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How to accelerate online direct to consumer strategies beyond COVID-19

COVID-19 has boosted the relevance of online D2C as more consumers embrace e-commerce. Get it right to enjoy both profitability and growth.

With retail outlets closed for protracted periods because of the COVID-19 outbreak, consumer product companies have had to increasingly re-examine their online direct to consumer (D2C) strategies. Many have sustained or increased sales through such channels despite traditional routes to market failing. Some are exploring fresh opportunities to create stronger, more resilient online D2C business models that will sustain them during the oncoming economic downturn.

In fact, the current crisis has turned D2C routes to market from an opportunity to a necessity. Online sales have rocketed. The average online transaction value has risen 74% compared with a year ago, according to the electronic payments company ACI Worldwide.[i] The crisis has accelerated the long running trend toward e-commerce, with 44% of consumers expecting to do more grocery shopping online and 39% expecting to do more durables shopping online over the next one to two years according to the **EY Future Consumer Index.**

Consumers are also turning to businesses that can communicate a strong sense of social purpose on issues such as community, health and the environment as part of their overall value proposition. Online D2C provides businesses with an ideal platform for such messaging, as well as helping them demonstrate tangible reasons to purchase direct: offer differentiation, unique shopping experience and attractive pricing. In fact, while availability is most important for 59% of global consumers in the immediate wake of the pandemic, as the expected recession bites, such online channels may provide businesses with the right economic model to deliver better value to consumers at a perceived fair price.

These immediate concerns add urgency to existing reasons for creating online D2C models that are controlled exclusively by the consumer product company. One has been to capture e-commerce growth to offset the generally flat performance seen in offline channels where a proliferation of brands has made it difficult to get space on retail shelves. Another has been to reduce dependency on retailers and regain control over pricing policies to limit the erosion of profit on companies' high-margin products and innovations. And, finally, the growing recognition that businesses must become much more consumer-centric – a trend that has become a burning issue in the current business environment.

Not surprisingly, many consumer product companies want to realign their online D2C strategies to capture these emerging opportunities and achieve their longer-term strategic goals. Even though leading players in the sector have successfully seen a quarter of all sales move profitably online in this way, many have floundered in creating winning D2C initiatives. This test and see approach may have served businesses well before the pandemic, but the market is now moving rapidly. Even before the crisis, consumer products companies were seeing about 70% of their growth coming from D2C online channels.[ii] With consumers acclimating more rapidly to online shopping in the longer term, businesses getting their online D2C strategies right could be in a unique position to build growth, market share and profitability.

Chapter 1

Understanding the challenges

The rationale for launching online D2C strategies has never been stronger, but the challenges for doing so successfully have also deepened.

Understanding which categories are likely to be most successful, and how to implement effective governance, operations, supply chains and data management are hurdles that consumer product companies must overcome. These considerations are further complicated by variations among countries in issues such as privacy law, consumer attitudes and the cost of doing business: what works well in one market may fail in another.

In particular, the crisis has accelerated two long-term problems that consumer product companies face to achieve success with an online D2C model: poor product choices and consumer value propositions, and a limited understanding of creating profitable channels.

First, in the rush to compete in the e-commerce space and capture a "fair share" of the market, some businesses have poured money into ill-conceived online D2C projects. Although we have seen a significant culling of weak product lines by many organizations – and a strengthening of other offerings – it demonstrates that an understanding of which lines of business and consumer value propositions are best suited to online D2C remains elusive. For example, many have failed to sufficiently engage and incentivize consumers in sufficient numbers to bypass traditional retailers by developing compelling offers and brand experiences. Without a solid grasp of the fundamental economics behind such choices, the winners of today could well be the losers of tomorrow.

Second, many businesses have demonstrated the limits of their knowledge when it comes to making this business model profitable. For example, most start-up online D2C brands over the past few years have focused almost exclusively on growth to gain market share. The assumption has been that profitability would follow. When sales plummet, the pay-to-play model breaks down. With little money to meet the exorbitantly high costs of online consumer acquisition, traffic to those websites dries up – reportedly during the COVID-19 crisis by between 25% and 90% in some cases.[iv] Profitability needs to move more center stage in online D2C strategies. Our research shows that online D2C channels can comfortably achieve a 15% to 25% profit after operating costs – including those relating to marketing, consumer engagement, and supply chain.

Case study: Camera company refocused on online D2C due to crisis [iii]

Click to learn more

Deciding where to play

The strongest online D2C models closely match the economic attractiveness of the product on offer with the strength of the consumer value proposition. Working critically through our D2C business assessment framework should help organizations decide where to play. The constraints involved will differ from sector to sector. For example, while food and beverage products may pass the size test, they are often low value, and items that are perishable pose logistical challenges. Even so, companies do prosper in this sector. For example, a famous snack and beverages multinational successfully launched two online D2C platforms targeting specific consumer trends that emerged during the pandemic's lockdown period within 30 days.

D2C potential assessment framework

Category economic attractiveness

Order value: will the average basket size support a cost-intensive fulfillment model? Is there opportunity for increase (cross-selling, personalization)?

Order frequency: does purchasing frequency allow for a subscription-based model that will generate recurring revenue streams?

Acquisition costs: can the existing consumer database be leveraged to optimize mix of traffic acquistion options?

Retention/customer lifetime: can cost-effective CRM campaigns be implemented to increase long-term loyalty and profitability?

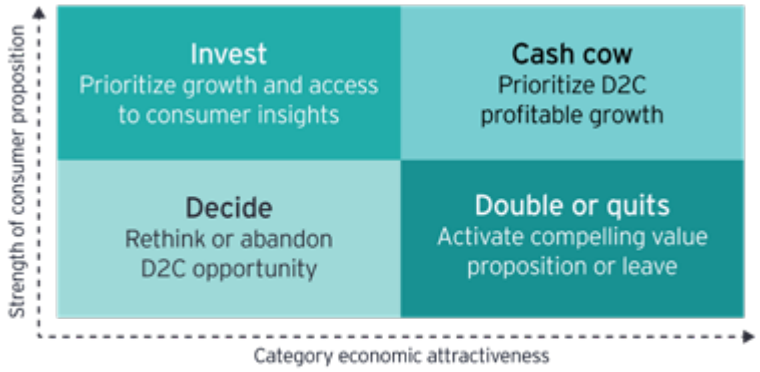
Strength of consumer proposition

Strategic role of the D2C channel: What is the value proposition for the consumer?

Differentiated offer: how will the product or service be differentiated from traditional channels, while managing complexity levels?

Pricing: which tactics are used to increase consumer perceived value?

Experience: what additional features will be implemented to support the consumer's end-to-end journey, i.e. tutorials, demo, support?



Source: EY-Parthenon Research and Analysis

Chapter 2

Winning in online D2C

Successfully competing in this field demands the implementation of a dedicated and agile online D2C operating model.

Traditionally, consumer product companies have faced operational problems with implementing online D2C channels because they significantly alter business and operating models. First, they remove the distribution intermediary – the retailer – and replace it with a complex, direct model that serves many people. The business must deal with an omni-channel strategy, be able to forecast demand, create bespoke supply chain and delivery processes, as well as handling payments, return management and customer communication. Second, it requires a shift away from marketing campaigns that are primarily designed to increase brand awareness to those that directly encourage consumers to purchase goods from the company's online outlets – ideally becoming brand ambassadors in the process. This shift regards consumers as long-term assets worthy of investment.

Successful online D2C strategies must manage the double complexity that these challenges present, while also meeting the high expectations that have been created by digitally native vertical brands: short delivery times, personalized consumer relationships, frequently renewed products and service offerings, purpose-led visions and socially sensitive propositions.

There is no easy answer to these challenges. Depending on the organization's strategic agenda, e-commerce maturity and financial resources, we believe that there are four online direct routes to consumer that can achieve profitability and growth. They involve different levels of operational outsourcing and partnership building. The simplest model involves the consumer product company putting its online catalog on an existing marketplace, such as Amazon or Alibaba. Alternatively, the business can open its own webstore, but rely on retail partners for distribution. D2C strategies can entail creating a webstore with distribution and fulfilment provided by logistics partners or launching a full-stack D2C channel. In each case the key to success involves harnessing online sales channels with a relevant supply chain and distribution model supported by a fully integrated, data-driven infrastructure (see Four possible online direct to consumer models).

Four possible online direct to consumer models

"Pure" D2C model – brand.com

Full stack

Description

Brand establishes storefront, as well as production, warehousing, distribution capabilities (last mile fulfillment typically third-party led)

Channel	Fulfillment
Brand	Brand/third-party led

Economic model

Benefits

- Direct access to final consumer
- Control over offer, data, brand experience and pricing

Challenges

- Operational complexity
- High marketing and advertising costs
- Potential channel conflicts

Storefront

Description

- Brand establishes web shop front end to engage with consumers and take orders
- Orders are fulfilled by third-party distributor(s)

Channel	Fulfillment
Brand	Distributor

Economic model

Benefits

- Speed – quick and easy to establish with a storefront
- Access to data through consumer engagement

Challenges

- Logistics problems reflect on brand
- High marketing and advertising costs

D2C "through intermediates"

Marketplace

Description

Brand sells directly to the end consumer via an existing third-party e-commerce platform

Channel	Fulfillment
Marketplace	Brand/marketplace

Economic model

Benefits

- Speed and reach – leverages scale of existing platforms
- Direct access to final client
- Control over the offer and pricing

Challenges

- No common standard to all marketplaces
- Additional skills are required, such as for promoting presence on marketplace
- Commission fees

Retail

Description

- Brand establishes web shop to engage with consumers and take orders
- Orders are are fulfilled via retail channel, i.e., click and collect

Channel	Fulfillment
Brand	Brand/retail

Economic model

Benefits

- Leverages existing channels
- Suitable for products that require pre-certification, i.e., proof of age

Challenges

- Reduced margin through retail channel
- Operational complexity, i.e., managing stock levels in retail stores

Source: EY-Parthenon Research and Analysis

While there is no one-size-fits all solution for creating online D2C channels, mastering the following disciplines is critical, whichever model you choose.

Mindset and talent

Consumer products companies must understand that the new channel is effectively a vertical retailer in its own right. This entails significant change in mindset best embodied by agile working practices and the creation of new strategic roles within the business staffed by people with deep experience in online D2C. For example, when the shoemaker Birkenstock Digital GMhB recruited 45 people for its D2C initiative, it favored those with backgrounds in ecommerce and digital expertise over those with deep experience in the shoe industry.[v] Nike's acquisition of Zodiac predictive analytics group enabled the business to support multiple D2C teams with core technical expertise as its offerings matured.[vi] Training must be geared to specific retail capabilities, including promotion, loyalty programs and sales – and dealing with the integration of new partners. Creating the right teams with consumer-centric mindsets and skills will enable the business to engage and incentivize consumers by developing compelling offers and brand experiences.

Partners and ecosystems

Businesses must continue to nurture and strengthen relationships with retailers and look to build ecosystems. Being sensitive to the needs of existing retail partnerships means clearly distinguishing online and offline products and promotions. In some instances, selling direct to the consumer with a click-and-collect process at a retail partner may be more attractive and cost-effective than building a model that delivers the goods to the consumers' homes. The US beverage retailer Drizly has adopted such an approach.

Since online D2C platforms generate more insight into consumer behavior, it is often possible to build an ecosystem of services around a core offering. For example, a beverages company could add snacks, experiences and delivery by teaming up with businesses in related sectors.

Data and consumers

Online D2C channels equipped with data management platforms to reconcile offline and online data provide a window into consumer behavior on a scale and timeliness otherwise unavailable to consumer products companies. This enables rapid response and innovation based on changing trends. Businesses can adapt their offerings by increasing the effectiveness of marketing campaigns, personalizing products and customizing services within days and weeks – thereby replicating the agility of digital-only start-ups.

Enterprises launching products and brands that differentiate beyond price are more likely to succeed in the coming years: the EY Future Consumer Index shows that 67% of consumers are more likely to purchase from businesses with social purpose. Having a distinctive proposition can also prevent the business from having to enter into price wars with competitors. Additional insights gleaned from consumer data could inform overall advertising spend and even the mergers and acquisitions pipeline.

Profitability and growth

As businesses create innovative and meaningful ways of connecting with consumers, they must ensure that marketing spend does not nudge the online D2C initiative into unprofitable territory. Companies are already beginning to seek ways of avoiding the excesses of the broken pay-to-play D2C model: spending too much to acquire traffic and hoping for the best has shown to be a faulty strategy in the current crisis. Businesses that win create and engage a consumer community with relevant and savvy marketing and develop sound CRM disciplines to increase purchasing frequency and loyalty.

Our analysis of leading online D2C brands shows that the paid traffic acquisition budget will continue to take up between 20% and 30% of online D2C sales revenue if true growth and scalability is to be achieved – a percentage that could well rise in the future. Equally, some companies with strong brands have achieved 45% of their revenue for the channel from direct traffic and organic search, illustrating that an innovative approach traffic acquisition pays dividends.

67% **of consumers are more likely to purchase from businesses with social purpose**

Summary

The current crisis has certainly accelerated some online D2C initiatives and inspired new ones that may never have existed otherwise. Being consumer centric, offering compelling products and services, delivering a differentiated shopping experience – coupled with a powerful, agile operating model is the key to success. It is a key that could unlock accelerated, profitable growth into the future for those businesses that get it right.

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