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Moving Downstream: Selling Direct to Consumers

Why Consumer Products Manufacturers Sell Direct — and How to Make It Work

As consumers increasingly come to expect a more experiential shopping trip while at the same time online shopping becomes more prevalent, many consumer products manufacturers are selling their products directly to end-consumers. Is selling direct to your consumer, and thus bypassing your traditional downstream partners, relevant for your market and right for your business?

This paper outlines the key factors that consumer products manufacturers should consider when assessing whether or not to move downstream.

Market Pressures and Motivations

Consumer products manufacturers (CPMs) are experiencing significant pressures in today's marketplace, caused by increasingly savvy consumers, growing competition due to over-saturation of product alternatives, rapid channel innovation, and the consolidation and internationalisation of retailers. Add to this the growth of private labels, shelf space limitations, limited access to customer data, reduced assortments being stocked, limited input to price and promotions, and no control of the aftersales service, and the picture can end up looking quite bleak.

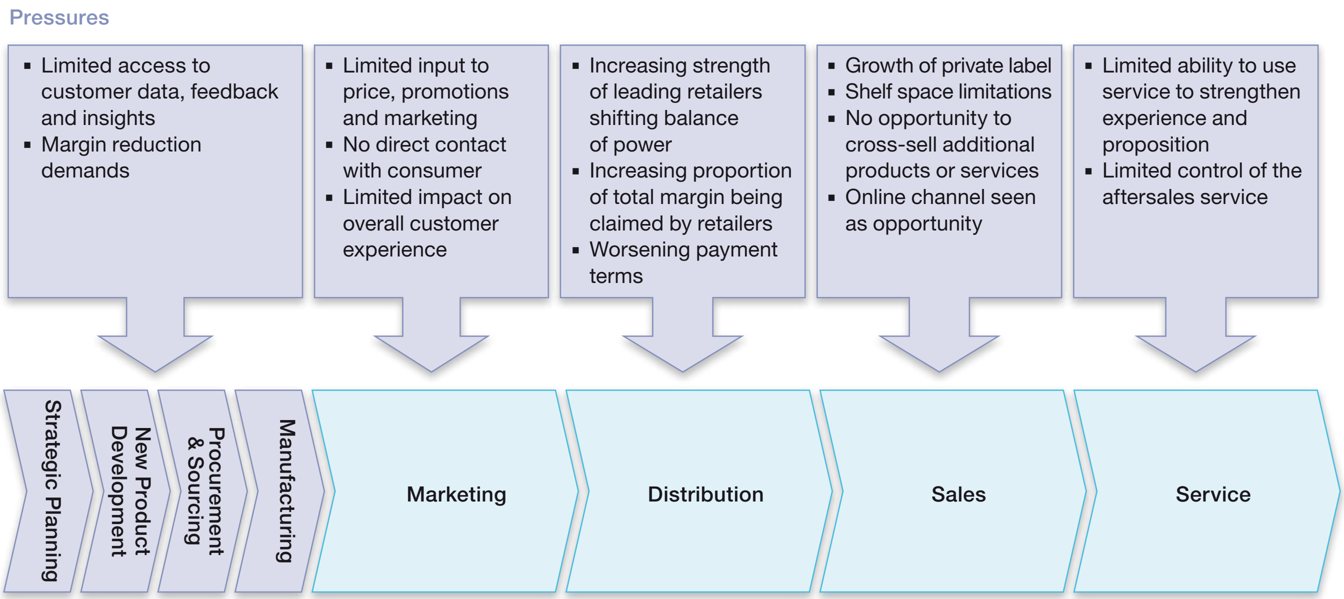
As a consequence, CPMs are increasingly looking at direct-to-consumer selling. Six key motivations can be identified:

- Recovery of share of margin
- Increased brand visibility and control
- Shopper experience control
- Strengthened relationship with/ insight into end-consumer
- Improved ability to sell a wider assortment and services
- Improved price and promotions control

A number of CPMs have already made a shift to direct selling and are achieving benefits. Take Levi's, for example, which operates retail stores, shop-in-shops and an online store as direct channels, besides its traditional indirect channels. These channels provide the company with the opportunity to showcase its entire product line-up, control its overall customer experience, strengthen its customer relationship and increase share of margin. The company reported that sales through direct channels represented approximately 8% of net revenue in 2008, up from 4% in 2006.[1]

Similarly, Nike operates its own retail stores, factory outlets and an online store, providing the company with improved control of the brand and customer experience, and increased margins. By 2011, the company expects its direct-to-consumer sales to increase to 15% of sales, up from the current 12%.[2] Other companies that have gone direct-to-the-consumer in some manner include L'Oreal, Nestlé, Procter & Gamble, Sony, Nokia, Apple, Kraft and Heineken.

Consumer Products Manufacturers Experience Significant Market Pressures



Source: Capgemini Consulting

[1] "Levi's bets on premium positioning - CEO John Anderson aims to pump up the tops business, international sales and product quality at Levi's, Dockers," DNR, April 2008; LEVI STRAUSS & CO, SEC Filing 10K

[2] http://invest.nike.com/phoenix.zhtml?c=100529&p=irol-newsArticle&ID=1047074&highlight

Is It the Right Decision?

In determining whether to go direct, manufacturers need to consider the type of proposition they currently offer and whether moving downstream can help them protect and improve it. As a rule of thumb, Capgemini Consulting recommends that in particular those products or categories that rely on a level of pre-/post-purchase service, and whereby the physical product is but one element of the overall proposition, are most suitable to a shift downstream. Conversely, if a manufacturer's proposition is primarily access- or price-centric, then it may be best to rely on existing indirect retail channels.

The commercial attractiveness of moving downstream is also determined by considering three factors:

- **Customer response.** How will the current end-consumers respond? What latent consumer need would you be addressing? What new consumers will this attract?
- **Market forces response.** How will your downstream partners respond? How will your competitors respond?
- **Internal competencies.** Will it distract from your core business? Can the required capabilities be developed/acquired? Will your culture enable it?

These questions will need to be addressed and the various scenarios modelled and assessed.

Dimensions of a Manufacturer's Proposition

Any consumer products manufacturer will rely on a combination of these five dimensions to define its customer proposition. The dominant dimensions can inform the extent to which a move direct-to-consumer is appropriate.

	Price	Access	Product	Service	Experience
Description	The extent to which low selling price is a key proposition characteristic. Rarely a driver for moving direct-to-consumer.	The extent to which the consumption need is immediate and needs to be able to be satisfied immediately. Rarely a driver for moving direct-to-consumer.	The extent to which product attributes themselves are a key component of the proposition. Can allow for a move direct-to-consumer.	The extent to which pre- and post-sales service can form an integral part of the proposition. Depending on service provided by retailers this can be a driver for moving direct-to-consumer.	The extent to which the overall shopping, owning and using of product forms an integral part of the proposition. Commonly a driver for moving direct-to-consumer.
Example	Northern Foods, a British food manufacturer, produces low-cost product with core proposition being value-for-money. There would thus be limited value in moving downstream.	Coca-Cola is sold in over 200 countries and thousands of on- and off-premise outlets. Replicating this type of coverage would be prohibitively difficult.	Godiva Chocolatier sells its chocolate and related products through own retail boutiques, shop-in-shops and website.	Dell controls all its customer care directly and gets customer feedback through its web 2.0 applications.	Apple products have a proposition strongly based on pleasure of end-to-end experience. Stores feature a "Genius Bar" for answering product-related customer queries.

Source: Capgemini Consulting

One Solution Doesn't Fit All

For those CPMs for which direct selling is an option, moving downstream is not a one-solution-fits-all situation. First of all, factors such as which suite of channels offer the appropriate revenue, cost and risk compromise need to be determined.

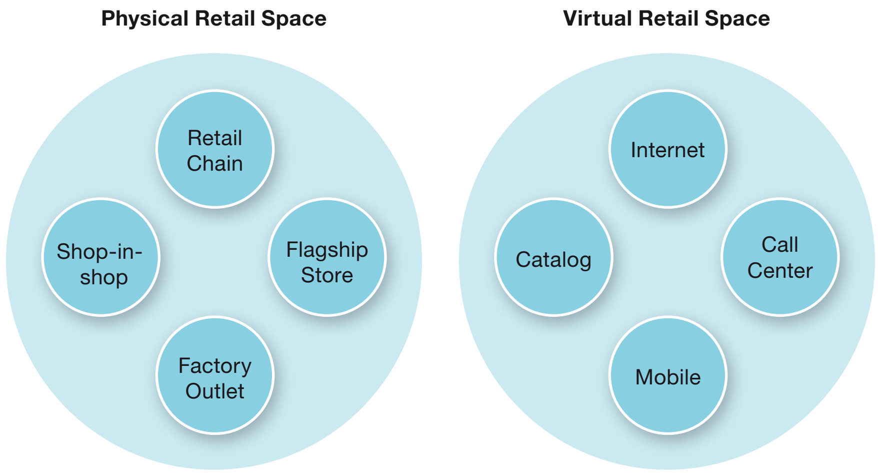
Let's look more closely at each of the direct channels.

Physical Retail Space

Shop-in-shops: Enables better control over the shopping proposition and increased ability to grow market coverage without the full-on investment of a flagship store or retail chain. CPMs in this case have increased control over fixtures, assortment and pricing and any staff is generally trained by them. They do not, however, have full control nor do they get full share of margin. Given the relative low cost and risk, it is a common first foray into a direct-to-consumer model. Examples of this model are numerous; apparel, cosmetics and luxury CPMs such as Clinique and Louis Vuitton commonly have a space within large department stores that they manage semi-independently.

Flagship stores: Intended more as marketing tools than as a revenue source in most cases. CPMs have full control of the overall shopping proposition, and the ability to offer additional brand- and revenue-enhancing services and offerings. Companies such as Apple and Nokia have successfully strengthened their brand and their customer relationships through the pinpointed introduction of flagship stores. Flagship stores are often an interim step towards a full-blown retail chain rollout, as highlighted by Apple and Burberry, for example.

Direct-to-Consumer Channels



Source: Capgemini Consulting

Case Study: Fashion Manufacturer Implements Global Transformation of Retail Operation

Capgemini works with a worldwide leading fashion and high-value goods manufacturer, which also has a global wholesale operation and an expanding estate of global retail and e-commerce stores.

We are assisting the company with its large-scale global transformation initiative to implement a core retail operating model (using SAP Retail) of consistent technology and business processes. This programme is designed to help the company achieve aggressive expansion and profitability targets.

- Phase one comprised SAP Retail (Finance, Treasury, non-stock procurement, Sales and Stock reporting based on SAP POSDM and SAP MDM to provide accurate retail sales analysis across the company's worldwide retail estate for the first time).
- Phase two comprised SAP AFS manufacturing.
- Phase three comprised implementation over three stages: merchandise buying, wholesale sales; and warehouse management and retail operations.

To date the operating model and technology has been designed and implementation has been successfully completed in the UK, wider Europe and Hong Kong. The latter rollout also included an optimisation of their regional supply chain hub. The next phases will include rolling out the remainder of their Far East operations.

This programme is integral to this organisation successfully shifting to an increasingly retail-centric proposition and operating model.

Retail chains: The sole way of physically delivering all potential benefits across brand, revenue and margin is by introducing a chain of retail stores. This enables full control of assortment, price, proposition and customer relationship/insight, while also enabling available margin. In many cases, such as Nike and Levi's, it also evolves into a significant revenue stream. Key risks to consider are spiralling capital and operational expenditure and alienation of traditional downstream stakeholders.

Factory outlets: Easily perceived as a bit of an anomaly, factory outlets are nevertheless a potential channel through which CPMs can go direct-to-consumer. Ostensibly intended as a way of generating revenue from end-of-season stock, this channel can be used as an initial access to the end-consumer. This is a typical approach for fashion companies in managing their end-of-season stock surplus. Companies such as Phillips-Van Heusen and Hugo Boss have successfully used factory outlets.

Virtual Retail Space

Internet: E-commerce is now a well-established form of selling. While it has been the playing field of the pure-players and increasingly the brick-and-mortar retailers, the impact of online direct selling by manufacturers is growing. One estimate indicates that approximately 5% of consumer online sales in the U.S. is generated through manufacturer web shops.[3]

The Internet as a direct-to-consumer channel offers a number of advantages for manufacturers. The cost of setting up an online channel is low compared to setting up a chain of retail stores. In addition, a complete range of

Case Study: Consumer Electronics Manufacturer Deploys Online Shops

Responding to increasing competitive pressure, a major consumer electronics manufacturer decided to start developing direct relationships with consumers. The chosen approach was to build its own direct online B2C sales channels.

The company's capabilities were optimized for B2B so new capabilities for B2C operations were needed. A decision was made to open online shops in three geographies and Capgemini was asked to help with the development and deployment.

During the development phase, Capgemini helped the client build out holistic shop operations covering various functional areas, including catalogue and sales planning, stock management, day-to-day shop keeping and digital marketing. Additional aspects included identifying and implementing various development initiatives into the online shop and identifying best practices at existing online shops in other markets.

The client's online shops were initially deployed in the three geographies, with additional markets to follow.

[3] "5 Trends for European online retail," http://blog.shop.org/2008/10/29/5-trends-for-european-online-retail/, October 29, 2008

products and services can be offered. The downside is that it is much more difficult to truly enrich the proposition and the customer relationship.

Catalogues: Once almost entirely written off as a thing of the past, catalogues will continue to play a role in the retail experience. In particular, for those product categories where assortment and price are reasonably stable, catalogues enable consumers to browse and consider purchases in the comfort of their own environment.

Call centres: The call-centre channel is used by manufacturers for both outbound and inbound customer contact. In most cases, this will be a supplementary channel, intended to resolve any queries or complaints and encourage or strengthen relationships with customers. Increasingly, however, in a multi-channel retail environment consumers will expect to be able to buy products through this channel.

Mobile: Mobile commerce offers an emerging opportunity for manufacturers to sell directly to consumers. The opportunities are numerous: from selling services through the phone (such as Nokia's music store), through to communicating personalised promotions (both in- and out-of-store), as well as the use of mobile phones to visit traditional e-commerce websites.

While these are the most common types of direct selling, other smaller niche channels also exist, such as direct network selling (Avon, Amway), door-to-door (Schwan's), airport and mall kiosks (Bose) and online sites where consumers can customise and buy products (Mars/M&M's, LEGO).

Differences Among Product Categories

The right direct-selling model will vary depending on the product category. The CPMs that are considered direct-selling leaders are often from the consumer electronics sector, and include Sony, Panasonic and Apple. These products are typically of higher value and have a more complex proposition, thus providing a greater case for investment in direct channels.

In the luxury goods market, the channels used vary depending on the subsector but overall there is a move to more direct selling, particularly through the Internet, shop-in-shops and flagship stores. In the apparel industry, companies have a tradition of integrated manufacturing and retailing, giving them the benefit of greater control of brand and supply chain measures. Companies in this segment are likely to use retail stores and the online channel to gain faster response time and reduced costs and to control the brand and customer experience. Typically, food and household products are still primarily sold using indirect channels. This will continue to be the case due to the reliance on retailer access and because these products are commonly part of a larger, diverse shopping basket.

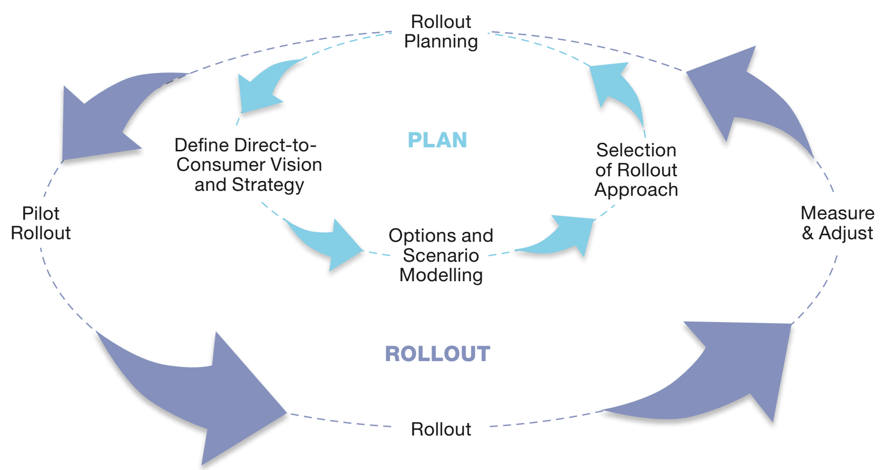
Taking an Iterative Approach

The uses of these physical and virtual channels are by no means mutually exclusive. Leading CPMs have developed and implemented retail channel strategies that have relied on multiple channels, both concurrent and sequential.

Those CPMs that have made the transition to a retail capability successfully have commonly done so in an iterative manner, testing the waters, refining and optimising along the way.

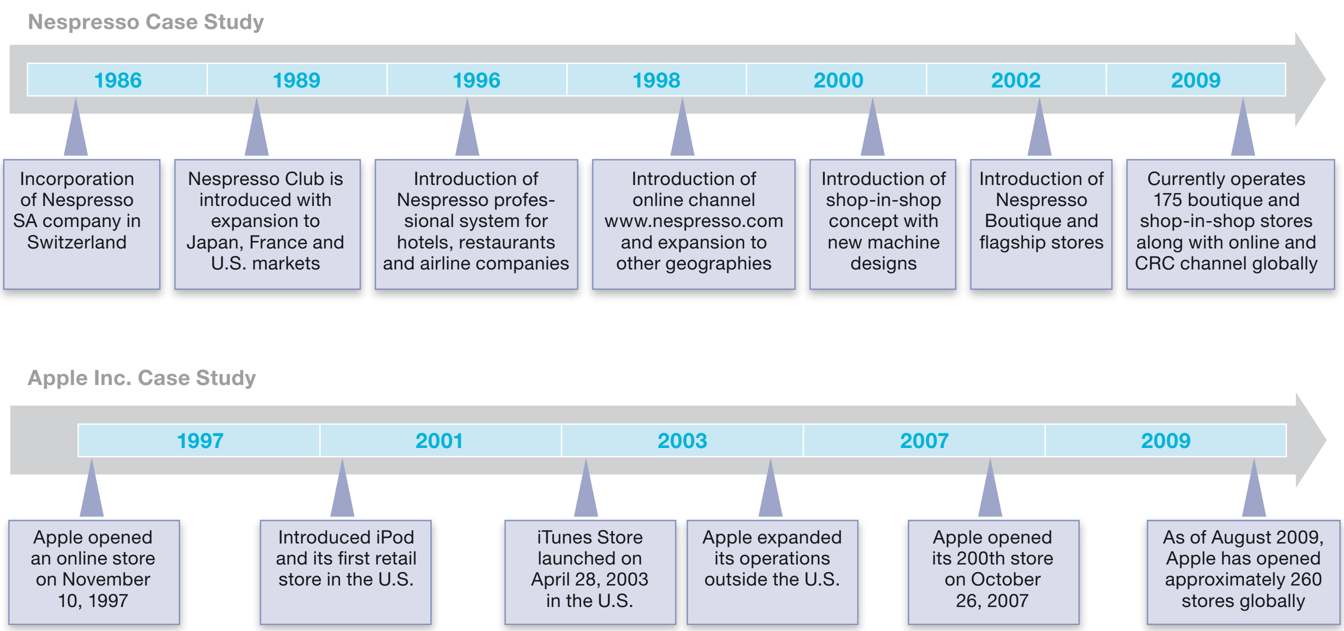
In addition, a company's internal capabilities will need to be put in place as time progresses, and the manufacturer's downstream partners may need to be taken on the journey.

An Iterative Approach to Direct Selling



Source: Capgemini Consulting

Direct-to-Consumer Examples of the Iterative Approach



Sources: Form 10Q, Apple Inc; http://www.apple.com/retail/storelist; Company Annual Reports, Apple Inc.; Nespresso Company Report, April 2008; http://www.nespresso.com/precom/aboutus/aboutus2.php

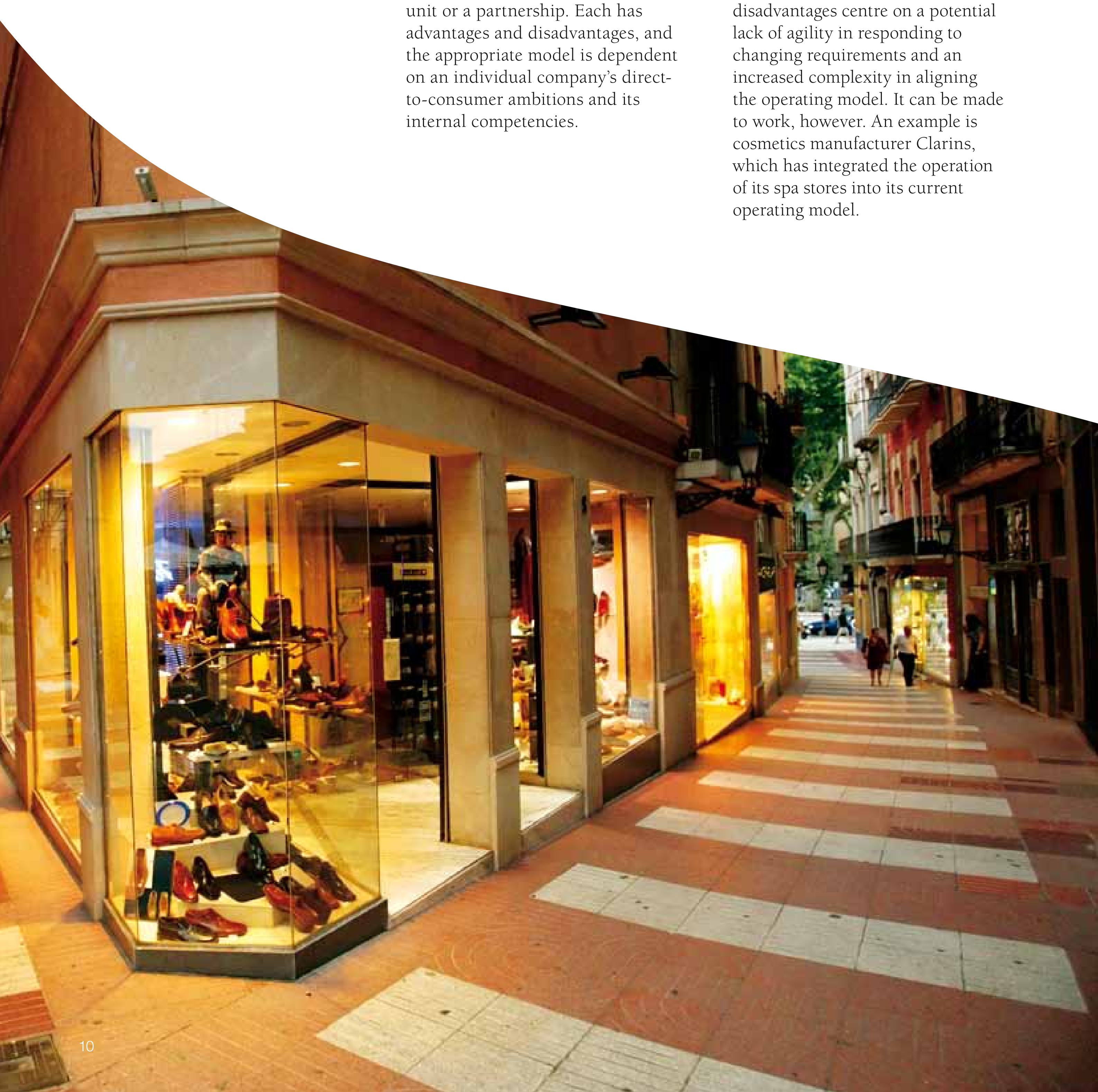
A common approach is to begin by testing one direct-to-consumer channel such as a shop-in-shop and then building out to flagship stores, potentially supported by an online channel, and through to a full-blown retail chain with an effective website and a supporting contact-centre channel. A full-blown retail chain, however, is not the end goal per se; the end goal is an appropriate retail presence. This will vary from no presence at all to an extensive multi-channel presence.

What channels a CPM selects and what order and timeline it defines for its transformation to a retail capability will depend in large part on its current competencies (people, process, organisation, technology) and the gap between these and what is required. The changes to the operating model can be significant but they can be influenced by the approach the CPM takes.

How to Make It Work: Three Models for Direct Selling

Capgemini Consulting has identified three main models that consumer products companies can choose from to move downstream: an embedded business unit, a separate business unit or a partnership. Each has advantages and disadvantages, and the appropriate model is dependent on an individual company's direct-to-consumer ambitions and its internal competencies.

1. Embedded Business Unit: An embedded business unit for direct selling enables a single unified focus on the overall customer proposition and allows a company to benefit from some synergies, in particular the support services. The key disadvantages centre on a potential lack of agility in responding to changing requirements and an increased complexity in aligning the operating model. It can be made to work, however. An example is cosmetics manufacturer Clarins, which has integrated the operation of its spa stores into its current operating model.



2. Separate Business Unit: Some manufacturers opt for a separate business unit, particularly in the initial phases. This allows the CPM to test the water while maintaining an overall focus on its current core competencies. Key risks to this model centre around the performance management of the separate units; if done poorly, intra-company competitiveness will undo the best intentions. Another potential risk is misalignment between intended propositions across products and channels. Once again, however, it's all about execution. Apple, where the company's core business of designing products remains separate from its retail activities, has proved that.

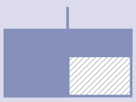
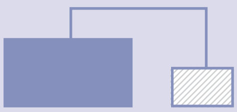
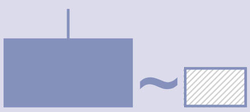
3. Partnership: The lowest-risk and lowest-investment model for going direct to the consumer is through a partnership. Taking a partnership approach to direct selling can enable a manufacturer to focus on its own core competencies, learn from retail best practices, share the risk and potentially allow it to grow more quickly. Often this model is most appropriate when entering developing economies. Key disadvantages to consider are reduced control over the proposition and reduced share of margin. A successful example is Nokia, which is rolling out its retail network in India through a partnership with HCL, a local Indian retail operation.

To Go Direct or Not to Go Direct?

There is no question that consumer product manufacturers face a wide range of pressures in today's volatile marketplace. Selling direct to the consumer won't ease all these pressures and is not the answer for every company. However, moving downstream is a strategy that should be seriously considered if your business is struggling to manage and control its overall proposition and maintain customer loyalty; if your potential margin share is being diluted by downstream players that are not offering sufficient value to your proposition; and if collaborating more closely with retailers will not deliver what's required.

As with most strategic considerations, however, the right idea is not enough. It is all about complementing an implementable strategy with a disciplined and effective execution. Capgemini Consulting has a proven track record of helping our consumer products clients through complex challenges such as going direct-to-consumers.

Three Models for Direct Selling

Option	Advantages	Disadvantages	Examples
Embedded Business Unit 	▪ Enables single viewpoint and single focus on customer proposition ▪ Economies of scale can be delivered	▪ Lack of agility in responding to changing customer requirements ▪ Requires all departments to understand and change to new ways of working	▪ Clarins is integrating the operation of its spa stores into its current operating model
Separate Business Unit 	▪ Does not detract focus from existing business ▪ Channel can be more easily trialed ▪ Measurement of that channel's specific costs can be easily made	▪ Can result in lack of consistency across different direct and indirect channels ▪ Can result in intra-company competitiveness	▪ Apple's core business of designing innovative products remains separate from its retail activities
Partnership 	▪ Focus on core competencies ▪ Risk sharing ▪ Enables faster growth	▪ Can result in lack of control of brand ▪ Shared business may result in lower margins	▪ Nokia is rolling out its retail network in India through a partnership with HCL, a local Indian retail operation

Sources: Capgemini analysis

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Capgemini, one of the world's foremost providers of consulting, technology and outsourcing services, enables its clients to transform and perform through technologies. Capgemini provides its clients with insights and capabilities that boost their freedom to achieve superior results through a unique way of working, the Collaborative Business Experience™. The Group relies on its global delivery model called Rightshore®, which aims to get the right balance of the best talent from multiple locations, working as one team to create and deliver the optimum solution for clients. Present in more than 30 countries, Capgemini reported 2008 global revenues of EUR 8.7 billion and employs over 90,000 people worldwide.

More information is available at **www.capgemini.com**.

About Capgemini's Consumer Products and Retail Practice

Capgemini's global Consumer Products and Retail practice works with 27 of the world's 30 largest consumer products companies, 27 of the world's top 30 retailers and hundreds more. Our team of approximately 5,000 specialists throughout the world helps these clients reap the benefits of industry-specific solutions such as Global ERP Integration, Demand and Supply Chain Management, Cost Reduction and Global Data Synchronization. More information is available at **www.capgemini.com/products**

About Capgemini's Consumer Products and Retail Insights Group

The consumer products and retail insights group carries out research and produces thought leadership and guidance on global issues affecting the industry.

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