Is it zero hour for consumer packaged goods companies?

A look at the changing landscape of direct-to-consumer

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The traditional business model that linked manufacturers, retailers, and consumers is finished.

Consumer packaged goods (CPGs) companies can no longer count on continued success based on the historic formula of mass production to mass distribution to mass marketing ("mass-to-mass-to-mass").

Geographical entry points are dwindling, and stores are now closing faster than they are opening. The ability to make new markets with product innovation (i.e., new flavor, features, or technology) has been largely co-opted by new brands with specific, differentiated attributes.

As a result, the core of competitive advantage is shifting. The benefits of growth, influence, and market share are quickly transitioning from traditional CPGs and retailers to a combination of online start-ups and platform companies. These new powerhouses are investing heavily in understanding the modern consumer and offering tailored propositions to meet specific needs.

The implications? The retail landscape has already watched dozens of brand names like Blockbuster become a distant memory. This new threat is real and the time to act is now. With once impenetrable business models exposed and at risk, CPGs must get ahead of the full-scale disruption curve and invest in robust digital and social platforms and channels that will enable them to effectively engage with consumers.

The good news: early leaders' direct-to-consumer (D2C) value propositions and business models are resonating with consumers. CPGs can learn from these efforts and make strategic and tactical moves (e.g., build, buy, partner) to accelerate their own movement into the D2C space and create a sustainable advantage.

Consider Amazon, Facebook, and Google.

These are some of the platforms that enable start-ups and others to gain share in a way that was impossible in the mass-to-mass-to-mass world.

Google is the default search engine with **3.5B searches every day.** Startups can buy select terms to target specific segments.

(Source: Search Engine Land: Google Still Doing At Least **1 Trillion Searches** Per Year, January 16, 2015)

Facebook provides the default social experience for **1.1B daily active users.** Startups use this platform to micro target specific consumers.

(Source: Venture Beat: Facebook passes 1.65 billion monthly active users, **54% access the service only on mobile**, April 27, 2016)

An important first step is to understand how start-ups and platform companies have fundamentally changed the competitive dynamics for consumer markets companies.

Online start-ups

Starting a business now requires little more than an idea and a Kick-starter account: the cost of launching a start-up has dropped from $5M in 2000 to less than $5000 earlier in this decade.[1]

Hundreds of start-ups have come online, leveraging technology, distribution, and marketing channels to aggressively pursue products from razors to food to mattresses. These new companies are going to market with intense focus on select categories. They continually improvise and innovate based on consumer response and feedback. Even a slow response results in knowledge they can apply to their next moves.

Newcomers tend to take market share in small pieces, but those pieces can add up to significant losses for large incumbents that rely on traditional value chains and are often too entrenched to respond to disruption. Scale, assets, and brand are no longer barriers to entry, and everything else (i.e., manufacturing, sales and marketing, distribution, and customer service) can be outsourced.

As start-ups continue to unbundle incumbent portfolios thoughtfully and with precision, CPGs are beginning to sit up and take notice. One CPG executive told us, “We have had more competitors launch products in the last 18 months than in the last 18 years.”

[1] CBInsights November 18, 2015

Platforms

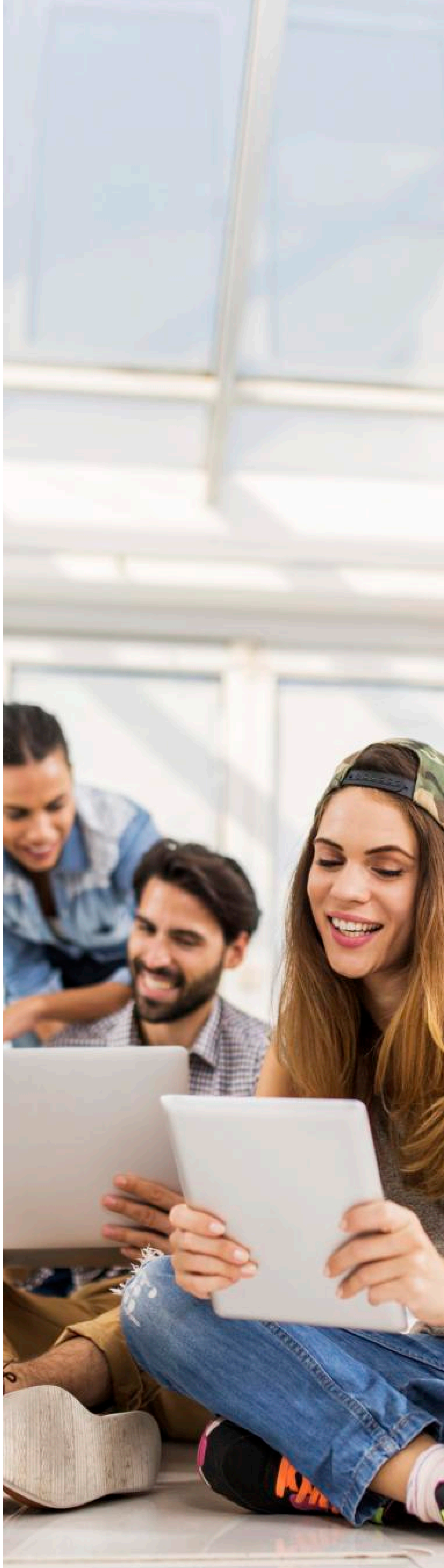
In addition to online start-ups, platforms are emerging that break the mass-to-mass-to-mass paradigm further and connect multiple sellers with multiple buyers.

Platforms have become the default entry point for specific consumer experiences. They are not predisposed to maintain market share for incumbents—they let consumers and algorithms decide. For example, Google makes companies visible with 3.5B searches per day by potential consumers and Facebook provides reach and targeting with 1.1B potential consumers who are daily active users.

Once-defendable shares of shelf positions or ownership of traditional mass marketing channels have become increasingly less important as consumers' expectations for choice, price, and convenience continue to change. In fact, some players in the market are increasingly defining their customer offerings themselves, blurring the traditional line between retailer and manufacturer.

Platforms also expand to create integrated ecosystems. In addition to the top three, Pinterest, Jet, and others provide infinite shelf space and ample opportunity for new brands and products to introduce themselves to consumers—a capability that was effectively impossible in a mass-to-mass-to-mass world.

The threats are obvious. In the immediate term, large incumbents' risk of share dilution to competitive brands is high. This threat includes online start-ups as well as platform companies becoming product companies. See illustration at left.



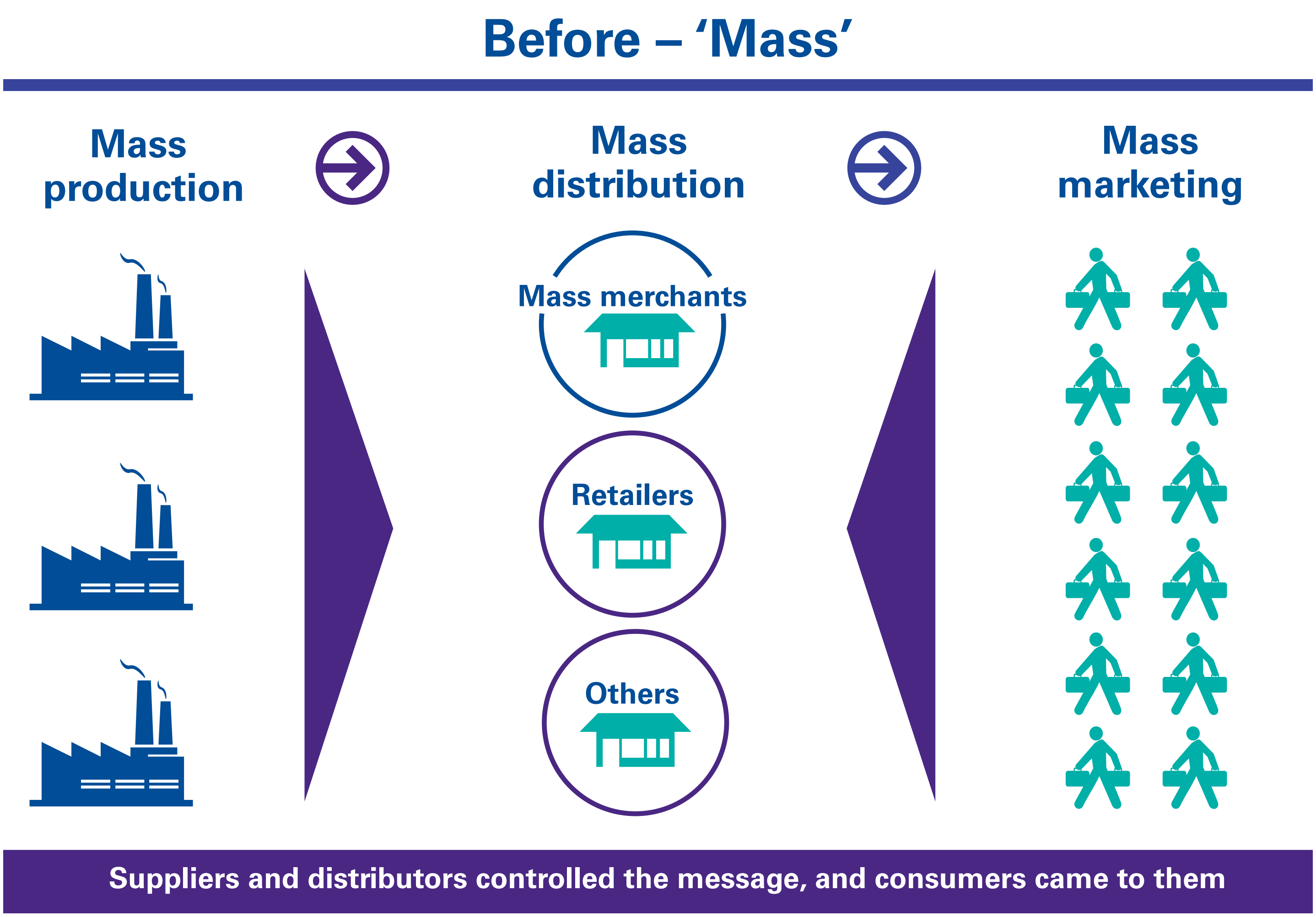
Welcome to the "zero hour"

The core of competitive advantage has changed, creating a "seminal moment" for CPGs, which are gradually ceding growth, influence and market share to online start-ups and platform companies. These new competitors offer business models that consumers prefer, and many CPGs are ill-equipped to respond to meet consumers' needs.

How CPGs are losing ground

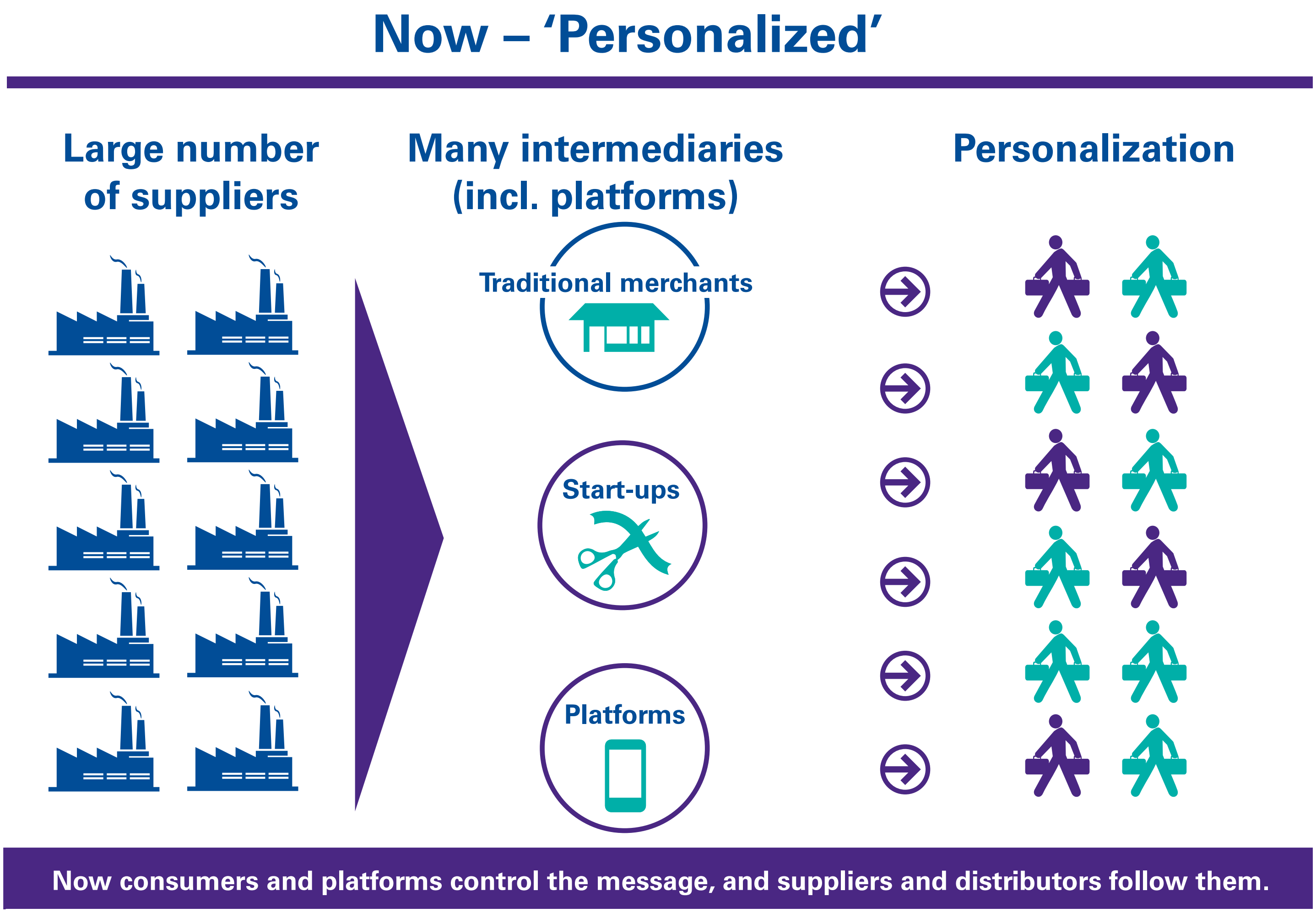
The core of competitive dynamics is shifting from control of supply to control over demand

Illustration 1



When the Internet emerged, mass merchants built for retail scale were forced to adapt slowly, painfully, and very expensively to an omni world. CPGs are now facing a similar moment. They are built to ship truckloads of pallets to huge distribution centers. Winning in the future will require personalization, agility, and the ability to pick, pack, and ship items across multiple channels, including direct to consumers.

As with other big shifts, some will make the transition to compete in the new world—but many will begin a long, slow decline into irrelevance. Consequently, regardless of which options CPGs choose, the status quo cannot be one of them.



Source: KPMG LLP, 2016

What can we learn from early leaders?

Early leaders established three pillars to position themselves for success:

1 **First, they defined and developed a distinct offering with a clear consumer benefit.** Our analysis revealed four winning value propositions, with leaders often combining two or more to create a truly compelling consumer offering, as depicted in illustration 2.

Illustration 2

D2C winning value propositions focus on four important goals

There are different ways to execute, and companies need to find an optimal combination to succeed.

Source: KPMG LLP, 2016

2 Second, they focused investment in capabilities required to compete in today's environment

— **Mobile first** – most consumers learn about and start their journeys on mobile, yet most CPGs still have mobile experiences scaled down from their desktop site (and most are corporate pages, not commerce pages). Leaders build experiences on mobile first (i.e., Birchbox), and scale up to bigger screen sizes (or even physical assets).

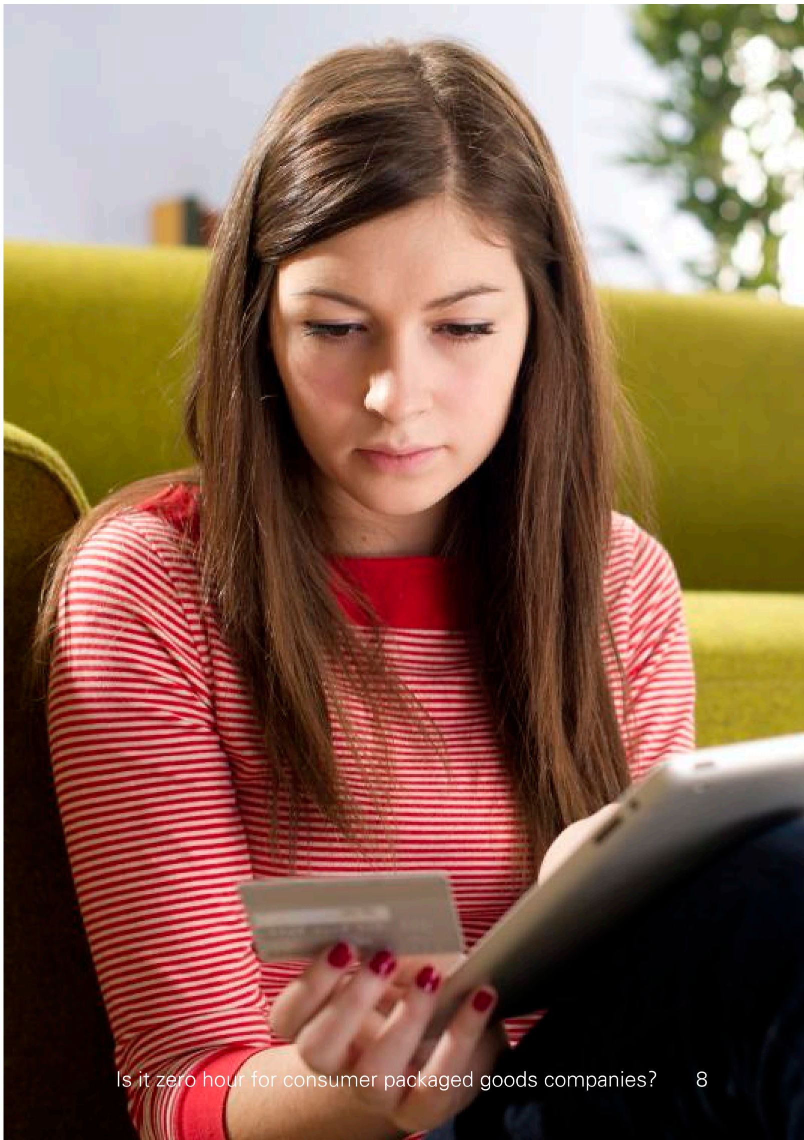
— **Distinct branding** – Think carefully about extending existing CPG brands into the D2C space. It can be done if an offering addresses a highly defined pain point (think HP Instant Ink)—but often, consumers are not convinced of the value, and channel partners perceive conflicting objectives. In contrast, most early leaders create new brands that convey a purpose. Even CPGs such as Unilever recognize the need for distinct branding with recent D2C acquisitions such as Dollar Shave Club, Murad, and Dermalogica.

— **Social/digital expertise** – Acquiring customers is often the hardest part of launching a new venture. In the past, companies often spent significant sums on large events and tried to capture a huge audience in one swoop (who remembers the sock puppets from the Super Bowl?). Today, however, leading start-ups begin with a thoughtful approach to social and digital channels (think Dollar Shave Club). They invest aggressively, but execute over a sustained period of time in which they can capture consumer data, refine their targeting, increase their share of wallet, and repeat.

— **End-to-end experience** – With no store-base to shape a brand, start-ups need to build a magical end-to-end experience. It begins with the first impression, often through mobile, all the way through the unboxing of a product and beyond to continuous consumer engagement (think Harry's Razors). No detail is too small, and every step along the way must be frictionless, support the brand and empower the customer—for whom the best experience quickly becomes the expectation.

3 Third, they had an entrepreneurial vision and built for the long term

With no core business to fall back on, enduring success is paramount. Leaders build a portfolio of options, fail fast, tolerate risk, and quickly scale winning propositions. Most start-ups cycle through innovation 10 times faster than incumbents and are therefore significantly better at finding and exploiting white spaces in markets. An experiential learning culture drives calculated risk taking, and the passion for innovation means setbacks are not necessarily deterrents.



Where can organizations begin?

For CPGs that are evaluating the journey, or those that have already started, here's a quick guide to an approach and questions that can accelerate the process.

Step 1 | Build a fact base

of emerging trends and signals that could impact your business. Rather than tomorrow or even this fiscal year, focus on the next 3 to 5 years:

— **Identify** new competitors, small and large, that could offer a better value proposition for your consumers—new product attributes, substitute products, different pricing models, more efficient distribution, more personal relationships. Think beyond your traditional business: the fight for consumer wallet is intense across all industries.

— **Learn** from leaders in other market spaces – codify the success they are having and the areas in which they are innovating. At the end of the day consumer expectations transcend industries.

— **Map** investment trends in and around your industry. Where is VC money flowing, capital being spent, and influence shifting?

— **Determine** how technology will impact your products and channels now and in future. Will our core product be leapfrogged, or traditional channels be disintermediated?

Step 2 | Derive implications and develop an appropriate level of urgency.

Synthesize the findings into implications for your business. Consider questions including:

— What does success look like?
What is our financial ambition?

— What level of disruptive risk are we facing today, in two years, five years? Where are we most at risk? product obsolescence, channel obsolescence?

— Which guiding principles should form the basis of our D2C model?

— Which stakeholders, internal and external, must be on board to accelerate our efforts—directors, shareholders, long-term employees?

— How late is too late to begin?

Step 3 | Build a portfolio of business model options

— **Utilize** learnings from early leaders, emerging competitors, and capital/technology developments to develop a series of business model options.

— **Evaluate** options along critical dimensions including size of the prize, ability and time to implement, resources and capabilities required, and organizational change management needed.

— **Assemble** options into a portfolio, and create and prioritize a multiyear map of initiatives to pursue.

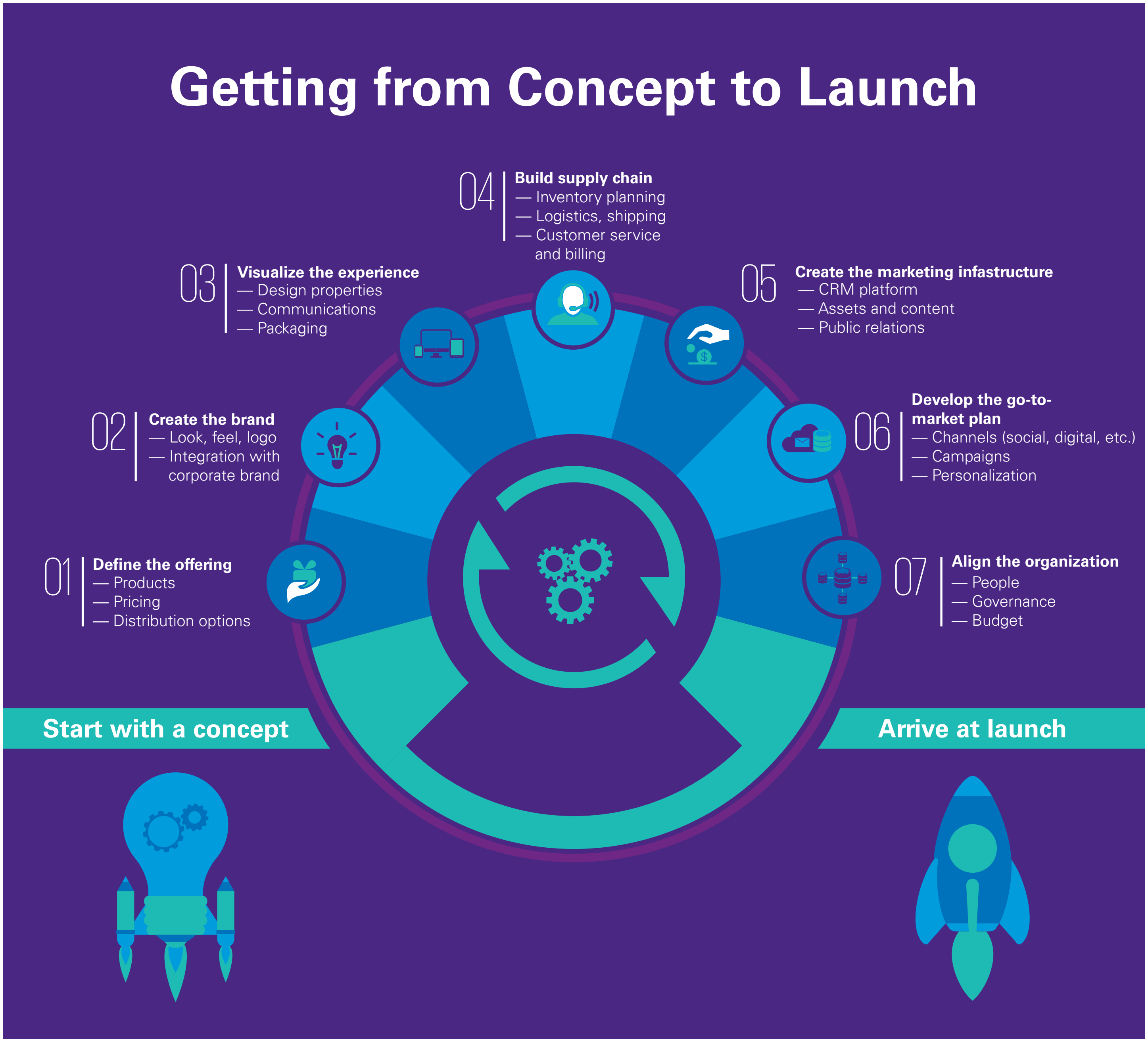
— **Fund** both near-term options that have greater clarity and long-term options that need further definition over time. You may need to begin both initiatives simultaneously.

— **Expect and accept** new profit models—different revenue and margin economics. Short-term benefits may be limited, so plan to invest for the long term.

Step 4 | Move from concept to launch

Assemble a dedicated team of entrepreneurially minded, high-performing leaders to run the initiative(s). Without such dedicated focus, efforts tend to stall and quickly fade as day jobs take precedence. Construct the building blocks of the business, leveraging best practices from leaders, investors, and others, as depicted Illustration 3 on the next page.

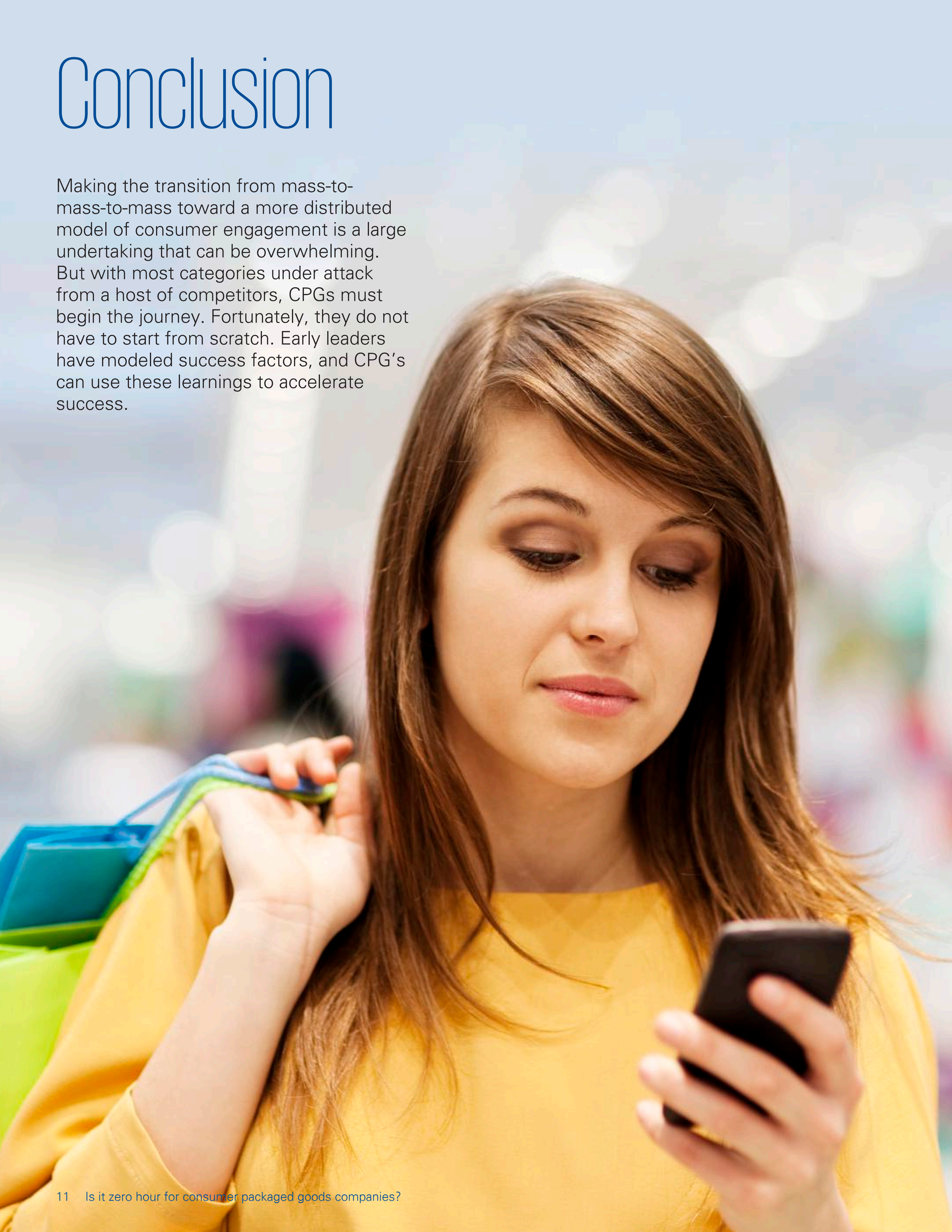
Illustration 3



Source: KPMG LLP, 2016

Conclusion

Making the transition from mass-to-mass-to-mass toward a more distributed model of consumer engagement is a large undertaking that can be overwhelming. But with most categories under attack from a host of competitors, CPGs must begin the journey. Fortunately, they do not have to start from scratch. Early leaders have modeled success factors, and CPG's can use these learnings to accelerate success.



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Scott is a managing director in KPMG Strategy with 20 years of experience across the retail and consumer sectors. He has spent significant time as a strategy and operations consultant and in senior executive roles at both a FORTUNE 150 retailer and a mobile commerce start-up. Scott has deep experience in defining and implementing major strategic initiatives across many channels and functions in retail. He has extensive experience in mobile, omnichannel, merchandising, marketing, product management, consumer life cycle management, and operations.

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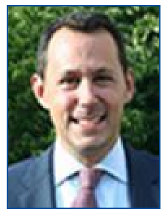

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