Direct-to-Consumer Business Model Risk Mitigation, Part 1 – Value Proposition and End-Consumer Needs

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Initiatives: Supply Chain Strategy, Leadership and Governance; Supply Chain Customer Fulfillment and Collaboration

COVID-19 has sent digital commerce sales surging and tempted brands to rush into D2C. Chief supply chain officers must ensure their teams learn from retailers in postpurchase fulfillment, work with marketing to support a unique value proposition, and learn to deliver end-consumer CX.

Overview

Impacts

- The COVID-19 pandemic is creating a surge in digital commerce sales that is tempting brands to rush into direct to consumer (D2C), but brands must understand the tough competition they face when moving to a D2C model.
- Brands can be overly confident in their product's appeal to consumers based on their performance in a retailer's basket — but haven't thought through what will tempt consumers to switch to buying directly.
- Retailers have developed formidable offerings to meet the needs of the end consumer, but brands are more used to serving retailers. Therefore, brands may not understand the CX that will attract and retain consumers.

Recommendations

Chief supply chain officers (CSCOs) responsible for supply chain strategy, leadership and governance:

- Keep consumers buying from you long after the pandemic by bringing your supply chain up to the retail competition. Do this by developing counterofferings that match the moves retailers make to deliver CX.
- Focus on your brand's unique selling proposition by working with sales and marketing on the areas where the supply chain can support differentiation efforts that attract consumers to switch to D2C for your brands.
Get to know the needs of the end consumer you will be serving by developing personas and associated customer journey maps (CJMs).

## Strategic Planning Assumption

By 2023, 75% of organizations selling direct to consumers will offer subscription services, but only 20% will succeed in increasing customer retention.

## Analysis

The coronavirus pandemic is driving an upsurge in sales across all digital commerce channels and tempting many brands to rush into a D2C business model. Tempting as D2C sounds, it also presents challenges and risks for brands and CSCO’s who have previously focused on supporting sales through an intermediary. Table 1 summarizes the key risks that CSCO’s must understand and mitigate.
Table 1: Use Business Model Attributes to Identify the Key Business Transformation Risks and Mitigations When Going D2C

<table>
<thead>
<tr>
<th>Business Model Element</th>
<th>Risk</th>
<th>Risk Mitigation</th>
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<tbody>
<tr>
<td>Value proposition</td>
<td>Lacks competitive differentiation</td>
<td>Conduct competitor scan</td>
</tr>
<tr>
<td></td>
<td>Not competing for target market</td>
<td>Determine what differentiates your offering</td>
</tr>
<tr>
<td>Customers</td>
<td>Reluctant to switch to your offering</td>
<td>Employ customer journey mapping and conduct interviews about CX</td>
</tr>
<tr>
<td>Financial model</td>
<td>Higher-than-expected capital investment or operating costs</td>
<td>Set executive expectations through capability modeling and gap analysis</td>
</tr>
<tr>
<td>Capabilities</td>
<td>Organization lacks the expertise to deliver and meet all CX expectations</td>
<td>Limit internal investment liability initially by partnering with third-party specialists</td>
</tr>
<tr>
<td></td>
<td>Unexpected technology complexity</td>
<td>Limit the scope of proof of concepts while you establish your technology maturity</td>
</tr>
</tbody>
</table>

Source: Gartner

As shown in Table 1, start with your competitors—not your customers—because you don’t yet know which particular end-consumer need you will serve. Begin with a competitor scan of retailers to see what they do particularly well. Then work out how you can differentiate yourself in the end consumer’s eyes and determine what your unique customer value proposition is. Only then can you identify which particular end-consumer personas form your target market. At this point, leverage persona and customer journey mapping so you can tailor your offering to meet your target’s CX needs. This document covers these first two business model elements—value proposition and customers. The next two elements, financial model and capabilities, will be covered in a second document.

Despite the risks of embarking on a new business model, many consumer product company CEOs are rushing their organizations to sell directly to consumers due to supply chain disruptions caused by the
COVID-19 pandemic. For example, Kraft Heinz launched its new “Heinz to Home” service during lockdown in the United Kingdom, Ireland and Australia. It offers cans of beans and soup or bottles of ketchup in bundles for between €12 and €22. \(^1\) PepsiCo has also launched two new websites, PantryShop.com and Snacks.com, to deliver its products directly to consumers in the U.S. \(^2\)

Sales of consumer packaged goods (CPGs) were trending upward year over year before COVID-19 struck. But as lockdown hit, many aspects of people’s lives changed, including their shopping habits when people were limited to going out for essentials only and made to stand in lines in supermarket parking lots six feet apart wearing masks. The Gartner Consumer Pandemic Attitudes and Behaviors Survey \(^3\) found that 36% of U.S. consumers tried a new brand for the first time during lockdown, and 36% bought from a website or app they had not used before. (see Figure 1).

**Figure 1: Changes in Shopping Habits Due to COVID-19**

<table>
<thead>
<tr>
<th>Percentage</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>36%</td>
<td>Bought something they don’t usually buy or tried a new brand for the first time</td>
</tr>
<tr>
<td>36%</td>
<td>Bought via a website or an app they had never used before</td>
</tr>
<tr>
<td>61%</td>
<td>Of these consumers say they expect to keep buying those items in the next 12 months</td>
</tr>
<tr>
<td>85%</td>
<td>Of these consumers expect to use the websites or apps about the same or more in the next 12 months</td>
</tr>
</tbody>
</table>

n = 1,505, representative of the national population in the U.S.

Source: 2020 Gartner Consumer Pandemic Attitudes and Behaviors Survey

COVID-19 has had a profound impact on the world in so many ways, including the acceleration toward contactless commerce (see Note 1). Digital commerce sales growth has been astounding, with the U.S. seeing more in one year than the last five years combined \(^4\) — up 44.5% from 2Q19 to 2Q20. As the pandemic continues, habits are becoming engrained. Eighty-five percent of consumers who bought from a website or app they had never used before expect to continue that behavior over the next 12 months (see Figure 1). So the question for brands is how best to meet the needs of consumers looking to adopt contactless commerce — continue to go indirect through retailers or marketplaces, or move to D2C?

The D2C channel not only provides consumer product companies with direct access to the growing online market, it also creates a direct connection to customers and gives brands access to vital first-party consumer data. This data can help marketers target ads more effectively. It can also be of great use to the whole organization, including supply chain, to inform all aspects of customer experience, product
and service design, pricing, and value proposition elements. The CSCO needs to understand the most significant factors that drive the CX of the target market and then lead their organization in the transformation necessary to deliver that CX through a new supply chain operating model. This will reshape elements in logistics (such as speed of delivery and returns policies), customer fulfillment (such as customer contact strategy and virtual agents), manufacturing for personalized products, planning disparate fulfillment channels, etc.

This research will answer the three key questions that CSCOs must consider with their sales and marketing colleagues before rushing into D2C:

1. Do you know your competition and what makes that retailer so successful at serving the end customer?

2. Do you know how to differentiate from that retailer with a unique customer value proposition that works in the D2C context?

3. Do you understand the needs of the consumers you are looking to serve directly and what sort of customer experience they expect?

The order of the three questions is both deliberate and important. You may want to skip the competitor scan and focus on customers and capabilities. We recommend you learn from those that have served the end consumer directly for years: retailers and marketplaces. Then you can determine if your proposition is differentiated and to whom it appeals. It is this subset of end consumers that you must then focus on understanding. Finally — only once you have addressed all of these questions — you should move on to establishing if the financial model is viable. Only if the answer is yes should you build or buy the capabilities needed to deliver it — which we will cover in a second document.

Impacts and Recommendations

Brands Must Understand the Tough Competition They Face When Going D2C

Many successful retailers operate in both the physical and digital space, with a store network as well as an online presence using a “unified commerce” approach (see 10 Things Retailers Must Get Right to Succeed at Unified Commerce — Part 1). To compete, many of the brands that have committed fully to making D2C central to their ongoing business success have also established their own store networks to support a unified commerce experience across physical and digital platforms. Nestlé created its own Nespresso flagship store network, L’Oréal acquired brands that have stores, and Nike developed its own stores and partnered with retailers like Foot Locker to bring its D2C offering to the heart of major cities around the world.

At least at the outset, however, you will probably not be considering developing your own store network. Concentrate initially on good online fulfillment and returns offering, while the broader organization establishes a website that offers seamless navigation and streamlined check-out. Use retailers’ capabilities as the benchmark to judge yourself by when establishing your D2C offering. Given most
brings will start online only, Amazon is a good retailer to emulate (see Supply Chain Executive Report: Competing Against Nontraditional Supply Chains).

Amazon has led with an insatiable appetite to improve CX and reduce customer effort. It offers streamlined ordering (one click from a site, two or three from an ad or social post) and fast home delivery (same day where possible). Competing with Amazon is made doubly difficult because Amazon controls so much "search" — the point where a consumer starts when they first consider buying a product. Much as your marketers will be doing everything they can to generate traffic to your new D2C site, the cards are stacked against you given that 47% of shoppers in the U.S. start their search on Amazon. That number soars to 74% for those consumers who have an Amazon Prime account. Prime membership also helps Amazon achieve industry-leading conversion rates of searches into transactions. Conversion rate is the percentage of clicks on an ad that convert into sales. The average industry conversion rate ranges from 1% to 4% by category, whereas Amazon boasts a nearly 10% conversion rate. This goes up to a 13% conversion rate for Prime customers (see Figure 2).

Figure 2: Know Your Competition’s Strengths When Launching Your D2C Offering
Over 100 million Americans have chosen to pay for Prime to cover their annual delivery charges on a huge range of products, and Amazon has incentivized them to stay loyal through an exclusive television channel, Kindle books and much more. And with over two billion visits a month, Amazon also has millions of ratings and reviews for products; this is key in driving up trust of purchases made through the company.

Many D2C brands consider Amazon a frenemy — it’s incredibly fierce competition as a retailer but D2C brands can choose to outsource the fulfillment aspect of their offering through Fulfillment by Amazon (FBA) and gain many of the benefits that Amazon offers to its own consumers. Of course, you are probably also selling through Amazon Marketplace, so Amazon is your customer, competitor and service provider too. The same is true with retailers. They will continue to be your main customers in the indirect channel as well as daunting competitors to your new D2C offering. It is important to manage channel conflict with retailers and marketplace operators. Those B2B customers and the internal account teams responsible for managing relationships with those trade partners can have mixed reactions to brands selling D2C. Large retailers are less likely to be threatened due to their own market leadership and critical mass of site and store traffic, but those with less-well-developed online offerings may threaten to delist.

Your sales account teams need to manage these retailer fears and responses to avoid harm to those relationships. As part of this, you (as the CSCO) may be asked to create a differentiated set of SKUs in order to avoid direct price comparison and retaliation. But a better route is to communicate the benefits to your trade partners that selling D2C can have in driving brand loyalty, which has the potential to generate consumer insight that can inform brand marketing on retailer sites, in stores and in online marketplaces.

Recommendations:

- Inform your own e-commerce approach by thoroughly examining what retailers offer in areas like speed and cost of shipping, returns policy, and minimum basket size to qualify for free shipping, etc.
- Improve D2C demand forecasts by robustly challenging marketers’ assumptions on customer acquisition costs (CACs). Brands often assume higher site traffic and underforecast the costs to attract consumers to their website, store or app.
- Limit the number of SKUs you launch as part of your initial assortment. Launch products from one business unit (BU) first, as different product lines often have different attributes or purchase processes that increase the complexity of product management and commerce functionality.

Supply Chains Must Enable a Differentiated D2C Customer Value Proposition

Your brands are already selling successfully through your retail partners. They already have an established customer value proposition in the context of a retail shopping basket. But — and it’s a large but — will they work outside of that basket?
The D2C business model only works if the value proposition appeals to new customers (the end consumers) enough to make them switch channels. In addition, customers must pay enough to cover the costs so you have a viable financial model that makes it worth investing in many new capabilities.

Your marketers should be asking if they have products that make sense for consumers to buy directly. Many underestimate CACs, which can mean that fewer consumers than expected make their way onto your brand’s website. If your value proposition simply tries to emulate the retailer, the key question for the consumer will be, “Why should I shop with you rather than just add another item to my existing retail shopping basket?”

Your value proposition needs to be unique — not something that Amazon or Walmart.com can offer. It would be a brave brand indeed that thinks undercutting retail partners on price is the right way to differentiate its value proposition. To drive long-term success with D2C beyond the immediate opportunity afforded by lockdown, you need to find sustainable differentiators beyond price.

Learn from leading brands and the way they have differentiated their offering to make it worth the consumers’ time to shop direct. Some leading examples where companies have brought many sustainable brand differentiators together include:

- **Nike**, which has combined customization and service elevation by offering “Nike By You” custom shoes and developing the “Nike Run Club” to build loyalty through a sense of community. Nike custom shoes are sold at a premium over Nike’s standard offerings; only a limited number of customized products are orderable per day to match with capacity and enhance the sense of uniqueness. Nike Run Club is part of a wide ecosystem of health-focused partners that builds consumer engagement through activities and coaching.  

- **Graze**, a healthy snack company that has built its value proposition around data-driven personalization. Customers share their snack likes, dislikes and allergies, and receive a regular subscription box full of personalized goodies. This data allows the company to deliver over 200 million personalized snack combinations from its portfolio of 500 products.

In summary, when sitting down at the high stakes game of D2C poker against retailers, make sure you have cards in your hand to give yourself a chance of winning — as represented in Figure 3.
The value proposition may feel like the domain of other functions. But when putting together the business case for D2C, CSCOs should be totally involved in developing the value proposition and translating it into the capabilities they need to create buy-in to support that proposition. Each one of the brand differentiators in Figure 3 can be enhanced by the supply chain or alternatively undermined by its lack of capabilities. For example, to support the personalized offering you must ensure that the business case for D2C includes the investments you need to make in the supply chain to cover the considerably higher operating costs of personalizing at manufacturing or late-stage product differentiation. To offer exclusive products, you may need to be prepared to manage a higher SKU count. For service elevation, you might need tracking capabilities to improve CX and a two-way supply chain to deliver parcels to consumers’ homes and bring them back. These are all capabilities that may enhance the ability of a brand to compete. To understand exactly which are critical to your offering, focus on the end consumer — which we will do in the next section.

Recommendations:

- Support your product authority using online exclusives, limited editions and product collaborations with partners.

- Leverage the fact that you are the manufacturer and are uniquely positioned to deliver truly personalized products.
Many Brands Don’t Know the Needs of New D2C Customers

Now that you understand the competition and have settled on your value proposition, the next area of focus is to get to know the new customers you are hoping to attract with your offering — the end consumers. D2C end consumers have a totally different set of needs than B2B trading partners like retailers and marketplace operators. To build and maintain brand equity and consumer affinity in the digital space, you need to understand what motivates and frustrates your new D2C customers.

A leading approach to understanding the end consumer is to develop customer personas and associated CJMs to pinpoint the specific persona that a business model is addressing and to map their interactions with your organization (see Supply Chain Customer Centricity Part 2: Leverage Personas and Journey Mapping to Understand and Design the CX). Before you can build a CJM, it’s good practice to identify a “persona” for whom the CJM will be designed. In this context, a persona is a representation of your most valuable customers, including their wants, needs, goals and mindsets. It’s commonly depicted as a single individual with a picture and a name and serves as a powerful tool to help teams empathize with their customers. A persona must be rooted in data and facts, which can come from interviews, surveys, analytics tools, ethnographic studies and focus groups, to name a few sources.

Then, Gartner recommends using the Buy/Own/Advocate customer journey model shown in Figure 4 as a way of capturing every touchpoint that the D2C consumer has with your brand. Companies typically begin by mapping the journeys of their existing customers. In a static business model environment, CJMs like the one shown in Figure 4 support continuous improvement. In the case of business model transformation — like the move to D2C — your teams will need to work with other functions to gather the evidence to build new Buy, Own, Advocate models to support each new business model. Once the models are complete, you can use them to ensure you are delivering on the end consumer’s need with minimal customer effort and pain points. The models also ensure you are anticipating and answering customer questions, reducing wait times, and rectifying errors quickly and efficiently.

- Consider elevating the shopper experience through conversational commerce, concierge services, sampling, gifting and premium unboxing experiences.
- Express brand credentials through guided selling and customer advocacy.
- If your offering includes subscription, ensure that consumers are offered the ability to flex or pause their subscription so that a useful tie-in service doesn’t feel like they are locked in against their will.
CSCOs should focus their efforts on the elements of postpurchase fulfillment that do most to build trust through great CX that is needed to entice shoppers away from their trusted retailers and order from your new D2C site. One feature that is particularly important is the ability to change their mind. You may be accustomed to returns levels from your retailer partners of between 0% and 1%. For D2C, there is a need to eliminate purchase anxiety by offering risk-free trials that include free return shipping if the shopper is not satisfied with their purchase. So brands must do more than build a cost-effective and competitive forward logistics solution. Give consumers real-time visibility of their delivery and the ability to cancel or redirect while in transit, as well as return for free. CSCOs must be prepared to build traceability and visibility capabilities for product deliveries and returns by managing all product and data flows all the way through to the reverse logistics process.

Recommendations:

- Develop a more comprehensive understanding of the supply chain capabilities needed to transition from B2B to D2C by starting with your consumer needs and an understanding of your key competitors’ propositions.

- Address key system gaps and physical capabilities by working as a multifunctional team to develop the digital commerce technology landscape that will support your new D2C business model. (We will cover this in a “Part 2” document.)

- Investigate opportunities to collaborate with retailers and marketplaces in areas such as drop shipping and single-unit picking to support your digital commerce growth, as the key point to
remember is that the D2C route to market is not the only game in town.

Acronym Key and Glossary Terms

<table>
<thead>
<tr>
<th>Acronym</th>
<th>Definition</th>
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<tbody>
<tr>
<td>B2B</td>
<td>Business-to-Business</td>
</tr>
<tr>
<td>CAC</td>
<td>Customer Acquisition Cost</td>
</tr>
<tr>
<td>D2C (or DTC)</td>
<td>Direct-to-Consumer</td>
</tr>
</tbody>
</table>

Evidence

1. Heinz to Home, Heinz Ireland.
2. PepsiCo Launches New Direct-to-Consumer Offerings to Deliver Food and Beverage Products and Meet Increased Demand Amid Pandemic, PepsiCo.
3. Gartner Consumer Pandemic Attitudes and Behaviors Survey (8 to 18 May 2020; n = 1,505)
4. Quarterly Retail E-Commerce Sales, 2Q20, U.S. Census Bureau.
7. Nike By You, Nike; Nike Run Club: How to Use Nike's App to Become a Better Runner, Wareable.
8. Graze.

Note 1: Contactless Commerce
Contactless commerce allows customers to conduct buying activities without touching public structures or hardware, and without getting in close contact with another person. Contactless commerce can be done digitally or physically for both online and in-person shopping, and covers the entire buying process from researching and ordering to payment and delivery.

Recommended by the Author
10 Things Retailers Must Get Right to Succeed at Unified Commerce — Part 1
Ignition Guide to Planning and Conducting a Customer Journey Mapping Workshop
Supply Chains’ Make-or-Break Business Strategy
How Supply Chain Leaders Can Use Voice of the Customer to Improve Customer Experience
10 Things COVID-19 Will Change in Digital Commerce
Please the Pickiest Consumers to Grow Retail Subscriptions

Top 10 Strategic Technology Trends for Manufacturing Industries: Product Personalization

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