McKinsey&Company
Operations Extranet

March 2017

CPG Manufacturing: Making the most of multichannel opportunities

Consumer-packaged-goods retailers are already competing in a multichannel world. Manufacturers need to think hard about what that means for them—and for their supply chains

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The consumer-packaged-goods (CPG) sector is in the middle of a multi-channel revolution. When McKinsey surveyed 3,000 US consumers about online shopping for CPG products, more than 40 percent of them had purchased CPG products online in the past six months, and 80 percent of them now conduct online research about purchases, even if they eventually choose to buy from a store.

Specialist online players are rapidly expanding and refining their grocery offerings, while bricks-and-mortar retailers have rushed to develop their own Internet offerings. The arguments are compelling. Online sales in the US grew an estimated 15.6 percent in 2016, against 2.9 percent growth for overall retail sales. Internet shopping accounted for 11.7 percent of total US retail sales in 2016, rising from 10.5 percent in 2015. Retailers offering online purchasing combined with store-based fulfilment (where customers pick up orders in store, or received home delivery from their local store) have seen 40 to 70 percent annual growth in online sales. Multi-channel customers spend more too, with typical order sizes between 1.2 and 4 times larger than their single-channel counterparts. And when customers collect on-line orders in stores, they often pick up additional items.

This situation has all the makings of a virtuous circle: customers get the flexibility to switch between channels, retailers improve their offerings to help them do so, and as the offer becomes more appealing, customers buy even more.

Respondents to the McKinsey survey were very clear that they like lower prices. Some 59 percent of online buyers said this was a main reason for shopping online, more than twice the number that cited any other aspect other than free delivery. What they don't like is having to wait. Of participants who buy at least one category offline, 85 percent gave long delivery times one of their top three barriers.

For retailers and manufacturers, those demands create a significant supply-chain conundrum. Low prices call for efficient plant-to-customer logistics, while the need to provide speed (such as same- or next-day delivery) and convenience (free returns and a large assortment) pushes costs higher through a combination of expedited transportation, local warehousing, and last-mile parcel delivery.

The fight for the winning model

Today, several different supply chain models are battling to solve the cost– convenience conundrum. The most significant new force in multichannel distribution is the great retail disrupter, Amazon, which is bringing a growing CPG offering to customers via its network of more than 200 distribution, sorting, and other logistics centers across the US. The prime reason is simple: speed. Two-day delivery is increasingly standard, with next-day and same-day becoming the new battleground. In this environment, companies with few distribution centers (DCs) are simply not competitive.

Bricks-and-mortar retailers have structural advantages of their own, however: they can use their existing stores as both distribution centers and collection points for on-line customers. Walmart is piloting an automated in-store pickup option for online orders, and the company has recently announced a switch from three-day to two-day delivery as standard.

Today, neither side has a decisive edge. For traditional retailers, picking from store shelves for later collection by the customer is more expensive than shipping a parcel from a DC, but it’s often cheaper than the traditional retail experience, thanks to efficiencies in the use of in-store labor. Retailers can gain other advantages from in-store picking as well: fewer markdowns, as online orders absorb excess store inventory, and extra purchases when customers collect their packages. For online-only players, the lack of a physical storefront network complicates getting goods into the hands of busy customers at convenient times.

Both camps are innovating furiously to find ways around the limitations of their models. In areas with high online demand, some retailers are converting existing locations into “dark stores” dedicated to e-fulfilment, while unstaffed, temperature-controlled kiosks help speed and simplify customer collections. Amazon’s move into bricks & mortar retail includes a large number of delivery lockers in convenience stores around the world, and several dedicated bookstores and pickup locations in areas with high concentrations of customers, including university campuses. The company is also developing a number of click-and-collect drive-up grocery stores, and a new, technology-heavy concept that eliminates check-out lines completely—instead using sensors and a smartphone app to bill customers automatically for the goods they carry out of the store.

Manufacturers are already moving

As customers increasingly demand multi-channel options, manufacturers will need to decide if they are happy to leave their multi-channel success in the hands of others, or if they want to take more control over their own destiny. Leading players have already started to change their sales and distribution systems to meet the needs of the multi-channel world.

CPG manufacturers are clearly excited by the potential of multi-channel sales. New channels mean the possibility of new customers and incremental sales. They also offer opportunities to build more direct, and perhaps more enduring, relationships with consumers. Many of the major players are already experimenting with internet-based direct sales of consumer products, or buying start-ups that are doing it already. Procter and Gamble has launched an online subscription service for laundry-detergent pods, while other CPG companies have embarked on a wide range of multi-channel experiments, from installing vending machines in urban areas to websites that direct users to appropriate online or bricks and mortar retailers based on their location.

Why the back end matters most

Innovative multi-channel sales and marketing strategies are important, but we believe that it is changes behind the scenes that will ultimately determine the success of CPG manufacturers' multi-channel efforts. Supply-chain capabilities will be a vital driver of multi-channel success for manufacturers, just as they are for retailers, but the systems, processes and infrastructure they need will be very different, for two reasons.

First, the high cost and complexity of building the dedicated infrastructure needed to provide next- or same-day shipping to millions of individual customers will see few CPG players willing to risk going it alone. Instead, they will look for collaboration partners who can provide the necessary assets. Second, many of the organizations best-positioned to provide those assets are their existing customers—which are crying out for manufacturers to play their part in helping to bring down fulfilment costs and boost service.

For example, as bricks-and-mortar retailers square up to the online specialists, a "long tail" of niche products is likely to become an increasingly important part of their competitive offering. Since stores and retailer DCs only have the space to hold faster-moving items, the rest will need to be shipped directly, and at short notice, from the manufacturers themselves. Retailers in North America and Europe are already using cloud-based services to enable seamless drop-shipping direct from manufacturers—thus expanding product offerings while minimizing inventory costs.

Other players are forming even closer supply-chain collaborations, particularly for logistics infrastructure—to the point of retailer and manufacturer employees working side by side in manufacturers' warehouses. Although some companies have objected to these arrangements, we believe the resistance is unlikely to persist for long, especially as more and more retailers are likely to ask for similar deals themselves.

Building the collaborative multi-channel supply chain

The changes to supply-chain capabilities required to enable these kinds of partnerships may be significant, and developing them will take time and effort. Critically, however, these new supply-chain muscles will support CPG companies across a broad range of current—and future—multi-channel opportunities. A forthcoming article, "Building omnichannel excellence," will describe these in greater detail.

Several no-regret activities make sense as first steps for CPG manufacturers, regardless of which multi-channel partnerships they decide to develop. For example, they can make changes to packaging to make more products more suitable for delivery by courier and similar services. These might include improvements to durability to prevent damage when items are transported alone rather than in cases, and changes to dimensions to reduce courier shipping costs by optimizing "dimensional weight".[1] Online ordering also offers companies new

[1] **Dimensional-weight pricing** is an approach increasingly used by couriers and delivery service providers to price transport based on the space taken by package as well as its weight. The approach is designed to improve transport utilization by encouraging shippers to use smaller overall package sizes.

sources of real-time data on product demand. Accordingly, demand-planning and forecasting systems should be adapted to make greater use of this data.

Next, manufacturers can consider changes to their distribution systems to support drop-shipping of products direct to customers. This will require new equipment and processes in DCs to handle the sorting, picking, packing, and shipping of single-product units (“eaches”), as well as new relationships with express parcel carriers and even network design adaptations to permit lower-cost next-day shipping to more customers.

Finally, CPG companies can use the same capabilities to support store-based multi-channel retail. Direct-store-delivery (DSD) processes accept on-line orders passed through from retailers, with goods kept in the DSD warehouse and not at the store.

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Multi-channel retail in CPG categories is entering a phase of rapid growth and dynamic change. While the best supply-chain and logistics processes to support this new environment are still emerging, manufacturers can’t afford to watch and wait. The multi-channel world will call for an intensely collaborative approach, with manufacturers creating relationships with new retail partners, and reinforcing existing ones with flexible, closely integrated supply chains. CPG players will need a host of new supply-chain capabilities to make these collaborations work, but by starting to develop those capabilities now, they will put themselves in the strongest possible position to meet the challenges of the future.

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