	True Friends: Good fit between company's offerings and customer's needs; highest profit potential
	Low Profitability	Strangers: Little fit between company's offerings and customer's needs; lowest profit potential	Barnacles: Limited fit between company's offerings and customer's needs; low profit potential
		Projected Loyalty	

- **True Friends (Invest)**: The firm wants to make continuous relationship investments to delight these good customers and turn them into "true believers", loyal customers who will tell others about their good experiences.
- **Barnacles (Divest)**: If they cannot be made profitable, they should be "fired". An example is smaller bank customers who bank regularly but do not generate enough returns to cover the costs of maintaining their accounts.

In line with the 80/20 rule, CPG firms mustn't overlook the oldest or youngest generations as they could be ignoring a potential income source. Different generations, even though they share some drivers for online purchasing (online lower prices or free delivery) usually need different engagement strategies.

		21–29 years old	30–44 years old	44–59 years old	60–70 years old
Common cross-generation online purchase decision influencers (% important or very important)	Free at-home delivery	81%	85%	82%	87%
	Pricing same or less than stores	78%	82%	78%	81%
	E-mailed coupons	71%	68%	64%	59%
Generation-specific online purchase decision influencers (% important or very important)	Unique package sizes	26%	21%	15%	14%
	New online-only products	35%	26%	25%	18%
	Social media promotion	38%	30%	24%	13%
	Mobile shopping app available	45%	36%	22%	15%
	Promotions on mobile device	46%	35%	24%	17%
Percentage of consumer's food, beverage, personal care, and household consumable purchases that are made online	Today	9%	9%	8%	7%
	In the next year	16%	15%	13%	11%
	In three years	23%	24%	20%	16%
	Implied 1-year growth	*69%*	*73%*	*65%*	*61%*
	Implied 3-year growth	*150%*	*178%*	*152%*	*143%*
Compared to this time last year, how consumers characterize the shift in their online purchases	Completely new sales	8%	7%	12%	13%
	Primarily new sales	16%	16%	23%	26%
	A balance	57%	57%	54%	51%
	Primarily a shift from other channels like grocery and mass merchandisers	15%	14%	8%	7%
	Completely a shift from other channels like grocery and mass merchandisers	5%	6%	3%	2%

Lowest across generations | Highest across generations

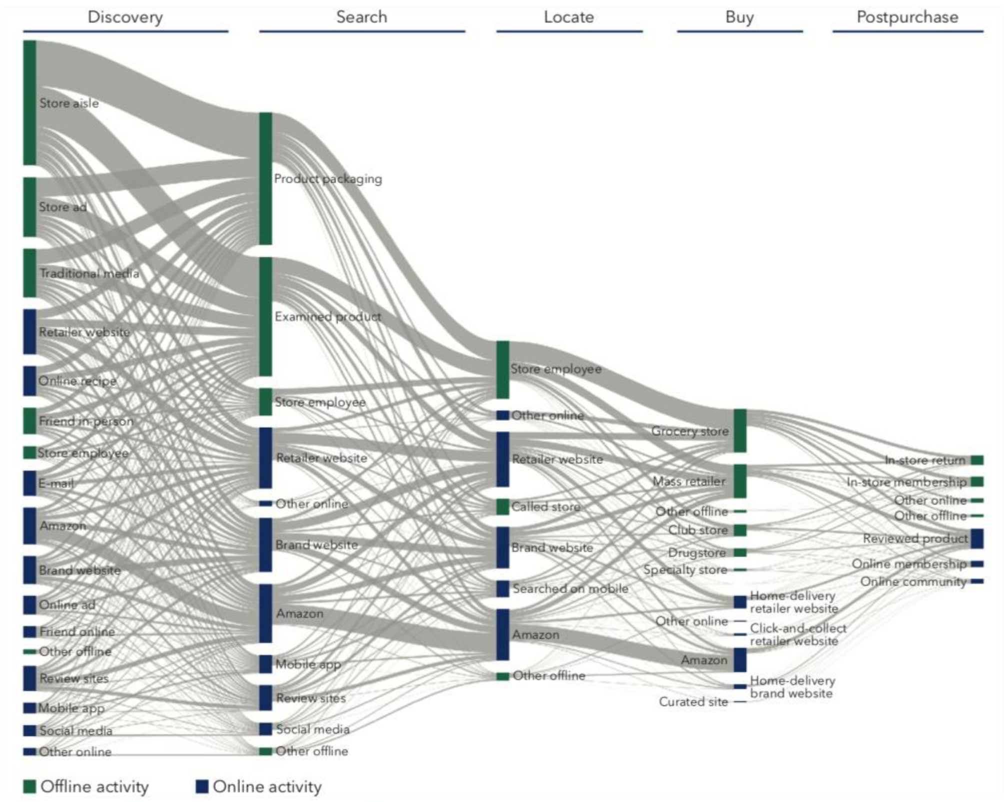
Figure 11: Capturing growth from four distinct generations of e-consumers (Conroy et al., n.d.).

Younger generations tend to be more attracted to unique package sizes, online only products, mobile apps, and promotions through those devices or social media. On the other hand, older generations usually buy DTC products they weren't buying before, searching for new sales. Figure 11 shows how effective different strategies are in capturing growth for different generations.

Now that it has been established which customers are worth engaging (both relationship and age groups), the what actions a firm can implement to gain and maintain purchasers should be analyzed. The purchasing path is fragmenting (Figure 12), consumers can switch back and forth between a lot of options, including physical shopping, and new competition is arising. Thus, CPG companies should act fast if they want their piece of the cake.

Every firm must have its **own website** even if it does not actually sell its products there. Brand awareness is difficult to control in the online world and using a company's website is the first place when engaging with consumers. A buy or add to cart option is a must, it is less important if that button connects, for example, to Amazon or Walmart.

Manufacturers also need to shift their investments towards digital media. Companies such as L'Oréal, which has created the online cosmetic brand *EM*, have proved that allocating resources to digital channels augments also impacts all channels. Online and mobile media have to be used not only to close sales but to build the brand and, during prepurchase phases, engage consumers to build advocacy for the postpurchase phase.



Source: GMA/IRI online grocery survey, April 2014.
Note: Respondents were asked to select the activities they engaged in when making their last purchase (N=6,895). The exhibit shows the movement from one stage to the next based on selected responses.

Figure 12: Consumers' purchasing pathway (Hadlock et al., n.d.).

Another action that manufacturers need to take is to simplify ordering, and to provide convenience to the customer. Through enjoyable experiences, apps or webpages that offer advanced search options and easy checkout, consumers are keener to buy and stick with the brand in the future.

Other engaging methods are **loyalty card programs** and **coupons**. By creating a loyalty program member or if a returning customer can get 10% or 20% off his next purchase or an extra 15% if he refers to a friend, companies can enable those customers to fall into the top 20% of buyers.

Moreover, being a consumer-oriented action, preparing a firm's capabilities to back up **customizable products** is an effective way to engage and maintain a customer. People love to feel that a brand cares about them and offering the option of creating a tailor-made offer generates loyalty and advocacy.

Subscription however, may be the most famous engagement method companies use to maintain consumers. Such method offers convenience to the buyer and it's a key in developing customer relationships. Once someone becomes a subscriber, he establishes a relationship and the business can build on and receive scheduled and secure revenues. Fee for membership also builds stickiness to the company.

For companies that typically sell DTC exclusively (or online only), Harry's is setting the bar for of moving from digital to *phygital* (both brick-and-mortar and online presence). The razor blades firm has partnered with Target since August 2016 once they analyzed that 75% of their customers shopped at Target and were telling them they wouldn't mind being able to pick up their razors while they were there – according to words of co-founder Jeff Raider. The agreement indeed worked, helping Harry's grab 50% share of Target's razor handle sales in the first four weeks after rollout and a 10% share of blades within weeks.

Finally, the **Internet of Things** is another engagement method that is becoming increasingly popular. Devices such as Amazon echo or Google home allow and often force the client to buy almost exclusively from the options these smart devices suggest. Additionally, partnering with hardware manufacturers such as electrical household appliances can become a new income source. Imagine for example that once a consumer runs out of detergent, your own washing machine orders a certain brand automatically.

4.1.5 Channel Management & Conflict

Going DTC is a herculean enterprise. Most likely every manufacturer is going to have to partner with different companies (retailers, distributors, …) to achieve a sustainable business. Moreover, the majority of CPG firms rely on traditional brick-and-mortar stores as their primarily income source. Amazon isn't helping either: success in the online world almost obliges a firm to be present in its marketplace, willingly or not.

With so many relationships, the interests of the different players will probably collide. For their own sake, manufacturers need to come up with various solutions which satisfy every player without taking their eye off the consumer.

First of all, every manufacturer must ask the following questions regarding their DTC strategy: What **role** will the direct to consumer channel play? What goals does the company want to achieve by going DTC? For some companies such as the Dollar Shave Club the DTC website is working as a sales driver and, in the other hand, P&G launched a test website to find out which preferred scents, sizes and cleaning boosts their Tide customers wanted. Figure 13 shows various roles and what capabilities companies need for each role. As companies approach the sales side, channel conflict increases. Which role each company should approach for every brand is going to be discussed in depth later on (Implementation

Methodology) when all the inputs a company manage are considered. However, even though conflict seems unavoidable, there are some actions that manufacturers can take.

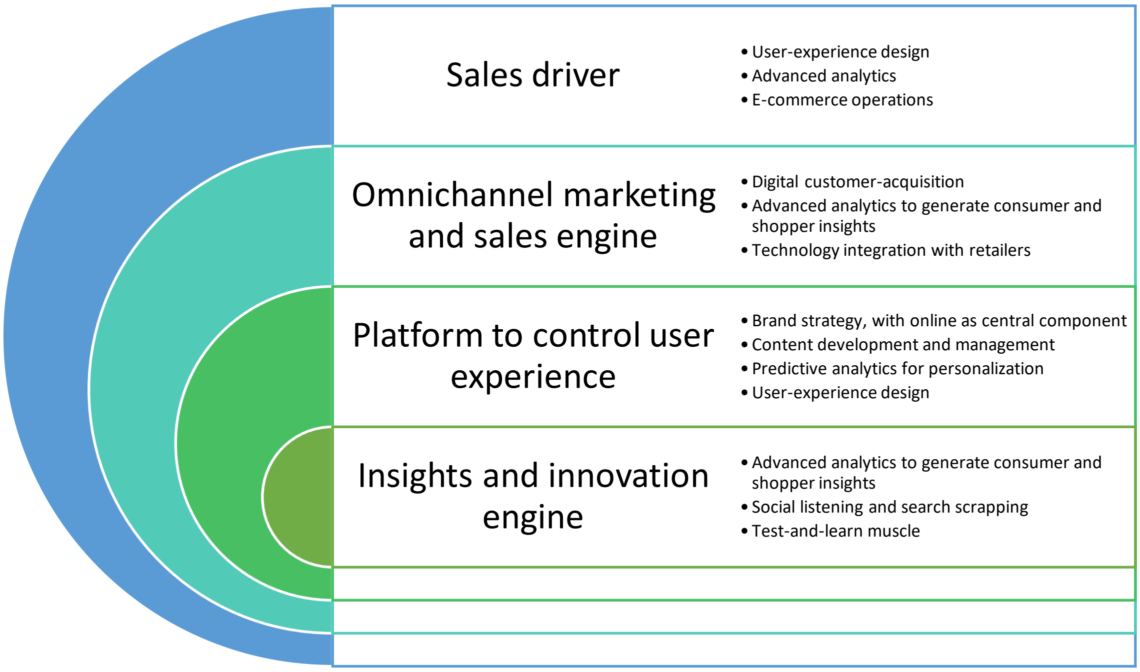


Figure 13: Different website roles for CPG brands.

- Develop an **exclusive online brand**. A good way to avoid conflict with retailers is to sell online a whole different brand so that if consumers identify with a certain brand sold traditionally in brick-and-mortar stores, buying a different product won't conflict with retailers.
- Create demand for a brand through **exclusive products**. Unique or customized products generate buzz and demand without underselling retailers or competing against them directly.
- Create a **tiered distribution system**. Offer retailers exclusive items only if they purchase bulk quantities of the company's general items and force them to adhere to MAP agreements.
- **Differentiate pack sizes**. Making price comparisons more difficult through different channels is going to minimize conflict.

- **Differentiate the product assortment across channels**. Imagine if Oral-b sold its electric toothbrushes in brick-and-mortar stores but used its website to sell replacements and/or toothpaste and similar mouthcare items.

4.1.6 Promotion

Manufacturers are realizing that top selling positions are very difficult to overthrow. High rankings lead to more high rankings thus giving early movers a considerable advantage. CPG firms face the paradigm change where consumer interest is the driver for virtual shelf position, rather than trade spending.

Think about the following questions: How many times has a consumer reached the second page on Amazon while deciding which product he wanted to purchase? How many times has he, even for mere curiosity, visited a CPG owned website for a purchase? Manufacturers face the challenging question of how and where they should spend their money to promote its products and how do they generate enough buzz to persuade and lead consumers to their products or website? Listed below are several options that manufacturers can implement, and every firm will have to study which mix produces the maximum ROI.

- Consumers love getting anything free. And even though it may seem a bad economic decision, it can spread the word about a new company or product or even convince that undecided potential consumer. Free trials, discount deals or free shipping for first-time purchasers are some of the tradeoffs companies can do to capture new and loyal customers.
- Digital Marketing and social media. Platforms have become the default entry point for some consumer experiences. Facebook, Instagram or Google advertising is a must if companies want to promote a new product or brand. However, when investing in

digital marketing, companies need to acknowledge that it may be necessary to invest over a sustained period of time, fact that additionally allows to recollect consumer data and to fine tune targeting.

- Although virtual shelf space is unlimited, reports tell that consumers mostly buy from the first products listed and almost always from the first search page. Now, third-party sites like Walmart.com or Amazon are starting to allow advertising to promote a firm's product, just as if they were promoting the product in a conventional store.
- One of the biggest challenges of selling DTC is the inability to physically touch, see and experience the product. Pop-up stores not only help generating buzz but also complete the customer experience by adding the physical testing dimension.

Figure 14: Amazon pop up store.

- Mondelez International's gifts.oreo.com, a seasonal website that allowed consumers to order holiday gift tin boxes of White Fudge Covered Oreos, helped the company to generate buzz about the brand and to also test a 100% self-managed DTC supply chain. Consumers are interested in buying unique products and limited time websites, products, seasonal promotions are a way to do so.

- Target the indifferent brick-and-mortar shopper with convenience-oriented offerings given that for some consumers buying CPG product online wasn't even an option they considered.
- Rotating inventory in brick-and-mortar can also help manufacturers to promote their DTC websites. Physical shelf space is limited, and if manufacturers want to introduce a new product, another must leave that space. If that product is a popular one, consumers may be willing to purchase it once it is rotated out of the brick-and-mortar store.

4.2 Sales

Selling a product might not be the most challenging part when trying to implement successfully a DTC strategy. However, it is crucial that companies know how, where, and when do they need to sell their different products available online. Products that tend to run out periodically are more likely to benefit from regular deliveries whereas other consumer goods will favor an on-demand strategy.

4.2.1 Demand forecasting

E-commerce has brought a logistics nightmare. Same-day or two-day delivery forces manufacturers to respond rapidly to a purchase. Moreover, as there is almost infinite virtual shelf space, consumers may demand a product which manufacturers never thought would sell in a specific location thus incurring huge transportation costs given tight delivery windows. The easy solution would be to keep large inventory in every city however, this idea is economically unfeasible due to inventory costs. CPG manufacturers and retailers alongside, need to develop demand forecasting capabilities if they want their DTC strategies to be viable.

Historically, both retailers and manufacturers forecasted demand given point-of-sale collected data, through market experimentation, using statistical methods like the trend projection method, or combining multiple methods. CPG manufacturers looked downstream (at the end of the purchasing pathway) to control their production and demand.

But, as online searching (via apps, websites, google, …) is getting more and more popular, and available everywhere and anytime (Figure 15), the possibility to predict demand upstream the purchase pathway becomes a reality. Nowadays *e-players* can look and be ready to detect and use demand signals before the purchase is made.

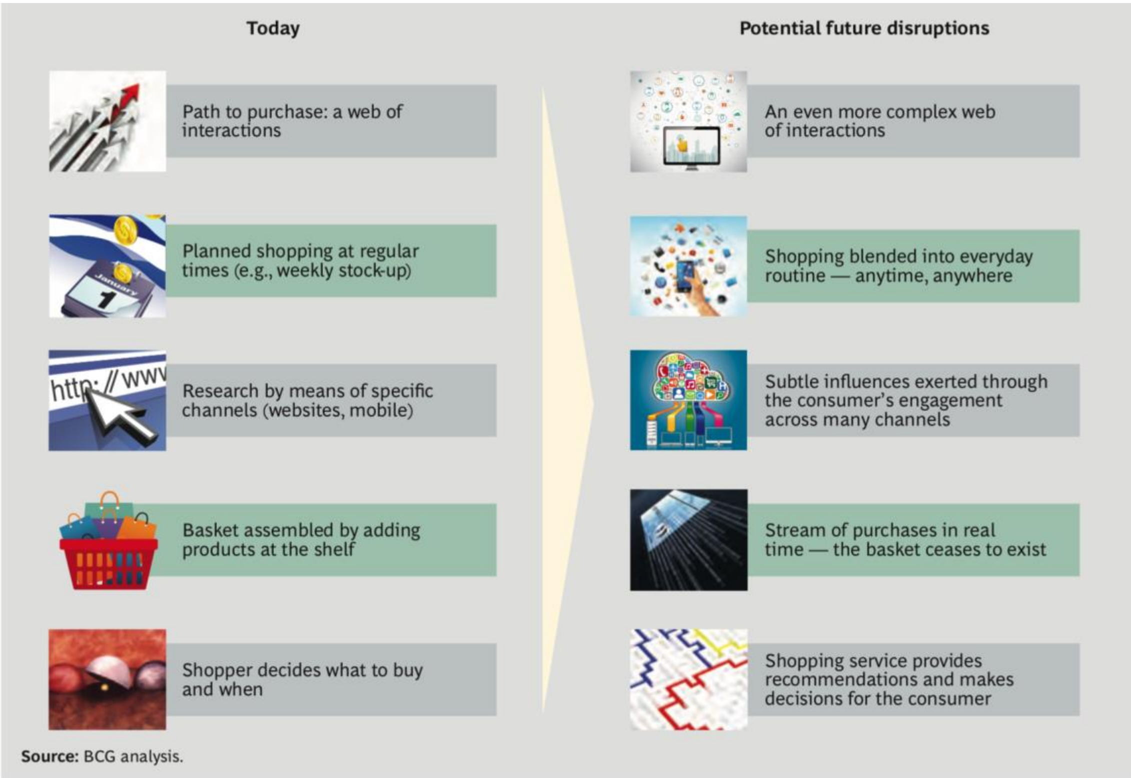


Figure 15: E-commerce today's and possible future disruptions (Hadlock et al., n.d.).

The amount of google searches on a certain cookie brand, shoppers wish lists, or potential buyers that stopped just before paying provide almost real-time data. Additionally, buzz generated in social media and viral videos can signal the purchase intention of consumers. Mastering the insights of the discovery and search place is necessary to forecast demand.

4.2.2 Models

Now that it has been established how manufacturers can engage with consumers and how can they promote a brand or product for the online market, the sales models they can use and what kind of products do these models suit best will be studied. It is not necessary that products fall into only one model (in fact the best sales performance almost always is based in more than one method) although, for better clarification, they are going to be discussed independently.

- **Subscription** brings all the benefits that DTC offers. People use a lot of products than need frequent replenishment, just what subscription is for, periodical, convenient deliveries. First of all, it provides a consistent revenue stream since purchases are made periodically. Besides, the client no longer is a consumer but a subscriber, establishing a relationship between sellers and buyers. Such relationship allows for brand image control and provides recurring insights, thus building the foundations from where business can grow and monetize. From the logistics point of view, subscription eases DTC unpredictability. Manufacturers know when, where, and what do they have to deliver.

  However, there are different subscription models and almost all of them have to do with the payment method. Should we enroll our customers in a yearly, automatically renewed subscription? Should companies demand monthly or annual payments (Figure 16)? Manufacturers must consider what is going to maximize loyalty and act consequently. Maybe offer savings when one buys an annual subscription over a monthly subscription; or offer customers the chance to discover how regularly do they want their delivery without penalizing them. In the end consumers should have a seamless experience and the company should provide clients such an enjoyable experience that they even forget they subscribed for a product.

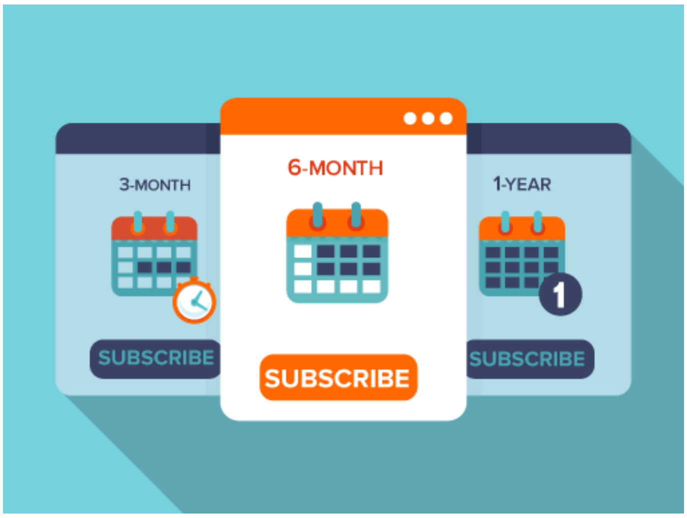


Figure 16: Different subscription options offer to choose how often and for how long deliveries will be.

- Many times, consumers are going to demand the same experience they get in a brick-and-mortar store or they may not want to subscribe for a product. Copying the same **traditional on-demand model** used in physical stores, manufacturers can decide to just place and promote their products in their own or in retailers' websites. Companies should be there for when a customer wants to compare ratings and read reviews and then decide if he wants to buy the product. If he does, offer him different delivery options and keep him satisfied.
- Some companies don't have the ability or the infrastructure to deliver at the clients' doorstep. **Click-and-collect** is the answer for them. The adoption of this model usually comes with some limitations. Even Amazon or Walmart shift part of their DTC efforts towards click-and-collect that can offer some sale benefits such as free and faster delivery (to a precise warehouse, supermarket, or distribution center) given cheaper transportation costs.

- What tools can manufacturers give to their customers to satisfy impulsive, non-expected, or unscheduled sales? **On-demand Dash buttons** (Amazon physical device) and **1-click-buy buttons** exist to fulfill that kind of sales. Nowadays the *e-commerce* accessibility is at a level where customers can buy everywhere (commuting, at a work-break, from the couch or bed, …) and products that fall into unpredicted or push sales can benefit from quick checkout tools that allow sales which wouldn't be made otherwise.
- **Niche focus** targets a specific kind of customers. Such consumers only care to get what they want, when they want. Paying premiums doesn't matter because they are paying for an improved customer experience. Some manufacturers can decide to focus only in a small product portfolio or its business category may be very specific (DTC wine delivery for example).
- One of the major problems DTC has is the excess of choices. And although it is also one of its main benefits, consumers dislike having to go to a lot of websites or using tons of apps to fill their shopping cart. **Bundles & kits** contribute to reduce this multi-option shopping dilemma while offering some discount or benefit bait. This tactic enables shoppers to custom their basket facilitating custom kits or suggesting products that go well with each other (buy toothpaste and suggest mouthwash inside the same platform).

4.3 Supply-chain

Selling DTC implies a huge change from the supply-chain point of view for every manufacturer that wasn't born for the online market first. And even for pure *e-manufacturers* there is a lot of effort behind how a final product is designed and manufactured, on how to get it from the factory to the end-consumer, and which assortment, what quantity of each item and where should a manufacturer keep its inventory.

4.3.1 Manufacturing

Designers encounter a great dilemma when it comes to thinking about the optimal solution for DTC products. Shipment costs are a big fraction of *e-commerce* total costs, but it makes no sense to design a transportation-based product if consumers won't find it appealing. Companies need to find the optimal between plain, space-efficient packaging that both protects the package while being handled and minimizes transportation costs and meeting consumers' demands, who don't care if a product is cylindrical and wastes space.

It is no minor decision to decide which features *e-commerce* products include and which technologies should a company develop and invest in. CPG manufacturers must consider variables such as, physical handling, ease of transport, stability, product digitization.

First of all, companies must acknowledge that there are some products in which the physical experience is a significant element of the shopping experience. How can manufacturers overcome that? In collaboration with marketing and IT departments, must develop a product eye-appealing and also virtually experiential. Virtual reality apps and video description mitigate physical handling as the product is digitized.

However, what designers must achieve is a DTC-friendly packaging. There is a need for a lightweight, leak proof, temperature stable, damage proof, and rectangular-fit product. Every product will have to strengthen some characteristics more than others but underestimating just one vital characteristic can lead to a failed DTC strategy.

Figure 17: Ben & Jerry's has proved that even temperature-controlled products are feasible for online selling.

However, there is a differentiation that has to be made between **fast** and **slow-moving SKUs** (Stock Keeping Units). There are products that are going to perform less well and that may not even qualify for free shipping even if a big purchase is placed because there is not enough demand. Slow-moving SKUs can benefit from production outsourcing.

A third-party manufacturer can handle low demand because it is manufacturing more than one product or different branded products (but still the same base). In that case, CPG companies can pay less attention to production and focus their efforts in marketing and sales. On the other hand, *e-friendly* products typically bring design owners more profit if manufacturing is kept in-house. Razor blade manufacturer Harry's, first started outsourcing its blade production to a German factory but once it had big enough client base proceeded with the factory purchase to control the sales pathway from start to end.

Finally, manufacturers face one challenge that comes with personalized products. We already know that DTC sites provide infinite shelf-space thus allowing for many product variations to exist. From the manufacturing side, this only adds complexity to the production line. There might be some attributes which consumers like but a thorough analysis is needed to avoid wasting money in an unsolicited product characteristic. There is a huge difference between profitable diversity and money-burning complexity.

Standardization can be a solution to take advantage of **value-adding complexity**. Companies with personalized products demand should invest in standardizing the costliest components. Moreover, CPG manufacturers can take an interesting approach of shipping products in bulk and customizing them closer to the demand, just before last mile deliveries.

4.3.2 Logistics

Whether CPG manufacturers like it or not, Amazon disrupted online sells introducing free *one-* or *two-day delivery* for premium members or qualifying purchases (usually orders of $35+). There is a need for speed and flexibility thus bringing added complexity to the logistics network. Additionally, CPG companies mustn't worry only about delivering a product from the factory to the end-user doorstep but to also handle returns, reverse logistics. Depending on whether a manufacturer or *e-tailer* focuses on the click-and-collect model or on the doorstep model, the infrastructure used will vary slightly.

However, it should be mentioned that manufacturers face a bigger challenge than retailers'. In 2017 manufacturers already carried 60% of the logistics cost and held 50% of inventory (Figure 18) (von Koeller et al., n.d.), with such percentages expected to shift even more towards the producer's side. In this section different alternatives that manufacturers can choose between to reduce logistics challenges and costs are going to be discussed.

Getting the order to the hands of the consumer is the most expensive, trickiest part of DTC that CPG companies are still struggling to master. Delivery options increase every day as new transportation players (Uber or Lyft) and options (click-and-collect, time slot delivery, lockers) continue proliferating. As technology improves bizarre ideas can become feasible (Amazon experimenting with drone deliveries is a clear example). CPG players should commit to omnichannel, to be prepared for consumers' demands and then choose the cost-minimizing channel which fulfills all requirements for each participant involved since home delivery is not the only option nor the preferred or viable one.

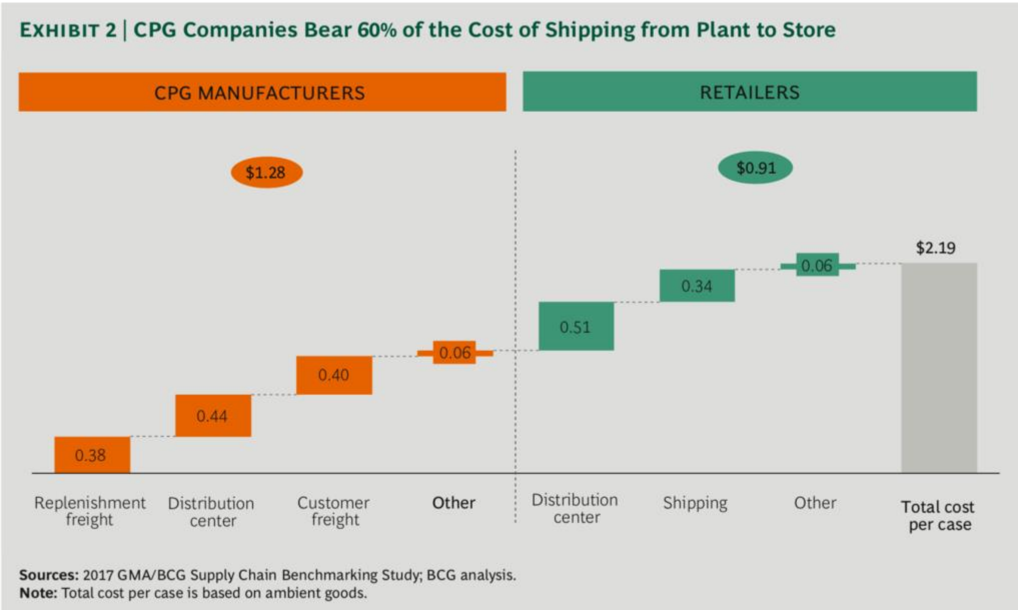


Figure 18: Shipping costs breakdown (von Koeller et al., n.d.).

First of all, manufacturers must establish the minimum price point that makes **individual SKUs shipment economically feasible** for home delivery. Nowadays, a reasonable starting point around $30 (Amazon or Walmart offer free delivery for orders over $35) makes a product home-delivery viable (Figure 19). Factors such as product weight, temperature control, fuel price, and delivery options and demand must be considered by CPG manufacturers and retailers.

There are still certain products perform less well online and do not qualify for free shipping, stressing the importance of the **ratio of price to shipping costs** as a control variable. Such products usually complement and are part of a larger *e-cart*, emphasizing the need to offer a variety of products and categories in the same DTC site.

Moreover, given the unpredictable nature of some variables (fuel, distributors availability, regulations) companies should apply a security percentage to the minimum free delivery price point that, additionally, avoids confusing consumers who will always want to pay the lowest price.

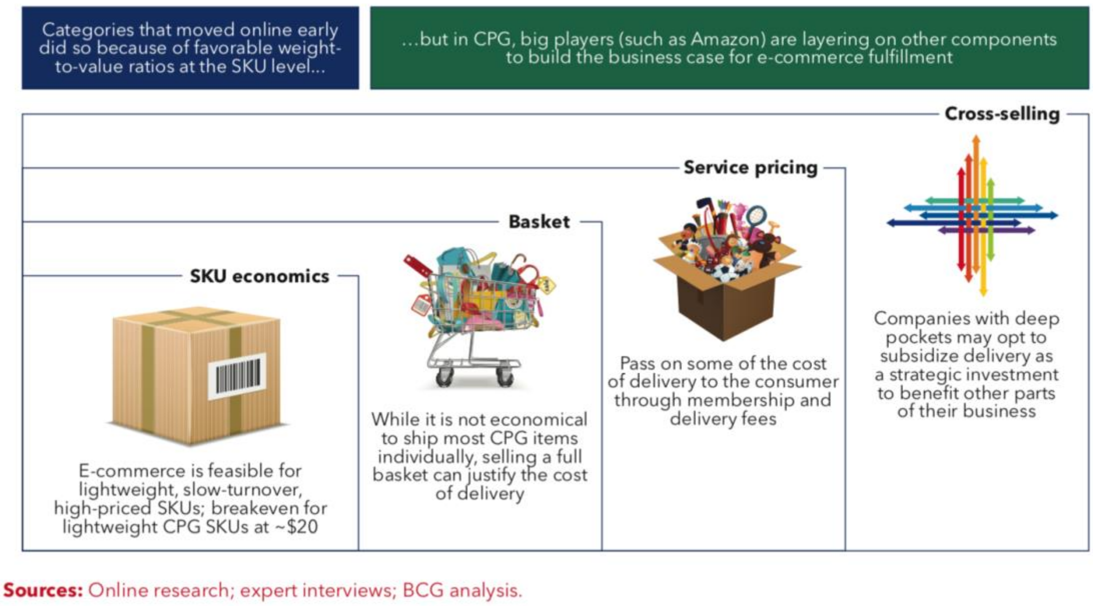


Figure 19: SKUs economics (Hadlock et al., n.d.).

CPG companies and retailers are seeking to make pickup and home delivery more affordable. Along the same lines, they are desperately seeking economies of scale to lower costs. Large metropolitan areas have the potential to provide a cost-effective distribution solution. If CPG DTC players had **distribution and fulfillment centers in the top 50 most populated metropolitan areas**, they would be able to reach and offer feasible pickup and home delivery options to over half of the United States population (Bureau, n.d.). Manufacturers must participate, now that they still can, in developing the distribution network alongside the biggest retailers.

Companies need to **study their geography**, they need to know where their customers are to invest in facilities near them since they are keeping afloat the company with their purchases. Moreover, CPG players can know then where to invest when in doubt or to test a pilot program.

Nevertheless, the increasing number of distribution centers is leading to a decentralized network. A large number of nodes implies having multiple routes and multiple partners for every kind of shipment thus optimizing transport. However, it has to come with powerful analytical capabilities given this new increased complexity to always leverage transportation towards the optimal route and not underutilize vehicles' capacity.

Once the "mile before the last mile" is covered (get the products to the last distribution center) the "last mile" must be addressed. Either you can deliver your product to the consumer's doorstep or the consumer covers the last mile and picks up its order.

If the orders volume is big enough, **delivering to the customer's home** as final shipping destination should not be a logistics problem but an IT problem. "Just" program (is no easy task) the optimal route and the number of trucks needed to deliver the orders in the specified day. However, for players without economies of scale or that face unpredicted demand (almost 100% of DTC sellers) outsourcing last mile delivery can be a reasonable option. If the CPG manufacturer (or retailer) isn't sure about economic viability of last mile delivery it can always delegate such tedious task to a specialized company. DTC sellers could ask themselves the following question: Why not utilize transportation companies' delivery services to link last mile delivery with the click-and-collect model? As a viable strategy, CPG manufacturers could focus in only one model and partner with other companies to outsource other options.

The **click-and-collect** model, already introduced, is becoming increasingly popular. It simplifies last-mile deliveries since they can be grouped together, being number of drop-off spots is substantially lower. Following the lead of early adopter countries like France (Figure 20), US consumers are delighted with the idea. In fact, consumers using purchasing online and then picking their orders in store are likely to spend more money than they did before due to additional purchases when they get to the physical store.

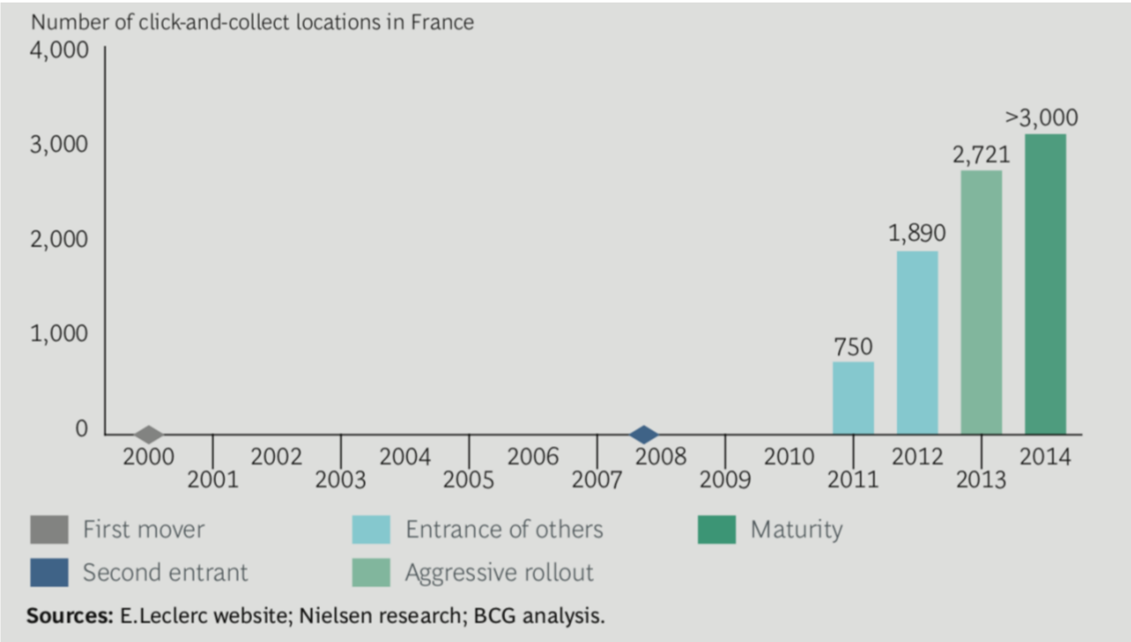


Figure 20: Growth of click-and-collect in France (Novacek, Black, Walsh, Rooney, & Hinchcliffe, n.d.).

Big retailers are already investing in facilities to allow for this category's unstoppable growth. Amazon recent $13,7 billion purchase of Whole Foods (Lutz, n.d.) not only was a move to become a CPG + DTC company but also to possess real state to expand its click-and-collect and lockers network. Walmart is the other leading giant in DTC sales. The company is also a CPG + DTC player and has been expanding its click-and-collect infrastructure taking advantage of the fact that over 90% of Americans live within a Walmart store ("Walmart Corporate," n.d.). CPG manufacturers then, must get ready their organizations to respond to big *e-tailers* click-and-collect demands even if they don't want to acquire their own infrastructures.

However, click-and-collect has to overcome certain challenges. First of all, companies have to decide which **front-end and back-end model** should they deploy. For the front-end model, DTC players can choose between one or a combination of the following options:

- In-store pickup: Typically used by DTC clothing companies, customers come inside the store to ask the staff for their order. To improve workflow and customer service companies should dedicate an exclusive online pickup zone. This option is the preferred one for urban areas with enough space to dedicate one part to DTC sales.
- Drive-through: The most time-efficient option as customers, in a first in first out service, can come and pickup their orders without getting of the car. The main inconvenient with this model is the need of enough exterior to implement the drive through space, even though there is no exclusive pickup space located in-store.
- Lockers: The previous two options needed personnel ready for a customer to show up during working hours. Lockers however provide the benefit of occupying little space and also being "autonomous" since an employee can load orders inside empty lockers and customers can pick them up without physical interaction between them. This option also allows for leasing space to other DTC players.

Figure 21: Amazon locker.

Companies will need to build the appropriate mix depending on their product portfolio. However, undervaluing a certain option must be carefully considered because some problems might arise later (imagine handling returns in a locker only network). In the other hand, the back-end model can choose between one or more of the following options:

- Ordinary stores with individual picking: Similar to the in-store pickup front-end model, employees are going to deal with handling and packing orders in a designated for DTC sales. One potential benefit of this model is the possibility to relocate underutilized human resources without actually hiring extra personnel.
- "Dark" stores: Facilities closed to the public dedicated exclusively to prepare orders. The main benefit is that they are designed based on DTC sales (and have enough space to do so) and can be located in the outskirts of big cities, being real estate cheaper and having a better network connection.
- CPG manufacturers' warehouses: Collaboration between manufacturers, distributors, and retailers is a key part of a successful DTC strategy. If the retailer has its own space inside the manufacturer's warehouse, the employees of the first can prepare and ship orders much faster to the end-user. Additionally, it can bolster manufacturer-retailer

relationships making easier sharing insights and promoting the other partner (manufacturer being partial to the retailer or vice versa) over the rest.

Again, there isn't a unique solution since every market and every company is different. Economic strength, scale, product type or location lead to different combinations and by analyzing all company's variables a feasible start point can be established.

But what happens when customers don't like going to a store to pick up their packages, but neither are they (almost never) home and don't trust leaving a package unattended all day long at their doorstep? DTC players need to be ready, by themselves or partnering, to **deliver in a precise time slot** if the consumer wants to (with a premium delivery fee, of course) or otherwise they might lose a customer over another player already capable of offering such service (Amazon *Prime Now* for example).

Finally, CPG manufacturers need to consider another factor when developing their distribution network. The customer is always right and wants to feel important and well-treated. What happens when a product isn't to his liking? CPG logistics need to be prepared for returns, converting the distribution channel into a two-way channel. **Reverse logistics** (Figure 22) is a fundamental part that needs some physical support because consumers might be purchasing online but they return the products to physical stores or post offices. Both manufacturers and retailers must acknowledge the imperative need for an efficient and satisfying returns experience if they aspire to maintain and even increase loyal customers, key in the online world.

Figure 22: Reverse logistics pathway.

4.3.3 Inventory Positioning

As the ultimate objective, *e-commerce* players are looking for a combination that allows them to keep inventory close to the end-consumer in an economically viable way. Combining the information on front-end and back-end models with different distribution centers options, Mckinsey&Company came up with several proposals for keeping inventory close to market (Figure 23).

In order for every single one of these models to be efficient, inventory visibility will have to be accurately. The decentralized network model is making **real-time inventory visibility** necessary. Being able to know where the products are and how fast they can be moved to a desired position (customers, lockers, dark stores, …) can help reduce lead times. Another benefit of inventory visibility is to reduce the minimum number of SKUs to reduce inventory costs while also avoiding stout-of-stock situations.

	Associated flows	Assortment	Main purpose
Central distribution center (DC)	• E-commerce: ship to customer • Replenishment to stores • Replenishment to wholesale customers	• All SKUs	• Central stocking point • Efficient processes • Economies of scale
Regional or national DC	• E-commerce: ship to customer • Replenishment to stores • Replenishment to wholesale customers	• Fast-moving SKUs • Partially long-tail SKUs (different strategies possible)	• Balance between speed and scale for fast-moving SKUs
City service center or dark store[1]	• E-commerce: ship to customer • Out-of-stock delivery to hub or spoke stores • Replenishment to stores (potentially)	• Maximum 8,000–10,000 SKUs • Typically SKUs requiring higher service level (A items, promotions)	• Enables same-day and next-day delivery for key areas or cities • Out-of-stock responsiveness • Short replenishment lead time for key SKUs
Hub store	• Walk-in customer • E-commerce: ship from store • Replenishment to spoke stores	• Displayed SKUs (typically more than in spoke stores) • Key additional e-commerce SKUs	• Enables same-day and next-day delivery for key areas or cities • Short replenishment lead time for key SKUs • Serves traditional walk-in customers
Spoke store	• Walk-in customer • E-commerce: ship from store	• Displayed SKUs that are sold in store	• Enables same-day and next-day delivery for key areas or cities • Serves traditional walk-in customers

[1]Includes extended backrooms of stores as long as they have some kind of warehouse-management process in place.

Figure 23: Different models for positioning inventory close to market.(Kumar, Lange, & Silén, n.d.).

4.4 IT

E-commerce brings a huge growth opportunity but, in order to maximize it, CPG players must build several capabilities. It is important to understand which IT (*Information Technology*) competences are needed and why. In this new digital world, the ability to generate and interpret Gigabytes and Gigabytes of data, and to interact with the digital customer is going to be crucial.

4.4.1 Insights factory

Email accounts, wish lists, digital carts, transactions records, and clicks on social media are some of the data generation sources that companies have access to. However, CPG players don't possess an infinite amount of resources to analyze data coming from all sort of customers neither are they interested in engaging with all of them. If we remember the 80/20 rule of sales (Engagement), manufacturers need to understand who their most profitable customers are and what do they want (or will want).

Big manufacturers, now that they still are in a dominant position, must seize the ability of generating large data sets and develop the tools to interpret them. **Big Data** and **Artificial Intelligence** are the main pillars that support top-notch performance and efficient customer engagement. These newer techniques allow CPG producers to generate real-time feedback and furthermore, predictive insights from where to decide strategic priorities. The most important areas where *E-players* should focus are represented in Figure 24.

Figure 24: Most important insight-generating areas.(Alldredge et al., n.d.).

Possessing key information puts the owner of such intelligence in a position of strength when it comes to negotiate with the rest of its business partners, hence the importance of developing a strong “insights factory”.

However, data is generated in thousands of places, and collecting it and moving it to where the company’s analyzing team is located is impossible. To meet the real-time necessities, manufacturers must build a system that links data seamlessly. Storing **information in the cloud** is the first step of later implementing an **ERP (Enterprise Resource Planning) software** to manage data and ultimately the company in real-time.

4.4.2 End-to-end data visibility

Another useful parameter that companies can track is where the key information is being generated. Geo-analytic tools to implement end-to-end data visibility (GPS tracking or point-of-sale information) are fundamental. Resource allocation due to scarcity is fundamental and knowing not only what to change but also where saves both time and money to CPG players.

4.4.3 IoT Ecosystem

Amazon dominates this new way of interacting with the customer. Creating an ecosystem is a straightforward concept that an analogy can help us explain: Imagine that a person starts to build walls around your house. As these walls get taller, first he would have to jump to see what is at the other side, then he would need a ladder and finally he wouldn’t be able to look over the wall at all.

Now imagine that his house is Amazon and that the walls are Amazon Alexa, Amazon Dot, Amazon Echo, and all the rest of present and future devices that the company sells (Figure 25). Creating an ecosystem consists of building barriers that discourage the customer to search for the best deal and for convenience buys where it is easy for him.

Figure 25: Amazon's hardware.("Why Amazon Alexa Skills Are Important For Your Brand," n.d.).

Both manufacturers and retailers must develop or partner to achieve the digital and physical part of the Internet of Things (IoT). For example, *Coca-Cola* could partner with *LG* so that your fridge orders their soda automatically when you are running out of it. In a more realistic approach, and in order to compete with Amazon, CPG manufacturers should consider partnering with Virtual Assistant developers (Google or Apple for example) and hardware manufacturers so that in the future Google Assistant or Siri tend to order a specific brand if they aren't asked otherwise.

4.4.4 Interactive experience

One of the setbacks that selling DTC has is the inability to try the product and to experiment with it. To compensate for that, companies try to make the selling experience as interactive and "real" as possible. For that end, companies are developing **Augmented Reality** apps, new technologies such as facial recognition, make your own product websites, or virtual assistants for example.

Unilever for example used facial recognition in an app and website to record the user face when tasting their Vegemite competitor, Marmite. Using technologies in an innovative way generates buzz (free marketing) and also allows the consumer to know others' opinions.

The digital shopping experience can also help to reduce the number of steps and time that the consumer spends since the purchasing decision has been made. For example, Social Media giants such as Youtube or Facebook and Instagram have already developed shoppable videos or posts that manufacturers can benefit from.

4.5 Customer Service

The *e-market* adds an extra problem to the already competitive CPG market due to a great supply variety: low brand loyalty. Although several models are arising to achieve loyalty such as brand positioning and subscriptions, providing an enjoyable consumer experience (pre-sale, during the transaction, and post-sale) comes with higher chances of securing recurring customers.

Manufacturers must acknowledge that there isn't any detail too small to provide a frictionless experience. For example, Walmart and Amazon offer a pay-with-cash option for customers that want to buy online but still don't have a credit card or don't trust entering their personal data in a webpage.

The actual consumer demands a personalized interaction and to do so, CPG players ought to develop a good consumer-centered network (IT). Even though it could be seen as a money drain, and time-consuming task (also for consumers), if CPG firms sell to their customers the benefit of cooperation, the firsts are going to be able to develop appealing products and the seconds are going to see their complains corrected. In the end, consumers are now both creators and consumers of information.

To interact and build relationships with their customers, firms need at least their own website and a strong presence in social media. Additionally, as we have seen with some examples, innovative low-risk campaigns broaden and deepen customer-manufacturer relationships and prepare the basis for a long-lasting win-win situation.

4.6 Partnership

Reading through the past categories, one can realize the enormous size that some players in consumer packaged goods market have and, moreover, the considerable number of different industries and businesses that interact with each other so that a product can end in the hands of a consumer. From the smallest to the biggest player, each one of them needs to partner to some extent. Advertising in social media, delivering through one or more carriers, outsourcing manufacturing, or selling in an *e-tailer* website are some partnership examples that CPG manufacturers seek or need.

Companies interested in finding a partnership should focus on the **synergies** that joining efforts would bring. The goal here is to try to replicate the scale of mass production and to achieve economies of scale. For example, it would make no sense to develop a distribution fleet for a brand producing only one specific product. However, a carrier can partner with several one-product-only producers and achieve economies of scale. In the other hand, the affected companies must explore what internal changes would be necessary to achieve the desired synergies.

CPG manufacturers face an arduous task in trying to **identify the most promising partners**. To help sorting out who should they partner with, there are several parameters that can be studied. Producers should avoid focusing in sales volume only even though it is an important criterion. But, as we have been discussing, collaboration with a partner in terms of building a business collaboratively and also the willingness to share data is even more important than sales volume. When it comes to partner with a retailer, CPG players should focus on the factors described in Figure 26.

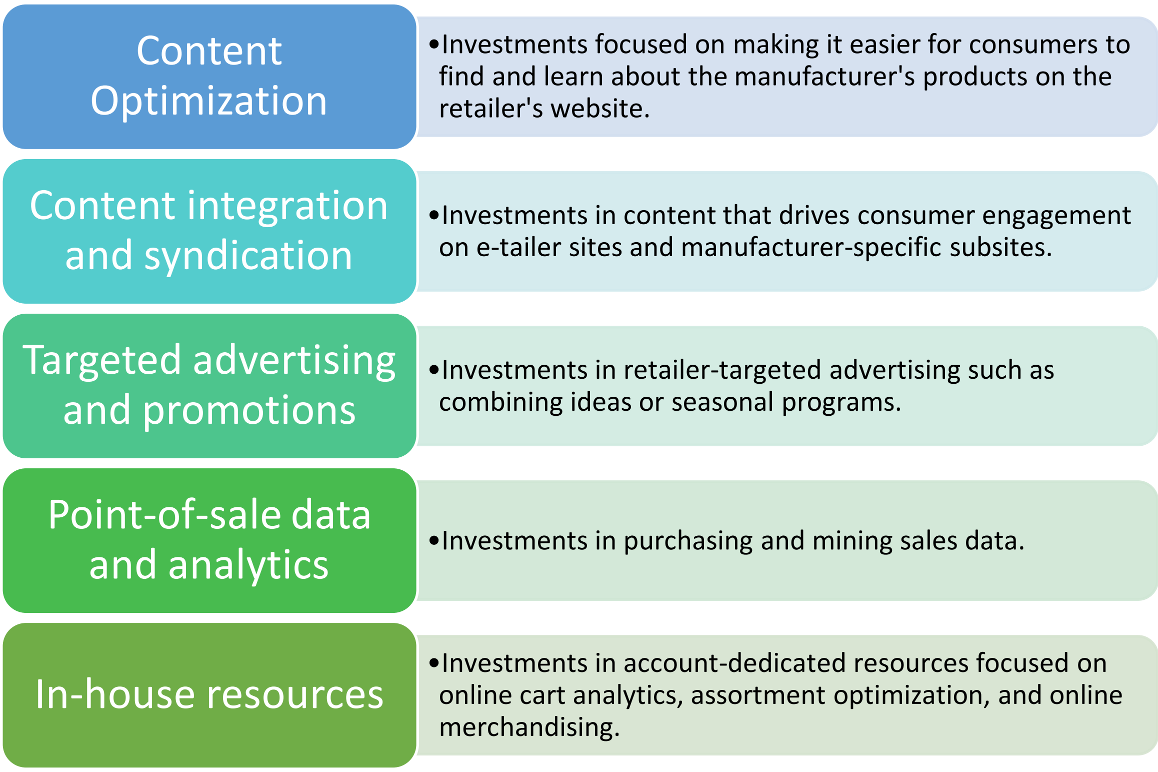


Figure 26: Investments to be made when partnering with a e-tailer.

A general approach on which skills and how to strengthen a satisfactory collaboration encompasses cost efficiency and demand creation. First of all, the teams in charge of establishing and maintaining partnerships must have **open and frequent communication** with the partner to understand the concerns and objectives along the entire value chain. Furthermore, teams should initiate a process of coming up with collaboration ideas seeking cost reduction and demand generation. Finally, the creation of a task force focused on training the teams in charge of partnerships is necessary to upgrade negotiation skills (including sales, finance, marketing, operations, and category management).

In terms of who to invest in, concentrating economic resources in the most relevant players is the best starting point. For example, Amazon has more than 132 million active customer accounts and has gathered and mined enough information (and is continuing to do so) to personalize offers effectively (Veldhoen et al., n.d.).

Speaking of Amazon, if a company aspires to succeed in the digital world, it must have a strategy for the Seattle giant. Amazon is trying (and achieving) to have the highest share of household spending and to further increase it by providing the optimal mix between convenience (subscription model for example), optimal prices, and selection. Right now, except for a minority of CPG manufacturers, not being present in Amazon's marketplace means not showing to the party at all. However, as almost every company has its products there, one has to be really careful. Amazon has considerable bargaining power over manufacturers due to its scale and its model is data driven (putting the consumer first) so, when negotiating with the leading *e-tailer*, manufacturers must be certain that they can meet its demands and still make a profit out of that deal.

Manufacturers, that are still assesing if bypassing the retailer makes sense, can also lean towards a **hosting model**. That means partnering with an IT company or division so that CPG producers forget about developing their own sites and infrastructure in-house and just focus on developing new products and selling them.

4.6.1 Vertical or horizontal collaboration?

For the moment, only vertical collaboration has been described. Nevertheless, we mustn't think that it is the only way that companies join forces. There are two different ways of collaboration: **vertical** and **horizontal**.

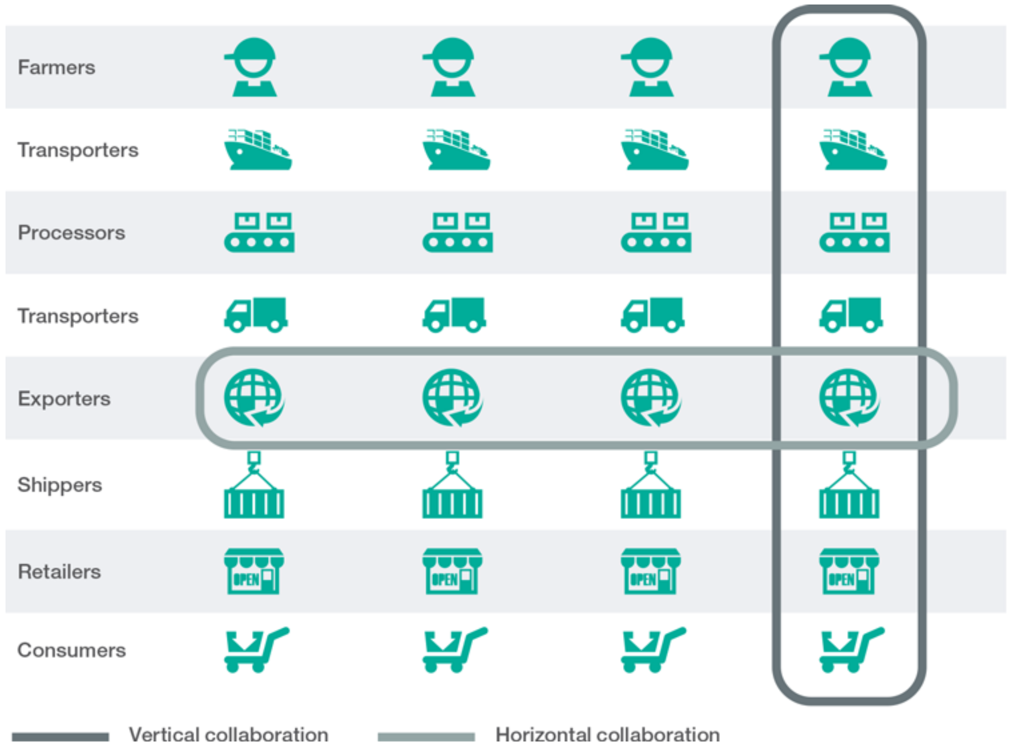


Figure 27: Vertical vs. Horizontal collaboration. ("7. Lessons for Implementation of Solutions," n.d.).

- Vertical collaboration → This type of collaboration takes place when two companies from different stages to serve relatively similar end consumers. As an example of vertical collaboration, we find Amazon's proposal to giants like Unilever or P&G to sell their products in its marketplace and once a purchase has been made, manufacturers deal only with producing the product and keeping enough inventory. With this agreement, the manufacturer gets the sale and Amazon forgets about keeping stock.
- Horizontal collaboration → This type of collaboration takes place when two companies at the same level or stage work together to facilitate achieving a common objective. An example of horizontal collaboration would be Adidas and Zalando that are currently sharing inventory.

Both types of collaboration allow manufacturers to be part of the success of the company they are partnering with thus being able to participate in strategic decisions that will ultimately benefit them.

5 Implementation Methodology

Up to this chapter, we have discussed why CPG manufacturers would want to pursue a DTC strategy and the factors that affect the success or failure of such strategy. However, there is not a magical path that companies can follow and achieve guaranteed success. The truth is that there are virtually infinite combinations that a CPG firm could develop. Through this chapter we are going to establish which factors or inputs are more relevant to help companies decide their strategy given their characteristics and, once that is sorted out, which capabilities or outputs should be developed. In addition to the variable part of every strategy, some general recommendations will be added that every company ought to develop for the sake of a profitable enterprise.

5.1 Inputs

In the first place, lets establish the relevant inputs that will determine the future DTC strategy. Although there are a lot of factors directly affecting a product and everything that surrounds it to become a sellable object, the objective here is to find a good compromise given the impossibility to analyze them all. Each of the inputs chosen is going to be further explained to justify and understand why it is relevant.

5.1.1 DTC Role

CPG companies must ask themselves the following question. Why do we want to pursue a DTC strategy and what do we want out of it? A clear answer to the question puts the firm on track to success while a vague response can lead to a trial and error path that at the very best, would only take a money and time toll but could ultimately lead to economical failure.

Slightly mentioned in Channel Management & Conflict, the DTC enterprise’s role (Figure 28) affects greatly on the project’s magnitude and provides context to which capabilities must be developed and, for those that are needed, if it makes sense to develop in-house or to out-source them. Moreover, it helps clarifying what KPI's need to be monitored (explained later in this paper) to determine success.

The definition of a role aids the manufacturer in determining P&L expectations, investment level, partnerships style, negotiations posture with other industries present in the value chain, or team capabilities among others. For example, if the manufacturer's goal is to just gain insights by launching a limited-edition product in a specific city, tracking profit could make the enterprise look like a failure when the company could have gained a lot of value instead.

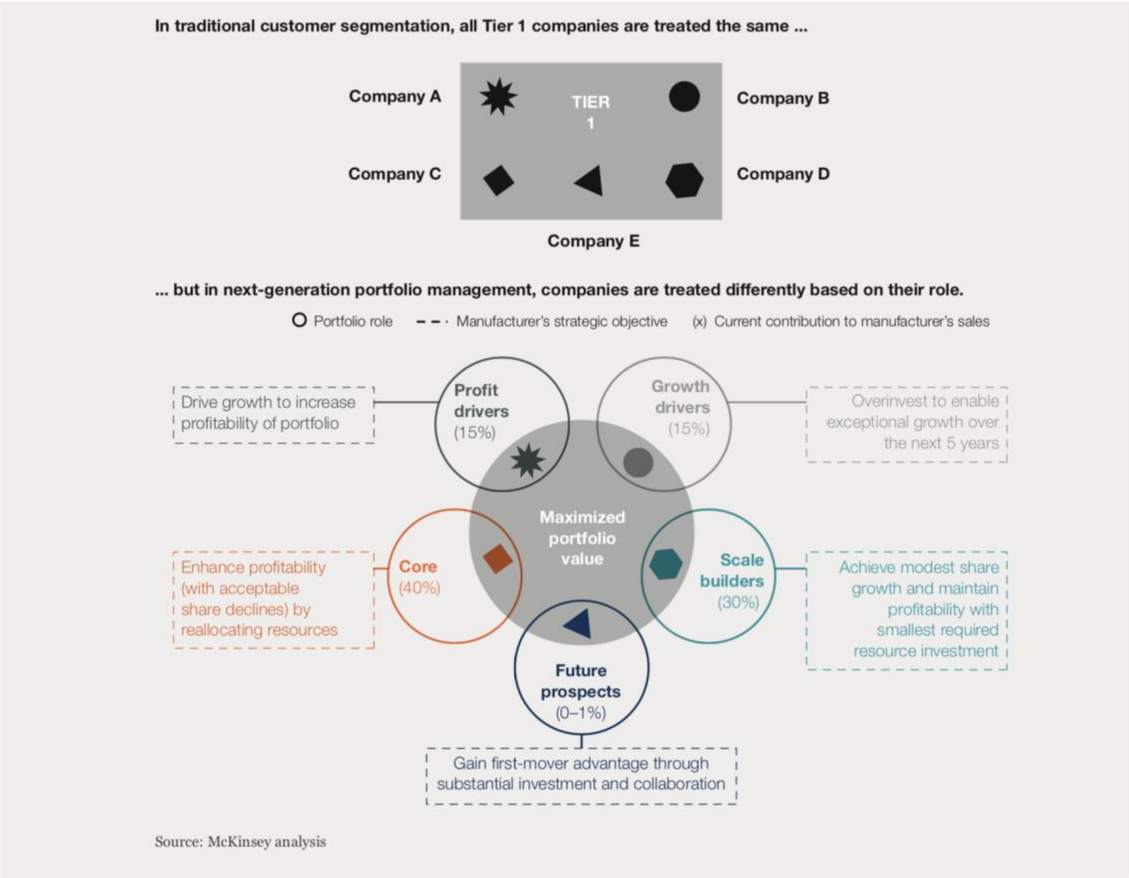


Figure 28: Portfolio roles inform the business objectives and expectations for each customer. (Alldredge et al., n.d.).

Even though there are plenty of roles that could be defined, we are going to differentiate among 4 groups:

- Sales driver or Core
- Profit & growth drivers
- Scale builders or user-experience control platforms
- Future bet or Innovation Engine

5.1.2 Brand awareness or Visibility

The investment level or the probability of succeeding rely on the visibility that your product or company has. From the perspective of how to start building a DTC strategy, consumers' recognition of the product or brand determine the potential (in terms of market share) that a certain initiative presents. For example, if the Ferrero group decided to sell *Nutella* directly to the consumer, the Italian firm could expect a sufficient sales volume to develop a subscription model and acquiring its own delivery fleet whereas a hypothetical Chicago-based new chocolate spread could hardly justify possessing its own vehicles fleet and struggle trying their customers to commit to monthly payments. We are going to separate the visibility a company can possess into 3 categories (Figure 29).

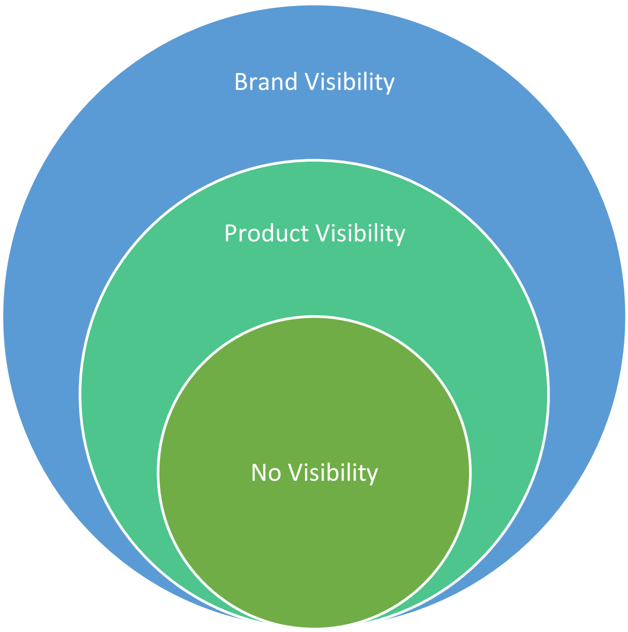


Figure 29: Different visibilities a CPG manufacturer deals with.

5.1.3 Company type/dimension

Company type or dimension is a factor that can be difficult to understand. Why is it relevant? What parts of a DTC strategy does it affect? We have to understand a company's dimension as the ability (or inability) that a CPG firm has to handle all the direct-to-consumer process by itself. However, this doesn't mean that the firm is going to do so (in fact, it is not).

This factor refers to the power that a CPG manufacturer has over its competitors and more important, over its partners along the value chain. We have already discussed how vital collaborations are to succeed in the *e-commerce* marketplace. From small to large firms, three separations are going to be made:

- Startup company
- Niche company
- Large CPG company

5.1.4 Product characteristics

There are virtually limitless products available to the consumer. And this variety continues to grow given that the online world gathers up all the products' combinations possible and also benefits from unlimited shelf space. Then, if there are thousands of different products, what are we looking for?

Defining product characteristics as an input to decide a certain DTC strategy has more to do with certain characteristics that require a different approach or an additional consideration when developing the strategy. We are going to differentiate between two categories:

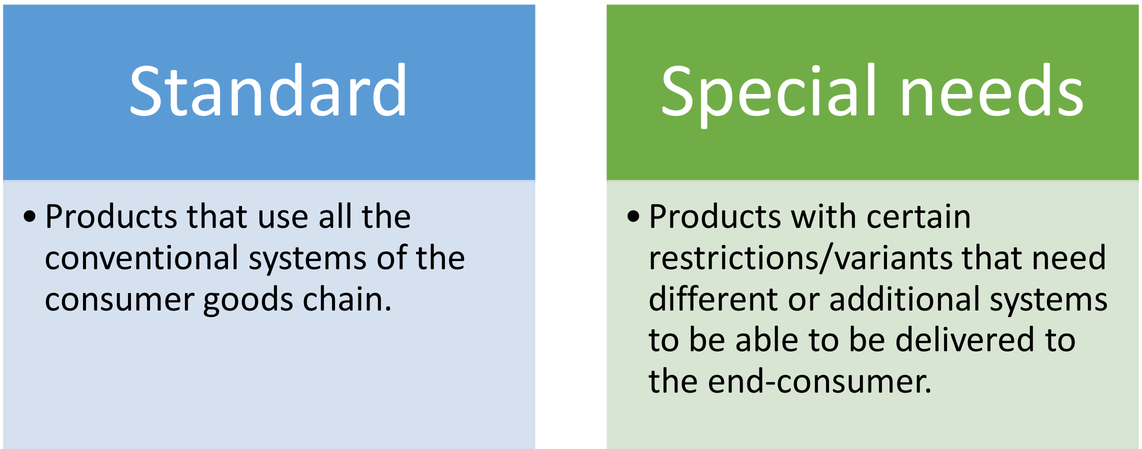


Figure 30: Standard vs. Special needs products.

Some examples of products requiring non-conventional systems could be temperature-sensitive products, perishable products, or legal-age products. Ice cream needs special containers and delivery systems that guarantee that the consumer doesn't get it melted. Beer would need some sort of confirmation that the person behind the purchase complies with legal age requirements.

5.1.5 Product intrinsic value

Straightaway related with the previous category, a product's intrinsic value can help the CPG manufacturer to decide several DTC strategy aspects such as the sales model, promotions, or logistics for example. Some products have more intrinsic value to the customer whereas other such as commodities will probably need to shape their DTC strategy to add or include some value-adding features (a subscription model can add convenience to a commodity like toilet paper). Some products will possess certain attributes that grants them a competitive advantage over the others (think about Apple products with a unique software) while other may be completely new and have no competition in the market (Nespresso when it released its coffee capsules).

In this case, we are going to distinguish three different product types:

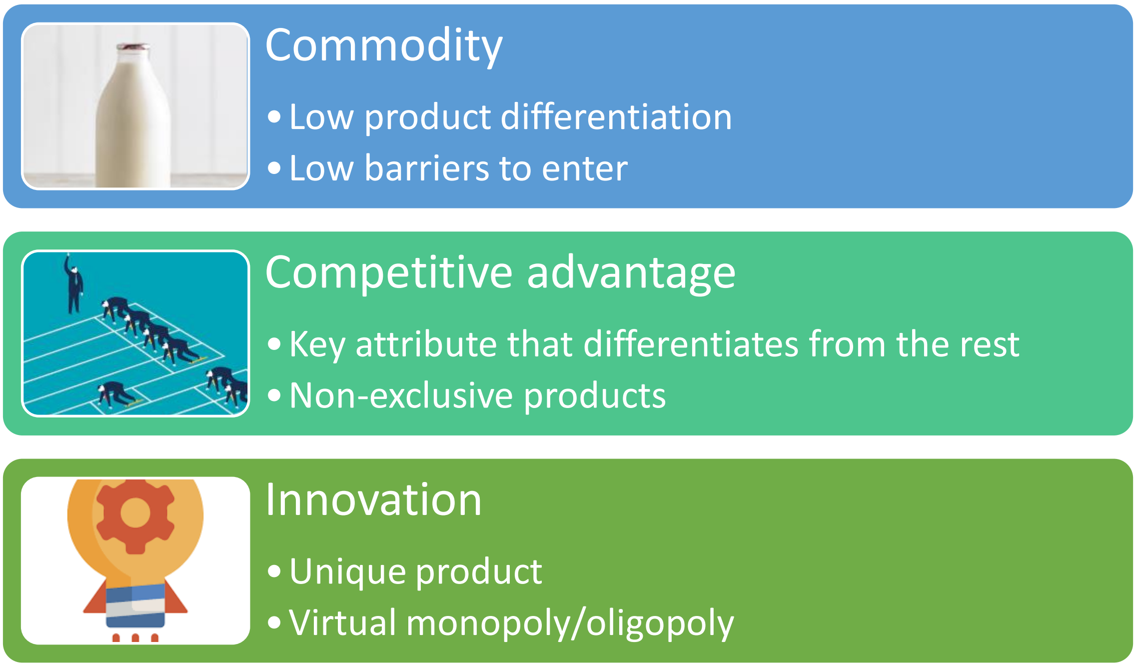


Figure 31: Different products' intrinsic value.

5.1.6 Targeted customers

Finally, companies must know (or at least have a pretty clear idea) of who their potential customers are. A mismatch in this input can cause the DTC effort to fail resoundingly when the product/enterprise could still have potential to be successful (remember the Engagement section). Moreover, knowing who does the company need to target helps focusing marketing and selling model efforts towards the customers providing the highest return on investment. For example, if you are aiming at elderly people, the *click-and-collect* model isn't probably the best option and developing it requires huge efforts.

However, making a generational separation is not always the best way to proceed. The digital marketplace acts somewhat different than traditional brick-and-mortar retail stores. According to a GroupM Next research ("The 6 Types of Digital Consumers and Their Paths to Purchase," n.d.), there are 6 different types of digital consumers:

- **Basic digital consumers**: Not highly digital users. They feel comfortable with *E-shopping* and research but are not mobile or social and have the second-highest likelihood of buying offline.
- **Retail scouts**: These consumers have short journeys and prefer retail sites to brand sites. They are comfortable buying online but have no preference between buying online or offline.
- **Brand scouts**: Similar to the retail scouts, the main difference here is that this type of consumer has a favorite brand and starts its purchasing path with a specific brand in mind.
- **Digitally driven segment**: This group, which will be predominant in 5 years from now, uses every digital tool at its disposal. Customers within this segment value convenience above all and avoid going to a physical store.
- **Calculated shoppers**: These customers know that they are going to buy a product but are still undecided which brand do they prefer. They behave similar to the Digital driven segment but take more time purchasing because they have no urgency and prefer to wait in order to get the best deal.
- **Eternal shoppers**: These are non-mobile shoppers. They have no rush to buy and just want answers to know what they buy, which brand do they prefer, and if they should ultimately buy.

This particular factor of the DTC strategy has also to pay a lot of attention in the purchasing path of each of different customer segment. That way, a CPG player is going to know where they should engage their potential customer to end up scoring a purchase (Figure 32).

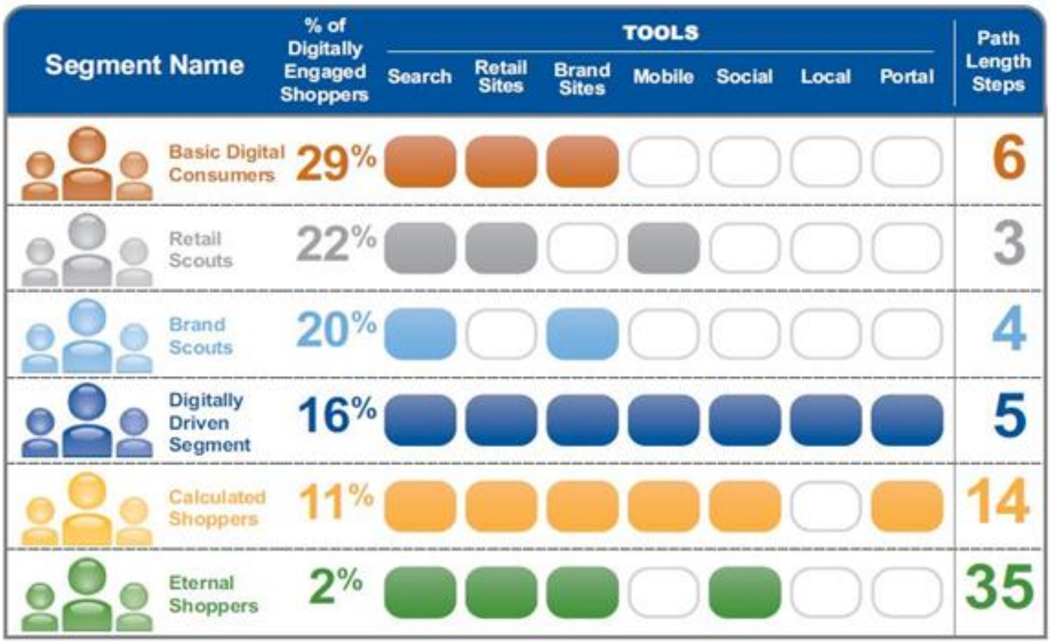


Figure 32: The six segments and their paths ("The 6 Types of Digital Consumers and Their Paths to Purchase," n.d.).

5.2 Outputs

Even though we still have to value and determine which input combinations make sense from a DTC perspective, lets first talk about the main pillars that differentiate one DTC strategy from another. Either digital or physical capabilities, companies need to know beforehand what they should and whether it would make more sense (thinking about risk, feasibility, or economically) to build/develop in-house or out-source it. During this section the sales model, manufacturing, logistics, and promotion & engagement are going to be discussed. We consider these 4 outputs as the ones determining the DTC strategy that a company should follow to succeed. Remember that the outputs selected have already been detailed, the objective here is to understand why we think that these, not other outputs, are the ones that shape a DTC strategy and how are they related to the inputs selected before.

5.2.1 Sales model

How do your clients interact with the company when they want to purchase a product? Would they need to physically move to pick they order up or could they have their order periodically delivered to their doorstep? What if none of the previous options were feasible and consumers would have to rely on traditional (but online) on-demand purchases? Or what if manufacturers could get enough customers to justify the operation of any system?

CPG manufacturers can choose within a bunch of sales models but almost every single model falls into one of the categories represented in Figure 33. Both on-demand and subscription models have already been explained earlier in this paper. For its part, a hybrid model consists of allowing the consumer to use at his disposal on-demand or subscription models by adding additional complexity to a manufacturer's management. A sub-model that must be mentioned given its actual and future relevance is the click-and-collect model. Even though it is closely related with the logistics part of the business, is the customer who ultimately decides which model does he prefer (when he has the choice) thus falling into the sales model category. Building click-and-collect infrastructures will depend directly on the targeted customer.

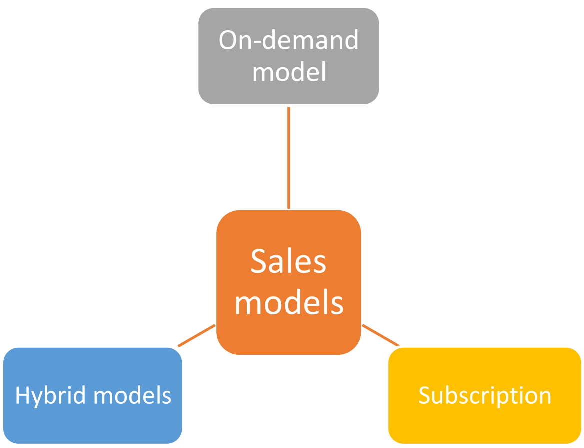


Figure 33: Sales models categories.

5.2.2 Manufacturing

Setting manufacturing as an output we are thinking about whether a CPG firm actually possesses (and wants) the facilities to manufacture its product/s or the capacity to do so. Generally, manufacturers can opt for three ways ranked in terms of ownership degree and control from most to least (Figure 34).

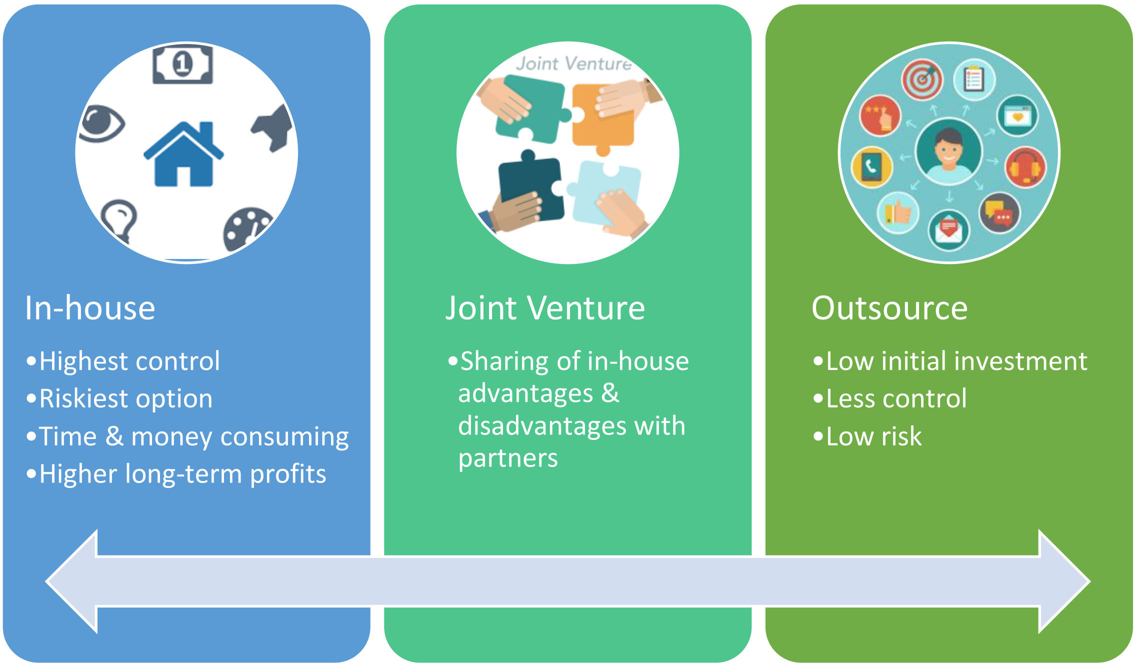


Figure 34: Different manufacturing options.

5.2.3 Logistics

This output shares a lot of similarities with manufacturing since both are englobed inside supply-chain. The additional and most important question that CPG players must know is if their sales volume is high enough to justify in-house systems. While manufacturing can be concentrated in a single factory for example, customers are spread all over the territory. Manufacturers will have to run some numbers to decide whether their purchases/population ratio exceeds a certain threshold that backs up the ownership of a logistics system (delivery fleet, tracking system, …) over hiring a third-party company. Again, a joint venture to share both risks and advantages is an option that should also be studied.

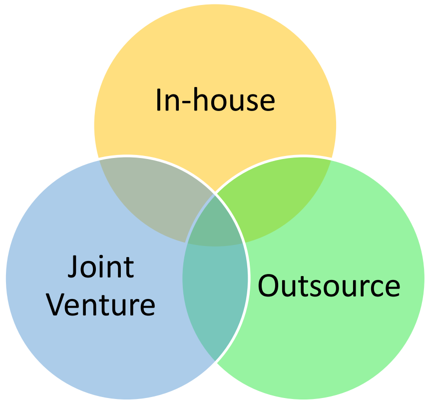


Figure 35: Logistics system options.

5.2.4 Product differentiation

There is an added difficulty level for CPG manufacturers to sell a new product or variation online. Channel conflict is a reality, retailers fear they are being bypassed and consumers can prefer buying old products through traditional channels. The key here is to offer them something that they cannot find anywhere else. It is going to depend on the product's characteristics, the brand image, and the competition but mainly there are three pathways that manufacturers can follow (Figure 36).

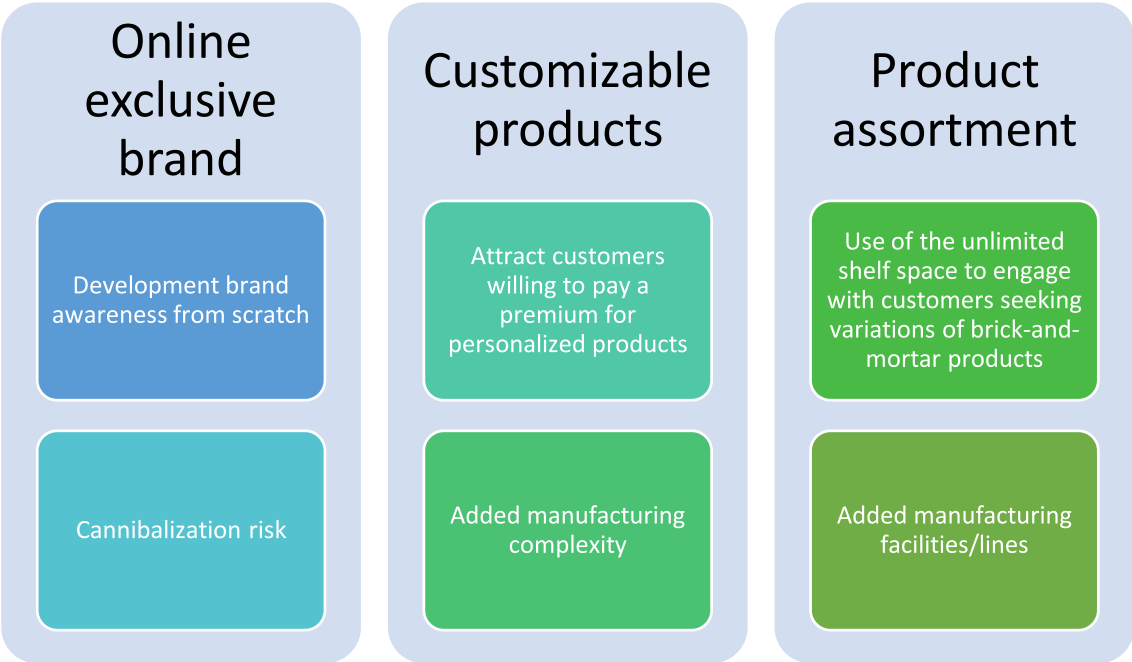


Figure 36: Different pathways leading towards product differentiation.

5.3 **Matrixes**

Finally, it is time to construct the matrix or matrixes that are going to serve as a tool for hesitant and/or lost CPG manufacturers trying to pursue a DTC strategy. However, when trying to develop our tool, we encounter one major issue: The number of possible input combinations is 1728. Evaluating every single one is an impossible task. To solve this problem, there are two options:

1. Group input combinations that need specific outputs and eliminate combinations that would be impossible in a real-world environment.
2. Use a top-down approach given that there are "only" 108 possible output combinations.

Using a top-down approach might be an easier task but we have to picture ourselves as companies trying to figure out what steps should they take. For this reason, a top-down analysis is not an appropriate approach since companies mustn't tailor their products to the capabilities that they can build. CPG manufacturers should build around its DTC product given its necessities.

The only way left is to group input combinations to start narrowing down the major DTC strategies that companies should be guided by when pursuing a DTC effort. A good starting point is to combine the desired DTC role with company type.

5.3.1 DTC Role vs. Company (Entrepreneur types)

E-commerce has allowed new companies to get a slice of the CPG pie. Barriers to entry have fallen and new players are entering the market. These new, smaller players focus all their efforts in engaging with a loyal customer base and start from scratch. In the other hand, whether the company specializes in a certain product category or is a large CPG player like P&G, they all start to realize the online marketplace is the future or a big part of it. Their willingness to shift towards DTC selling or their reluctance to fully embrace this paradigm change is going to determine the amount of resources they are willing to risk.

Table 2: DTC role vs. Company type.

<table>
<tr><th>DTC Role
Type</th><th>Sales driver or Core</th><th>Profit & growth drivers</th><th>Scale-builders or User-experience control platforms</th><th>Future bet or Innovation engine</th></tr>
<tr><td>Startup company</td><td colspan="3">Tightrope walkers</td><td></td></tr>
<tr><td>Niche company</td><td rowspan="2"></td><td rowspan="2">Sprinters</td><td rowspan="2">Joggers</td><td rowspan="2">Water-testers</td></tr>
<tr><td>Large CPG company</td></tr>
</table>

- **Tightrope walkers**: These companies go all-in when it comes to their own survival. If they are unable to reach certain thresholds in terms of sales volume, market share, or goodwill for example, tightrope walkers will be forced to shut down operations.

- **Sprinters**: These companies face a seismic organizational change. Even though brick-and-mortar sales are their major revenue source they believe online commerce is the path for future survival. Sprinters are determined to take higher risks and shape their organizations towards DTC commerce.
- **Joggers**: These companies are not ready to endure the challenges that sprinters are eager to develop but still don't want to fall behind other companies if DTC growth expectations were to rise abruptly. Joggers will take calculated risks and try to grow steadily but are more interested to build online presence.
- **Water-testers**: These companies don't think DTC commerce will represent a significant part of their revenue streams anytime soon. Water-testers are more interested in knowing if they could be able to embrace DTC commerce by developing one-time initiatives.

5.3.2 Targeted customers vs. Brand awareness (Customer types)

Now let's explore which possibilities CPG manufacturers have to engage the different online customers given their product or brand visibility. In an ideal situation a manufacturer would have both product and brand visibility, that would allow them to engage with their customer base in power position. What we have established by analyzing Targeted customers vs. Brand awareness are 4 different consumer types (Table 3) that, on paper, are profitable in a DTC environment. If there isn't a clear match (yellow color), the arrows point towards what consumer type should the companies go after (through marketing efforts or different value proposals).

Table 3: Targeted customers vs. Brand awareness.

<table>
<tr><th>Targeted customers vs. Brand awareness</th><th>Basic digital consumers</th><th>Retail scouts</th><th>Brand scouts</th><th>Digitally driven segment</th><th>Calculated shoppers</th><th>Eternal shoppers</th></tr>
<tr><td>No visibility</td><td></td><td>↓</td><td></td><td>↓</td><td rowspan="3">Treasure hunter</td><td rowspan="3">←</td></tr>
<tr><td>Product visibility</td><td colspan="2" rowspan="2">Amazonian</td><td>↓</td><td rowspan="2">Trigger-happy</td></tr>
<tr><td>Brand visibility</td><td>→</td><td>Fanboy</td></tr>
</table>

- **Amazonian**: This customer is going to purchase in an *e-tailer*'s website (hence the name given that *Amazon* is the leading *e-tailer*). Product assortment and ease is what an Amazonian is looking for when buying DTC.
- **Fanboy**: This customer is loyal to a specific brand and loves all its products. Companies should look after fanboys since they provide recurrent income and free marketing.
- **Trigger-happy**: This customer knows what he is looking for and doesn't want to lose time buying. Trigger-happy customers are willing to pay a premium for convenience and stick to well-known products or brands.
- **Treasure-hunter**: This customer knows what he is looking for but, as opposed to trigger-happy customers, prefers to research thoroughly and wait for the best, convenient deal. Treasure-hunters are not influenced by a product's (or brand) awareness and are not afraid of discovering new products.

5.3.3 Which inputs determine which outputs?

The number of possible input combinations has been reduced from 1728 to 96 (4x4x3x2) but explaining and differentiating among almost one hundred cases is still a herculean task. To eliminate combinations that continue to be nonsensical, we are going to see which specific inputs are directly related to each output.

i. Sales model: Companies cannot expect to sell detergent the same way they could sell their new flavored chips. In the same manner, a millennial is keener on subscribing for a product than a baby boomer that still prefers to click and buy each time. Then, customer types and product intrinsic value are the inputs which will determine the sales model.
ii. Manufacturing: CPG producers generate income from selling products rather than services. However, a factory is a resource consumer source that not every firm is able or willing to run. Given the economic strength and the willingness to take risks, that is given the entrepreneur type, the manufacturing model will be determined.
iii. Logistics: The main difference between manufacturing and logistics is scale economics. The end-consumer cannot be grouped together, making much more difficult to reach sufficient numbers. In addition to that, special product needs can make useless traditional logistics, making even harder achieving scale economics. For these reasons, the entrepreneur type and product characteristics will determine the logistics model.
iv. Product differentiation: If CPG manufacturers did not have enough problems battling against retailers, they also have to offer something unique to the distrusting customer. This last output is determined by different customer types and the product's intrinsic value.

5.3.4 Determining the DTC Strategy

Once a CPG manufacturer has researched and knows all its inputs, by using the previous and following matrixes (Table 2 to Table 7) the company possesses the guidelines to achieve DTC implementation success.

i. Sales model

Table 4: Determination of the sales model.

<table>
<tr><th>Customer types / Product intrinsic value</th><th>Amazonian</th><th>Fanboy</th><th>Trigger-happy</th><th>Treasure hunter</th></tr>
<tr><td>Commodity</td><td>Hybrid model*</td><td>Subscription</td><td colspan="2"></td></tr>
<tr><td>Competitive advantage</td><td rowspan="2">On-demand model*</td><td colspan="2">Hybrid model</td><td rowspan="2"></td></tr>
<tr><td>Innovation</td><td colspan="2">On-demand model</td></tr>
</table>

* In order to maximize the number of potential customers it is recommended that the CPG manufacturer partners with a retailer to enable the click-and-collect purchases.

ii. Manufacturing

Table 5: Determination of the manufacturing facilities ownership.

Entrepreneur types	Main recommendation	Secondary recommendation
Tightrope walkers	Outsource	-
Sprinters	In-house	Joint Venture
Joggers	Joint Venture	Outsource
Water-testers	In-house	Outsource

iii. Logistics

Table 6: Determination of the logistics ownership.

Entrepreneur Types / Product characteristics	Tightrope walkers	Sprinters	Joggers	Water-testers
Standard	Outsource	In-house	Joint Venture	Outsource
Special needs		Joint Venture/ Outsource		

iv. Product differentiation

Table 7: Determination of product differentiation.

Customer types / Product intrinsic value	Amazonian	Fanboy	Trigger-happy	Treasure hunter
Commodity	Product assortment	Customizable products	Product assortment	
Competitive advantage				Customizable products
Innovation	Online exclusive brand			

5.4 Transition plan

Large transformations take time to implement and even more time to reap the benefits. All CPG manufacturers decided to sign onto the DTC craze must acknowledge this fact and hedge their resources into various alternatives. Moreover, companies must change their mind-set (if they have not already done it) to survive and thrive in the *phygital* world. They have to be quick and flexible when implementing their DTC strategy, maintaining an iterative approach ready to apply rapid changes and adjustments. A *Mckinsey & Company* research (Kumar et al., n.d.) determined that, in addition to traditional project implementation skills and change management, three new elements are needed.

a) **Implement smaller pieces**: While waiting for the bigger plan (either to start implementing it or to complete it) companies should implement smaller pieces to start gaining know-how in this fast-changing environment.
b) **Test and learn**: Temporal or limited editions, pilots, and experiments are projects that CPG companies ought to implement on small scale to refine with low risk how DTC is going to impact the organization. A small-scale test allows to quickly gain experience, learn how to operate new capabilities, and to determine if the new concepts really add value to the business.
c) **Change the mind-set of the organization**: Be an *agile* organization. *E-commerce* for CPG manufacturers means thinking and acting like a start-up; which has new ideas and is not afraid to pursue them, allowing for mistakes and room to learn and grow. Organizations must encourage their employees to try new concepts and to acknowledge that there is no shame if some pilots fail.

6 Risk Management

For the moment there is no option to see the glass half full or half empty when it comes to selling DTC. The unwritten rule moving *e-commerce* is go big or go home; companies either win big or lose big (explaining the proliferation of small pilots) and due to the rapid growth pace, consequences are enormous.

6.1 Cost

Both retailers and manufacturers have to make DTC economics to work. In some cases, a series of tradeoffs will be necessary with CPG players choosing between near-term profitability or market share. Immediate profitability targets highly populated areas and is suitable for manufacturers with high-penetration category products (goods that are replenished periodically). In the other hand, opting for gaining market share will require a different approach since the project cannot be validated by measuring economic profitability. Offering a broader assortment increases volume but can be a double-edged sword due to high investment requirements.

6.2 Retailers

One of the main advantages that going DTC has is the ability to bypass the retailer but, at the same time, companies do not want to irritate their main revenue source. CPG manufacturers must think thoroughly how they are going to reassure their retail partners about their competitive intentions.

In the US market Amazon and Walmart are the main digital players, both introducing new features with which to engage with the customer and lock him down. As competition intensifies, ***e-tailers*** **will continue to put pressure on CPG manufacturers** so that delivery windows get narrowed or freight costs are assumed by the producer and not the final seller.

Manufacturers face the risk of paying penalties for missing retailers' demands and are almost forced (particularly for large CPG manufacturers with strong brick-and-mortar presence) to partner with giant online retailers under severe conditions.

Moreover, big **retailers are becoming CPG manufacturers** trying to bypass the manufacturer. The recent Amazon's acquisition of Whole Foods or Walmart's own brands like *Great Value* or *Sam's Choice* imply yet another risk for CPG manufacturers. If manufacturers do not offer an attractive enough deal, retailers could simply decide to boost their own brands and leave the rest of the producing players out of business.

6.3 Competition

That the number of CPG players is escalating is a fact that that large manufacturers can no longer overlook. **New companies** are coming up with new products and this is taking a toll in the sector. Fear of losing market share and avoiding a new Dollar Shave Club case (underestimate a start-up until is too late) is causing that CPG manufacturers often come up with products that cost a lot and give little or no additional value, ending up with a lower overall profit margin.

Transportation has been discussed earlier in this paper. What hasn't been considered is what happens when there is more demand than supply. This basic economic rule tells us that **transportation costs** will rise given that demand is increasing. Moreover, the pool of truck drivers is aging and, if new services such as autonomous vehicles don't arrive in time, manufacturers will see how transportation costs (which already account for the most part of a product's cost) continue rising towards dangerous unsustainable levels.

Increasing competition causes another dilemma for CPG manufacturers: Where and when do they bet their money? It is impossible to predict which model will catch fire and which winner should they place money in. Firms should think in terms of real share across all digital outlets but be careful because the digital marketplace is continuously evolving. To avoid the risk of betting all their money to one model only, companies should diversify and, even more important, have plans for quickly exiting bad bets.

6.4 Inexperience

"One size does not fit all". There is a need for tailoring new SKUs for these new DTC channels. Proliferation is commonplace and it has had an impact on reduction in order quantities. All this added **complexity** in SKUs is a major part in a company's cost structure. Manufacturers will have to handle more frequent network redesign, seeing how the industry lifecycles are converted from a once-a-decade exercise to a flexible, regular activity.

In the other hand, there is a need for reducing product complexity and manufacturers should think twice before launching product variations without understanding the effect on costs and complexity, and if consumers would appreciate having more choices or it would not add value.

Panic is spreading and, with the wrong strategy, manufacturers may be putting at risk the future of their firm making silly mistakes. For starters, some CPG players are not **listening to their customers' demands**. They are offering each and every DTC novelty even if their consumers do not want them. Imagine a new company that offers same-day delivery and the cheapest prices but forgets about convenience and free-shipping. If potential buyers fall into the second group, the company is heading towards a precipice. Every organization must recognize these differences if it does not want to invest money in features that are not making consumers more satisfied. Consumer goods producers must understand the tradeoffs and benefits of different offerings in each segment they are present in. Finally, a DTC strategy should be forward looking given this fast-paced industry and, more important, flexible to adapt to future demands.

Online commerce requires new processes and capabilities, leading to the key decision to either concentrate all digital capabilities in a single unit or conduct a more transversal approach across the organization. A BCG research in collaboration with Google, The Grocery Manufacturers Association, and IRI (Conroy et al., n.d.) establishes 4 basic models (Figure 37): Centralized, Hybrid, Built-in, and Standalone. All models have their strengths and risks, and the election of one model over another depends on the company previous structure and facility to integrate the new one.

A **centralized structure** aids achieving scale economics and provides better coordination and best-practice sharing between departments. In the cons side, it is less responsive to the individual needs of separate business units. The **hybrid structure** gives up scale needs but adapts easily to different objectives within the organization. However, if those are not clearly laid out, alignment with business units will not be ideal and governance will become more difficult. The third model, the **built-in** structure focuses on digital and *e-commerce* functionality integration throughout the entire organization, maximizing the ability to deliver a seamless experience across channels to all consumers. The major downside is that it requires clear ownership of decisions and an identifying process to sort out the optimal internal and external practices. In addition to that, it requires continuous learning and talent development to guarantee the seamless experience. Finally, a **standalone structure** is not linked to previous operating ways. It allows moving quickly to online commerce and it provides protection against retailers' retaliations. However, it can end up with duplicated structures thus raising operating costs. Also, there is the risk that the standalone structure makes decisions not consistent with corporate objectives.

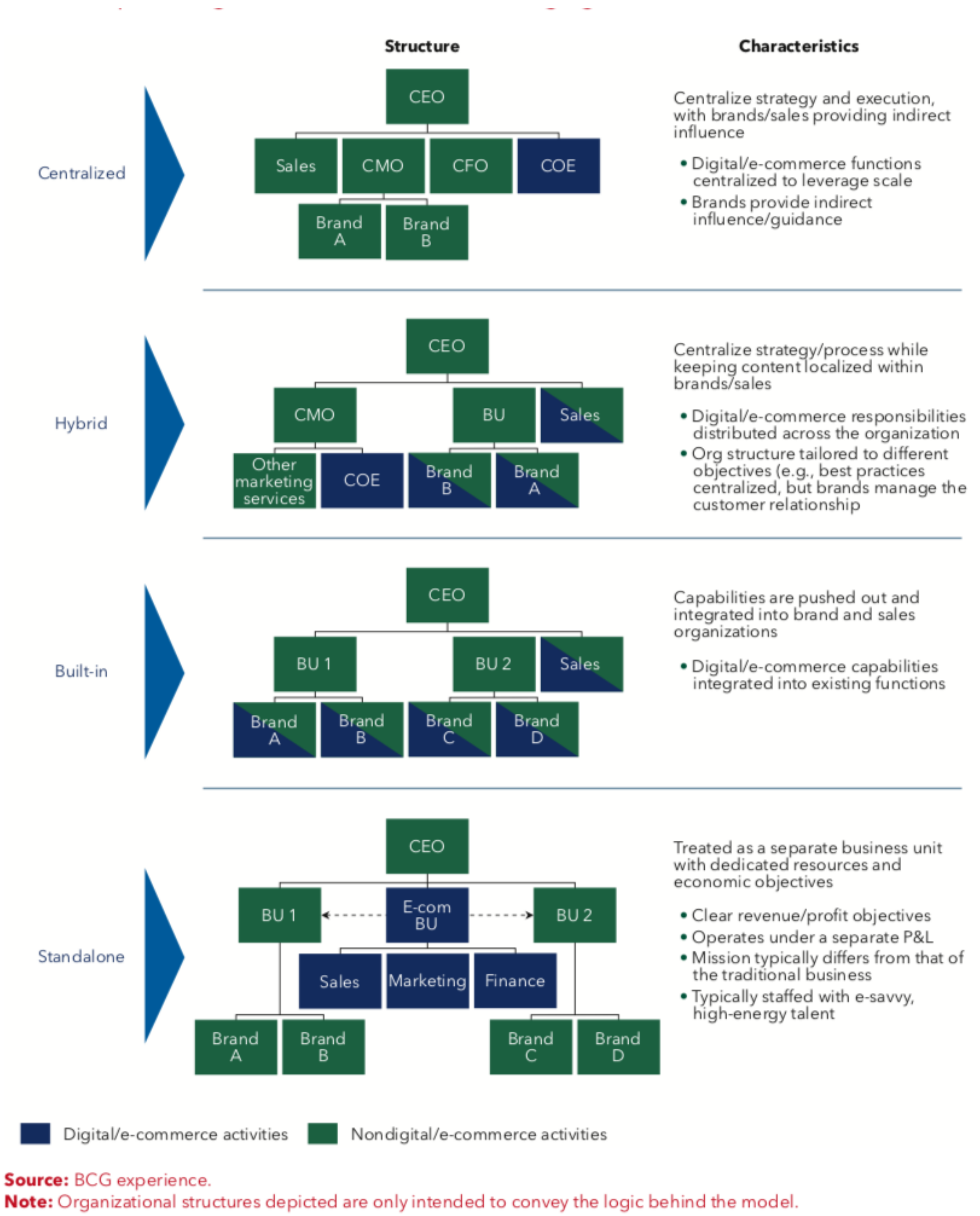


Figure 37: 4 Basic organizational models. (Hadlock et al., n.d.).

Besides big corporate decisions like choosing the organizational model there are other tensions that arise from going DTC. Several internal tensions, regardless of the organization model, are likely to proliferate. First of all, there is the risk of not being able to **manage and deliver inventory** in a channel-agnostic way when balancing between offline and online strategies. Also, different channels mean different prices with the associated risk that consumers find out and demand to pay the lowest price possible no matter the reasons behind a higher price. In the same way, **assigning budgets** to different channels now that boundaries are blurring will become more complex. **Accounting** will also become more complicated since the profit-and-loss structure depends now on the channel and product and not exclusively on the product. The coexistence of brick-and-mortar and digital commerce will also create conflict amongst customers. In-store and online promotions confuse them and lead to **sub-optimal economics**. Marketing has to pay special attention to brand messaging and content to act the same across channels to minimize consumer confusion.

Even the most successful CPG manufacturers face uncertainty. First of all, while enduring pressure exerted by shareholders' expectations, they need to decide whether to overcommit and use precious time and money to a business area that is currently small and presents high uncertainty. If leadership is not strong enough companies face a higher failure risk due to the digital business complexity. However, senior management experience is superficial when it comes to DTC commerce and they still have not developed the necessary skills and intuition.

Finally, manufacturers must always have in mind that the DTC segment is a fast-growing environment and that they have to change their mindset. Historically, CPG companies divest low-volume brands to potentiate bestsellers. Nevertheless, in today's environment this specific approach can be a **growth killer**. The ideal companies in which to invest in are those that still have sufficient demand room, far from reaching their limit, while those close to their organic limit should be sold off.

7 Validation Drivers

CPG manufacturers must control several key indicators to reassure their DTC efforts stay on track. To evaluate Direct to Consumer plays, CPG producers should supervise 4 types of metrics: end-to-end supply-chain metrics, general business indicators, long-term indicators (high lifetime value drivers), and consumer-related metrics low customer-acquisition costs).

7.1 End-to-end supply-chain metrics

Consumer goods producers have a lot of variables to control. In addition to that, DTC efforts often come with partnerships where manufacturers no longer have the ability to control everything and has to trust their new partners. To keep track of proper business operation, the following drivers list can help CPG manufacturers to know what to look for when trying to verify that everything is running as it should or to locate a problem.

- **Delivery speed:** The standard delivery time ranges between one day to a week thanks to Amazon's *two-day free shipping*. Manufacturers must reassure that their orders arrive on time to their customers. To track late deliveries, DTC players must control delivery lead time, that must be as close to the theoretical delivery lead time as possible.
- **Delivery precision:** In line with delivery speed, manufacturers must control that every order is delivered in a precise window. Either early or late deliveries are considered unsatisfactory deliveries. Manufacturers must track the percentage of successful deliveries to ramp up their service levels and avoid fines accorded with retailers or to fine the employed delivery service.
- **Shipment filling:** To add even more difficulty to speed and precision, manufacturers face the challenge of complex orders. The online marketplace offers a huge product's selection, each one coming in different shape and size. Managing on-time delivery

with full shipments becomes increasingly difficult as the product's portfolio increases (Figure 38). However, in order to keep transportation costs down, manufacturers should try to optimize their shipments filling.

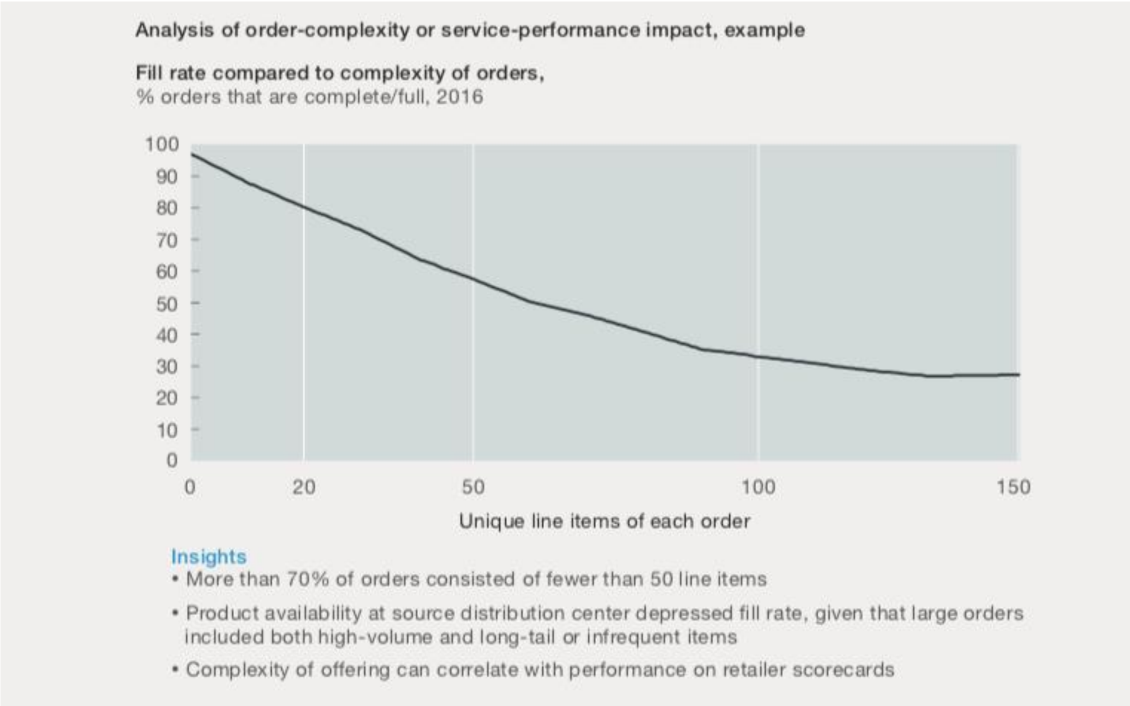


Figure 38: CPG manufacturers struggle to fulfill complex orders (Kuntze, Martin, Regnier, & Silva, n.d.).

- **Predictive accuracy:** Advances in machine learning, artificial intelligence, and big data must help manufacturers to predict demand more accurately from a SKUs point of view (which items are going to be purchased) and a time-horizon point of view (precise prediction over a long period of time). Manufacturers should aim at a 10% forecast precision improvement and a known horizon ranging from two weeks to a couple of months.
- **Rationalized portfolio:** New product introductions can boycott a viable DTC effort. Added complexity is not always profitable. Manufacturers must analyze effect on net margin that extra products bring. Reducing a portfolio's complexity can improve sales, net margin, delivery speed, and shipment filling.

7.2 General business indicators

Inside this category are financial measures common to CPG manufacturers. Metrics such as revenues, margins, internal rates of return, and cash flow (Bashkin, Joshi, Pacchia, & Ungerman, n.d.).

- Average gross margin per customer should be a minimum of six times the acquisition cost.
- Year over year growth rate of at least 50%.
- Capital investment should achieve the break-even point in no longer than four years
- Consistent cash flow regardless of business seasonality.

7.3 Long-term indicators

Unless the DTC strategy is developed with a time limitation in mind (pop-up stores, limited editions, …) it should achieve a high lifetime value. In order to do so, companies must pay close attention to:

- Average basket size big enough to cover the associated cost of goods sold.
- Achieve a minimum commitment level either through repeated purchases or lengthy commitments.
- Maintain low customer churn rates and positive net customer acquisition.

7.4 Consumer-related metrics

The number of potential *e-commerce* customers is rapidly increasing but so is the number of CPG players trying to capture the highest share possible of online consumers. Besides paying attention to supply-chain metrics that affect directly to customer satisfaction such as delivery precision or speed, manufacturers should also look closely to other metrics. Not every DTC enterprise is destined to succeed, and manufacturers can track the following metrics to know if they are making good progress or they should divest the enterprise and rethink their strategy before wasting more time and resources.

- Achieve low customer-acquisition costs, ensuring a minimum percentage of at least 10% of new customers coming through word of mouth and positive brand perception (online reviews and comments).
- Overall customer satisfaction. This metric is a combination of several factors being the most important accurate delivery, shipment options, customization options, online brand presence, and responsive customer service.

8 Conclusions

Consumers are shifting towards the online buying experience. If a CPG manufacturer strategy remains unchanged and focused exclusively on brick-and-mortar stores, its market share will, at best, stay the same. Although it is still uncertain the percentage of consumers that will decide for *e-commerce* as their primary option, growth in the consumer goods sector is going to be driven by online purchases in the foreseeable future. Manufacturers own survival will depend on their ability to adapt to the internet era and on which strategies will they rely on to pursue their DTC efforts.

However, this abrupt change from B2B to B2C brings exciting opportunities to CPG producers. From owning the entire purchase pathway to new, inexpensive ways of testing products, going DTC can be an opportunity to change the traditional *status quo*, where manufacturers only option was to sell their products to wholesalers or retailers. Thus, CPG producers can grasp more control and bargaining power over consumers and retailers by pursuing a DTC effort.

On the downside, the irruption of Amazon and Walmart's efforts to keep up can cause the situation to stay the same or even worse. Manufacturers face the risk to be almost forced to partner with these giant *e-tailers* under sever conditions. Moreover, retailers are also developing their own brands and becoming rivals in an already crowded marketplace. To add even more difficulties, as of 2018, there is not a universal algorithm that can tell manufacturers which strategy they should pursue to succeed in their DTC efforts.

In this part is where this report comes in. Analyzing which factors are most relevant in the CPG industry and how can they be related to certain strategies or capabilities that should be implemented and/or developed. Section 4 (Elements of DTC: Implementation) helped to visualize the enormous complexity of *e-commerce* that manufacturers confront before and during their DTC implementation. The objective was to narrow down the almost infinite possible input combinations into the truly relevant so that manufacturers could easily look at their product and company characteristics and have a clear enough picture of what to do.

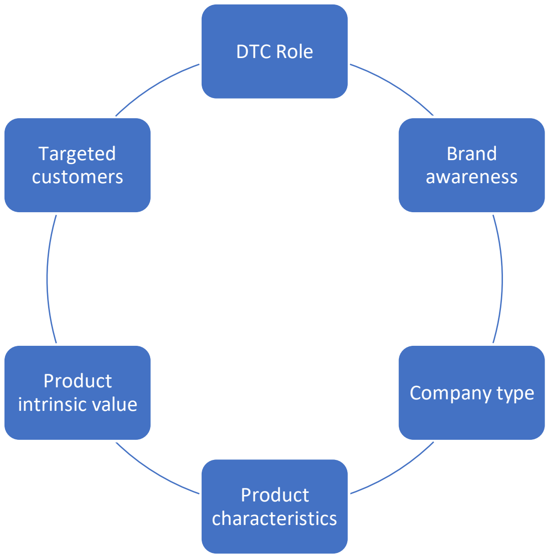


Figure 39: DTC strategy inputs.

Six major input groups (Figure 1) gave 1728 possible combinations. However, there were lots of combinations that did not make sense thus the creation of a visual tool (Figure 40) that allowed for an easy classification of a company and product, and a subsequent DTC strategy determination.

Going DTC is no easy venture, it comes with inherent risks that can be managed but not avoided. Furthermore, given that *e-commerce* is relatively in its early days, new problems will arise alongside with the business evolution and projects that once were profitable could become candidates for divestiture or the other way around; projects that were unfeasible could become future hits. Manufacturers will need to form strategic alliances and stablish partnerships that allow them to provide a good, fast, and reliable service.

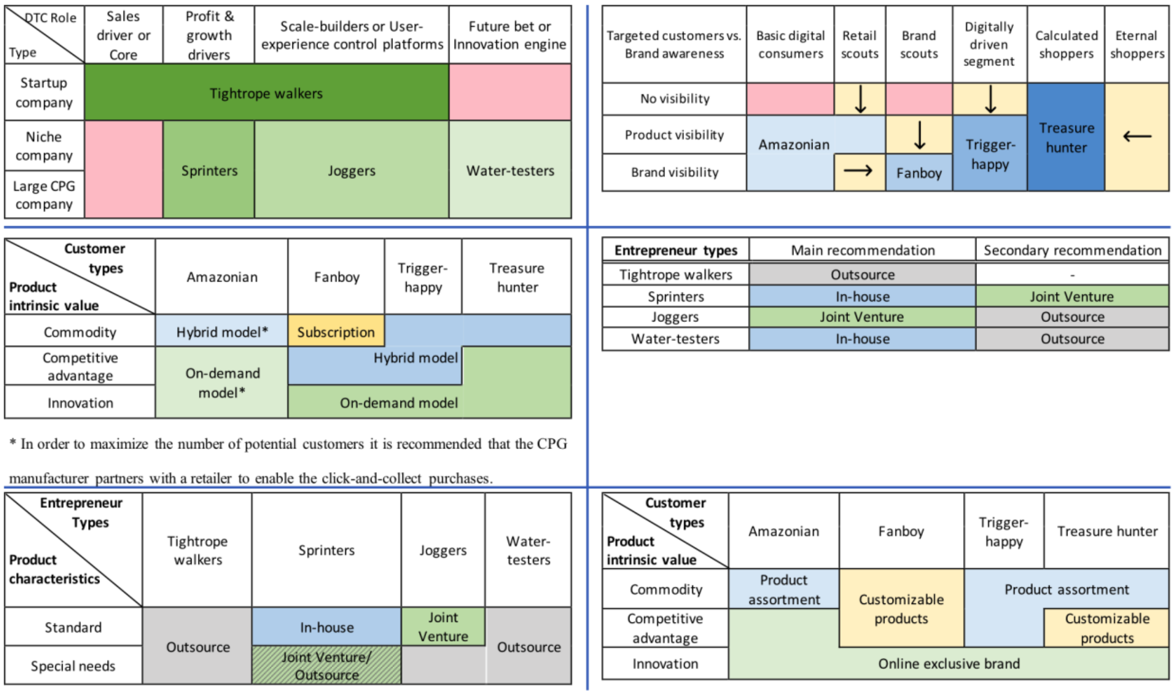


Figure 40: DTC strategy matrixes.

Every DTC player must be ready to adapt their entire organization to consumers' demands and capable to anticipate to changes and take advantage of it. For that purpose, advanced analytic tools must be developed and implemented so that manufacturers can track key parameters to know both what their customers demand and if they are staying in the correct path.

Overall, DTC commerce provides an interesting opportunity to increment market share and to challenge old consumer goods players. Due to relatively low initial investment and risk (through a test and learn enterprise manufacturers can avoid huge losses if the initiative does not succeed) CPG players, big or small, can become creative and become leaders in their (online) category overnight.

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