Marketing & Sales Practice

DTC e-commerce: How consumer brands can get it right

Consumer brands need to make direct-to-consumer economics feasible and the customer experience seamless.

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Consumer brands have been seeking to establish direct relations with end customers for a range of reasons: to generate deeper insights about consumer needs, to maintain control over their brand experience, and to differentiate their proposition to consumers. Increasingly, they also do it to drive sales (see sidebar, “Why go direct?”).

For any brands that have considered establishing a direct-to-consumer (DTC) channel in the past and decided against it, now is the time to reconsider. COVID-19 has accelerated profound business trends, including the massive consumer shift to digital channels. In the United States, for example, the increase in e-commerce penetration observed in the first half of 2020 was equivalent to that of the last decade. In Europe, overall digital adoption has jumped from 81 percent to 95 percent during the COVID-19 crisis.

Many companies have been active in launching new DTC programs during the pandemic. For example, PepsiCo and Kraft Heinz have both launched new DTC propositions in recent months. Nike’s digital sales grew by 36 percent in the first quarter of 2020, and Nike is aiming to grow the share of its DTC sales from 30 percent today to 50 percent in the near future. “The accelerated consumer shift toward digital is here to stay,” said John Donahoe, a Silicon Valley veteran who

Why go direct?

Consumer brands pursue different objectives with their direct-to-consumer (DTC) offerings. The following are some examples:

— *Customer-insight generation and community building.* Harry’s pre-launch campaign helped the company generate 100,000 email addresses from potential customers through a waitlist and social sharing. It also allowed the brand to send out free samples to the most prolific referrers and make various tweaks to its handles and razors based on what it learned from those customers early on, before releasing the products to a wider audience.

— *Brand building and differentiation.* Lego.com not only sells products but also features branded videos and games that tie in with Lego’s toys, creating a seamless brand experience across multiple media. During the COVID-19 pandemic, there has been a 70 percent increase in content uploads by users of Lego’s online platforms that help the company engage with consumers and find out what they like, especially in fast-growth markets, such as China.[1]

— *Fueling innovation.* DTC also provides the platform to test the latest innovation in products and services, giving brands direct access to consumer feedback for evaluation and testing. L’Oréal launched its augmented-reality try-on service in 2018 as a way for consumers to sample the brand’s makeup and hair-color products without going to a store. During the COVID-19 crisis, the use of this touchless service has increased substantially. It is currently being rolled out to additional countries, such as India.[2]

— *Driving sales.* In many cases, consumer brands combine this goal with some or all of the objectives listed above. Brands will want to minimize conflicts with their channel partners, a key concern for companies that mainly sell through retailers, wholesalers, and distributors. One option is to create a dedicated, exclusive e-commerce assortment. Another is to share customer insights generated through DTC with channel partners for mutual benefit.

[1] “Lego builds its brand in China with experiences,” WARC, January 13, 2020, warc.com.
[2] Sara Castellanos, “L’Oreal expands virtual try-on service,” *Wall Street Journal*, December 19, 2019, wsj.com.

became Nike president and CEO in January.[1] Our consumer sentiment research shows that two-thirds of consumers plan to continue to shop online after the pandemic.

What's stopping you?

The vast majority of consumer brands are used to selling through intermediaries, including retailers, online marketplaces, and specialized distributors. Their experience with direct consumer relationships and e-commerce is limited. As a result, they often hesitate to launch an e-commerce channel despite the obvious opportunity it offers. Just 60 percent of consumer-goods companies, at best, feel even moderately prepared to capture e-commerce growth opportunities. Here are some concerns expressed by top executives globally:

- "I'm worried about fulfillment. What if we disappoint online shoppers? I don't think they will have the patience to allow us to try again. We only have one shot to get this right."
- "There are so many variables. You need a pricing engine. Payment. Order tracking. Delivery. Returns. There's no end, and we have never done any of this before."
- "Won't DTC just cannibalize all my other channels, possibly at higher cost? What if it brings down our profitability?"
- "Building an e-commerce channel would absorb a lot of resources, and I'm not sure it would add much revenue. We have bigger fish to fry."
- "We are great at making things, and we are good at managing partners. But when it comes to selling directly to consumers, we don't really know where to start."

By having a deliberate strategy that clearly qualifies the opportunity and an execution capability to effectively convert customers at a reasonable cost, consumer companies can overcome these concerns and set up a profitable new source of growth.

Making the economics work

Driving sales while generating deeper consumer insights is valuable. But if the margin doesn't meet a company's targets, is it worth the hassle? For e-commerce to be a profit center rather than a loss leader, companies need to manage the economics of DTC effectively across revenue and cost.

Revenues

Leading brands thoughtfully consider their revenue goals for DTC and the ways to best to meet them.

DTC channel role. Start by defining the role DTC should play for the brand. Does the company aspire mainly to generate incremental sales? Or pursue other objectives, such as brand differentiation and insights generation? Or a combination? Nike, for example, invests in DTC as a way to further establish its brand. As the number of its third-party distribution partners grew over the years, the brand risked being diluted because of inconsistent consumer experiences. In 2020, Nike reported that one-third of its global sales were completed through Nike Direct.[2] In a similar vein, 75 percent of online shoppers say they prefer a personalized experience. For example, fashion brands such as Maje, Sandro, and The Kooples offer exclusive online presales to registered online customers.

Assortment. Many brands choose to adapt their DTC assortment to the specific requirements of their sector and consumers. The new web shops PepsiCo and Kraft Heinz launched this year offer only large items or bundles. This is to ensure that basket sizes are large enough to offset shipment costs, to avoid conflicts with other channels, and to provide convenience to those customers who

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[1] Phil Wahba, "How Nike hit its e-commerce goal 3 years early," *Fortune*, September 23, 2020, fortune.com.
[2] Kati Chitrakorn, "Inside Nike's latest bet to understand its customers," *Vogue Business*, July 28, 2020, voguebusiness.com.

prefer to buy certain items in bulk. In contrast, high-street fashion brand & Other Stories releases an exclusive, online-only collection every season to differentiate its e-shop. Successful DTC players usually limit their online portfolio to the products that provide a good balance of revenue potential, operational feasibility, and consumer benefit.

Prices. As a general rule, online prices should be on par with retail prices. But premiums can be justified by offering additional benefits, such as free delivery and returns, exclusive merchandise, or product personalization. Some players have devised unique online pricing schemes to drive frequency and total spend per year, especially in categories with high repeat-purchase potential. For example, Gillette encourages shoppers to subscribe to razor-blade delivery by offering the first kit for free. As an additional benefit, this model allows Gillette to build deeper relationships with its customers and foster loyalty.

Cost

Best-practice companies manage all elements of the online shopper journey to keep the costs of DTC in check.

Prepurchase. Marketing cost can be optimized by making the most of both paid and owned media investments, such as your own social media channels and outbound customer relationship management (CRM). Key efficiency indicators to watch include the customer acquisition cost (CAC) and the marketing return on investment (MROI) at the level of individual customers.

Delivery. Partnership fees, such as referral fees, are a key driver of supply-chain cost. Large corporations will want to establish frame contracts with logistics providers for all their brands. Lighter product packaging for the online assortment and flexible shipping options, such as click and collect or delivery to partner retailers, can help keep shipping costs down. In France, apparel brands H&M and Decathlon work with Mondial Relay, a leading distribution network that lets customers pick up their orders at newsstands and convenience stores.

Postpurchase. Acquiring a new customer can be up to five times as costly as retaining an existing customer. This is why managing customer lifetime value (CLV) is crucial to DTC profitability. Consumer brands will want to maintain relationships with existing customers and keep engaging them with new touchpoints. A great DTC experience typically generates a “lock-in” effect that leads to superior economics. L’Oréal, for example, encourages its customers to sign up for its online loyalty program Worth It Rewards. The more information subscribers offer, the more rewards they receive in return. Over time, product recommendations and offers become more targeted, incentivizing subscribers to buy more, which provides L’Oréal with more information—a virtuous cycle.

As a general rule, the DTC business model is viable when the CLV is twice as much as the CAC prior to rollout at scale (Exhibit 1).

Creating customer-centric capabilities to succeed with DTC

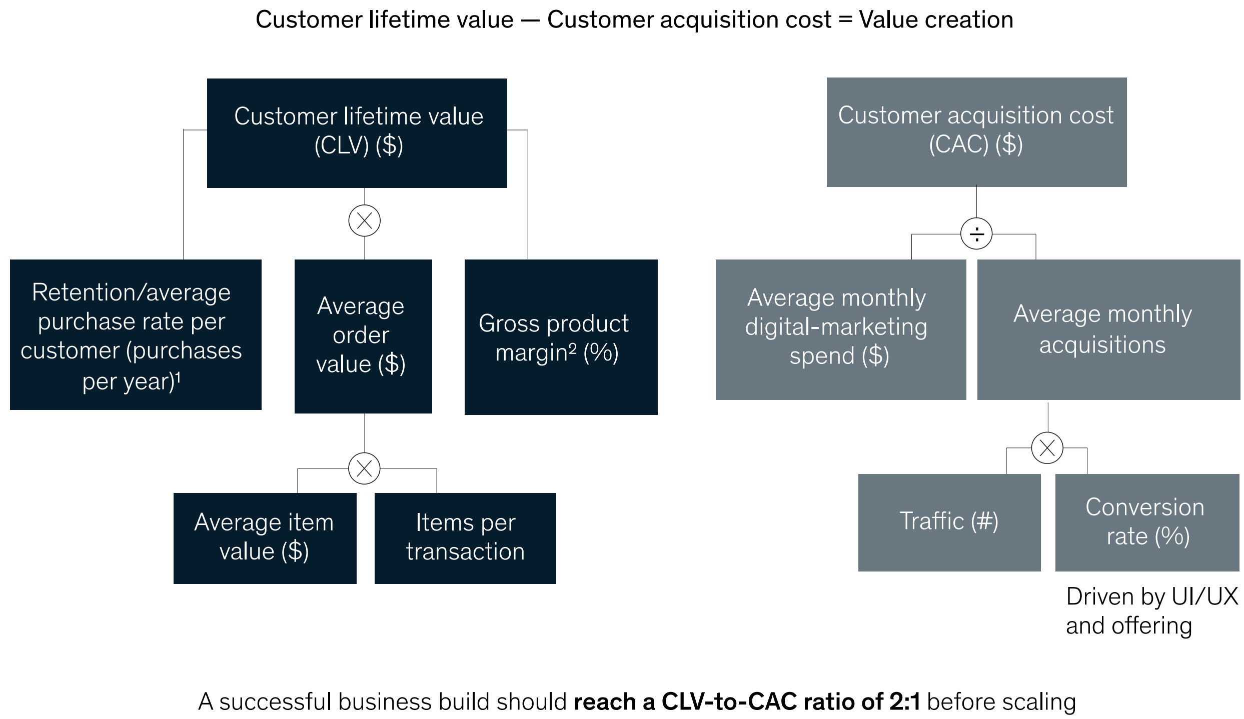
DTC requires a wide range of specific capabilities in addition to a compelling consumer offering. These include technology, operations, data and analytics, and an agile operating model (Exhibit 2). The common denominator? Customer centricity.

Technology. Significant factors drive technology decisions: cost, flexibility, security, support, and compatibility with existing systems. While those concerns are important, too often they edge out the most important consideration of all: customer experience. Leading companies codesign their online store with customers and build it iteratively, testing and refining critical front-end interfaces, such as the checkout process, in rapid pilots. They also invest in tech capabilities for connecting the back end of the e-commerce store with the rest of their IT architecture—including warehouse management, inventory synchronization, and order handling—to ensure excellence across the entire customer purchase journey. Some technology teams go further and, for real-time

Exhibit 1

Good direct-to-consumer economics target customer lifetime value at double the customer acquisition cost.

Illustrative theory of value creation



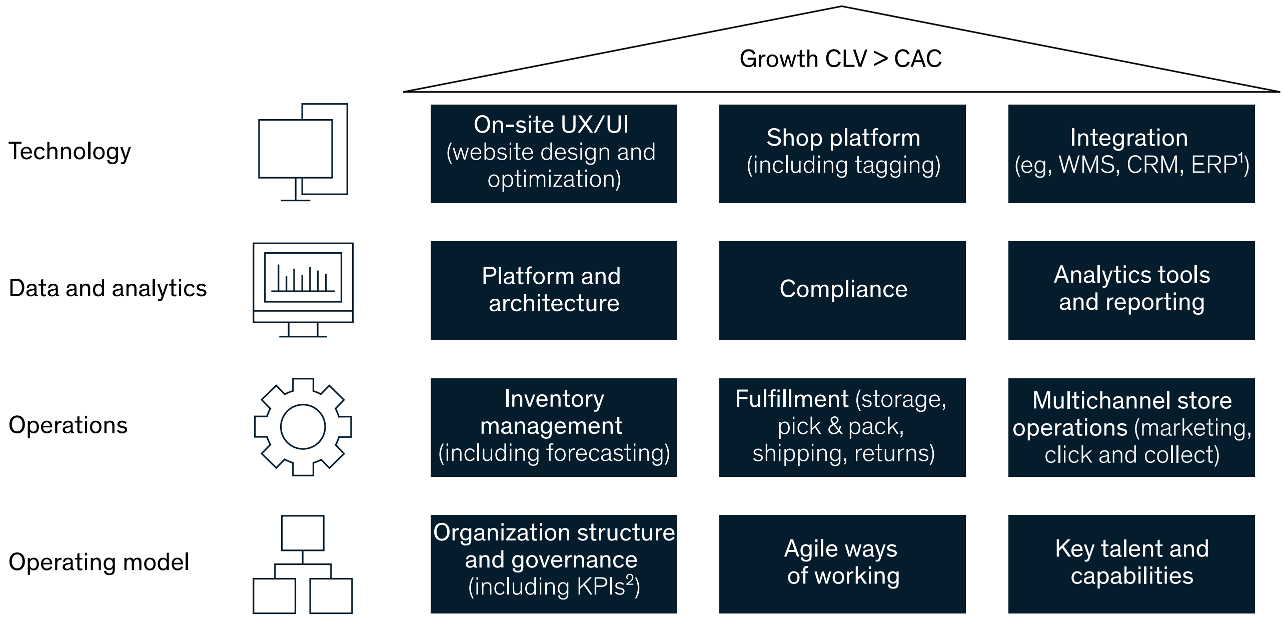
[1]Most common to look at 12 months, but definition can go beyond 12 months (“lifetime”).
[2]Accounts for shipping costs and transaction costs.

visibility, connect the order-management system directly to the handheld tablets carried by the pickers in the fulfillment warehouse. There are different avenues for building the shopping platform based on a business’s technology maturity, available talent, and sector situation: PepsiCo built PantryShop.com and Snacks.com fully in-house. In contrast, Kraft Heinz uses Shopify.

Data and analytics. Consumer-insights generation is a common reason to set up a DTC business. The challenge is to capture and ingest data from a range of sources and then consolidate them in a common data lake that can support analytical models. Best-practice companies focus their analytics on specific use cases that drive value so that analytical models have a clear focus, such as interaction preferences, purchase drivers, customer satisfaction, and potential signs or triggers of churn. They also invest in the talent to derive insights and commercial actions from these models. Whatever their specific DTC objectives, all companies will want to put in place strong data protocols to protect sensitive information and ensure compliance with current and future regulations.

Exhibit 2

Successful e-commerce is built on customer centricity.



[1]WMS = warehouse management system, CRM = customer relationship management, ERP = employee resource planning.
[2]KPIs = key performance indicators.
Source: McKinsey analysis

Operations. DTC requires a logistics setup that differs substantially from what supply-chain managers at most consumer brands are used to. At the early stages of DTC, brands often outsource logistics to guarantee quality, speed, and the flexibility to scale operations up or down as needed. Consumer brands that have their own retail network often use their stores as e-commerce fulfillment centers. Nike, for example, lets online shoppers pick up their purchases at brick-and-mortar Nike stores. During the COVID-19 crisis, Nike also introduced contact-free curbside pickup at selected stores. In the mission to optimize operations for the purchase process, it is important to also account for other phases of the customer journey, such as the returns process. Two out of three shoppers say they would not shop with a retailer again after a negative returns experience.[3]

Agile operating model. Consumer brands need to be able to adapt their ways of working to rapidly changing customer preferences. Building out an agile operating model enables small, cross-functional teams to work in short sprints to iterate on products and services based on customer outcomes. Using this approach, one home-goods company set up its end-to-end DTC business in only 13 weeks.

Getting started: Monday morning questions

Before investing in technology or hiring an agency to build the web shop, companies need to ask the following questions:

1. *What is the role of DTC in the channel strategy?* Will it help drive sales? Generate insights? Combat

[3]Lizzy Hillier, “The stakes have never been higher for e-commerce customer experience,” Econsultancy, October 16, 2020, econsultancy.com.

churn and stabilize market share? It is important to force clarity and assess relevant trade-offs, such as linkages to other channels and existing channel partners.

2. *What is the assortment and pricing strategy?* DTC requires a clear view of assortment and pricing as part of a broader channel strategy.

3. *How will you build up the necessary capabilities?* Brands don't have to do all the heavy lifting alone, but they will need to weigh the trade-offs of buying, building, and partnering extensively.

There are multiple ways to begin the DTC journey. For brands just starting with e-commerce, using online marketplaces and established apps can be effective ways to learn about what works well online. Other brands that are more digitally mature may want to scale their online presence to engage consumers and generate insights on what works well but hold off on launching e-commerce. But with shopper behavior changing so quickly, brands will need to move with urgency to answer the critical questions and determine how best to connect with their customers online.

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