A Brand Manufacturer's Guide to Direct-to-Consumer E-Commerce

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Executive Summary

Once upon a time, the lines between manufacturers and retailers were clear. Manufacturers made widgets, retailers bought large amounts of said widgets, and consumers bought widgets at stores. There were exceptions to this model – the first Niketown, for one, opened in 1990 in Portland, Oregon.[1] However, while the advent of online shopping a few more years into that decade gave rise to a host of new pure-play online retailers, the fundamentally linear model of the brick-and-mortar world – manufacturer to retailer to consumer – remained largely intact.

This linear model no longer rules. Thanks to widespread adoption of broadband, mobile, and social technologies and applications, and the emergence of Internet-of-Things technologies, consumers have access to more information and buying opportunities than ever before. They can compare pricing, read product reviews, complain about poor customer service on social media platforms, order groceries at 3 a.m., and so on. As a result, consumers have higher expectations of both brands and the retailers that sell those brands. Meeting these expectations is forcing brand manufacturers to rethink their relationship with, and dependence on, retail partners for getting their goods and services to consumers, and whether they themselves should begin selling directly to consumers, otherwise known as D2C.

This report examines the D2C model from the perspective of the brand manufacturer. It describes the drivers of D2C and the mindset changes that manufacturers will need to make, outlines the processes and capabilities that a manufacturer will need to have in place in order to implement a D2C strategy, and provides a model to guide manufacturers to the five stages of D2C maturity.

D2C Applies To Many Industries

One of the earliest D2C adopters was the software industry: as a digital product, software was naturally suited to online purchasing once the necessary security, payment, and download processes were in place. Companies such as Digital River were born in order to provide infrastructure and professional services support to these software companies. Apparel was another early-adopter industry: online shoe retailer Zappos proved that not being able to try before buying was not the barrier it was perceived to be if coupled with great customer service and free returns.

However, other industries have been hesitant about whether D2C would work for them. Consumer packaged goods companies selling lower-margin items like kitchen towels and toothpaste, for example, have concerns about potential channel conflict and, in the words of one D2C software executive, “biting the hand that feeds them.” Some of those hands wield tremendous power: Walmart, for example, accounts for around 11% of retail sales in the U.S.[2]

Similarly wary are companies in industries where channel relationships are heavily dependent on key personal relationships between channel partners and their direct sales counterparts, such as heavy industry. If the head of sales feels that online threatens her livelihood, she will put up some pretty strong resistance to D2C.

These concerns are certainly understandable: change can be frightening, especially for companies in mature industries that have operated in largely the same way for years, if not decades. Nevertheless, earlier adopters have had success with D2C and have found ways to overcome these issues. In fact, there is evidence that these concerns are not issues at all. This evidence, in addition to the pressures now facing manufacturers, is pushing even the more skeptical companies to change the question from “should we do D2C?” to “we think we need to do D2C to stay alive, but how do we do it?”

Multiple Forces Drive D2C Adoption

Manufacturers pursuing, or considering pursuing, a D2C strategy commonly hope it will result in the following benefits:

- **Increased sales.** Slightly over half (52%) of consumers are already visiting manufacturers' websites intending to make a purchase, and a third of those actually would prefer to buy from the manufacturer. If that manufacturer's site refers them to a retailer's website instead, more than 50% of the time the consumer will buy a competing product from another company.[3]
- **Increased margins.** Depending on the product category, net margin dollars per unit doubles with D2C. One vendor interviewed for this report reported seeing increases among his customers from 50% to as high as 400%.
- **Minimized dependence on retail partners.** Amazon's dominance of online retail, coupled with Walmart's and other big box stores' dominance of physical retail, puts the squeeze on manufacturers' margins. A favorite aphorism of Jeff Bezos, the CEO of Amazon, is, "Your margin is our opportunity." In the bricks-and-mortar world, major retailers plan to close stores in the U.S. this year, indicating a phenomenon the retail industry calls "overstoring," where there are too many stores open to support consumer demand profitably. Though Walmart remains huge, it will shed 154 stores. Meanwhile, Macy's is shutting 40 stores, Kohl's is closing 18, and Sports Authority is shutting all of its 140 stores and filing for bankruptcy.[4] All these closures mean less physical shelf space for brands, and thus shrinking opportunities to reach end customers. D2C is a way to counter this shrinkage.
- **More opportunities to offer broader product assortments.** Retailers rarely carry a brand's complete product catalog, preferring instead to provide shelf space for products most likely to generate regular sales. By opening and managing their own online store, manufacturers can offer as wide a product assortment as they want, further augmented by their own content such as detailed product descriptions, photos, and videos, which retailers may not use. As an example, if a pair of running shoes comes in five different colors and extra wide and narrow sizes, a retailer may sell just the three most popular colors only in regular sizes while the manufacturer could offer the entire range online.

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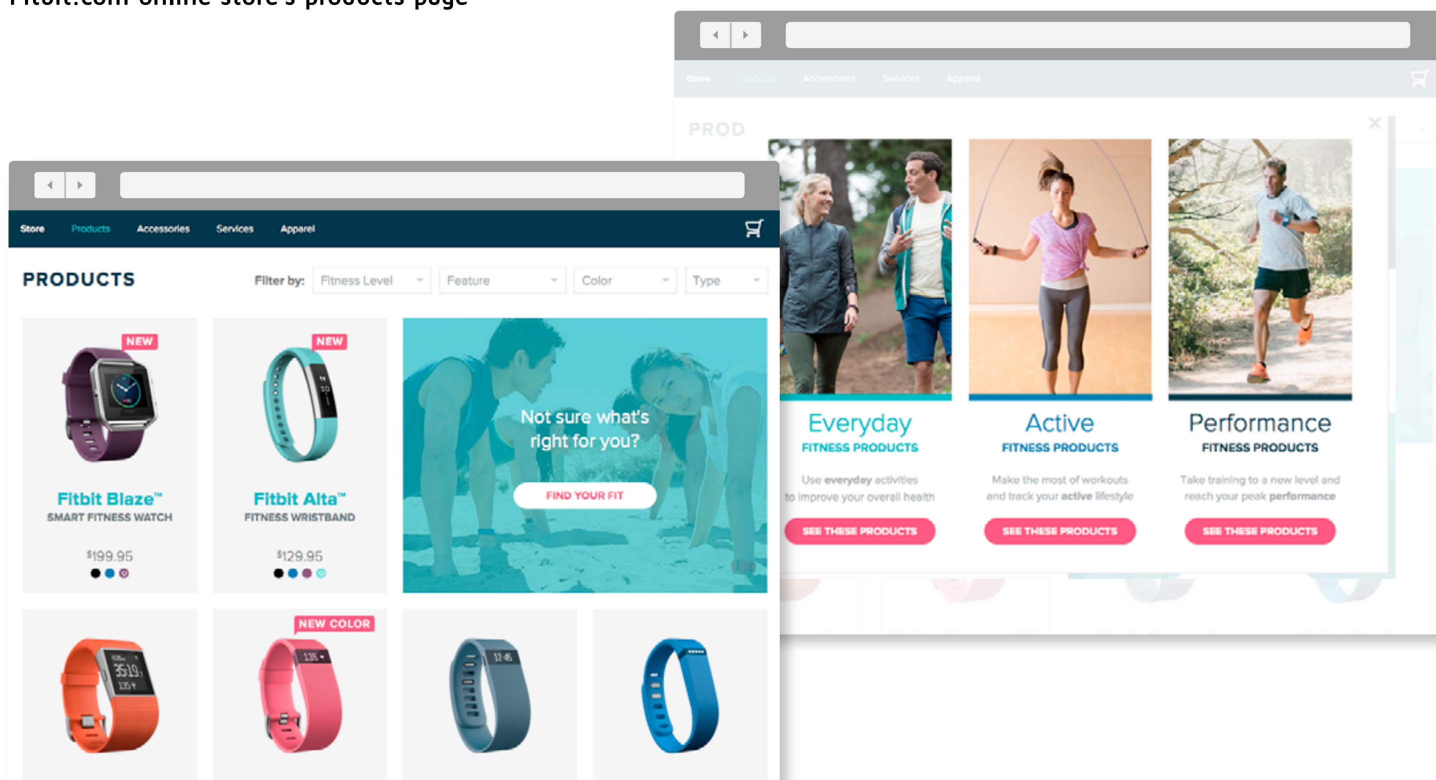
- **Improved customer engagement and loyalty.** The proliferation of online marketplaces has created an economy of little-known retailers who sell goods via intense price competition. This has a profound impact on margins for manufacturers, as enforcing their minimum advertised price in the online world is impossible. D2C gives manufacturers an alternative channel to consumers where they can counter the effect of price competition. They gain data on their customers' purchasing habits and can tailor product assortments and promotions accordingly. Figure 1 shows how Fitbit uses its online store to guide customers through product selection, providing advice on how to choose the best Fitbit model for their needs.

- **Access to customers in new geographies.** A manufacturer looking for new sources of growth today has a range of affordable options to sell online to customers in different countries. Online marketplaces, website translation and localization software and services, and cross-border software solutions that handle customs, duties and taxes, and payments, are now widely available, and consumers in fast-growing economies are a ready and willing market for foreign brands.[5]

Figure 2
Fitbit.com online store's products page



D2C Requires A Shift In Mindset To Investment and Experimentation...

While a D2C strategy can bring major benefits for manufacturers, it does require a shift in thinking. D2C is unlikely to succeed if it is a side project that consists of putting up a web store without making changes to other aspects of the organization.

Prepare to invest in consumer marketing, online content, and product information

Companies new to D2C may have marketing capabilities in B2B but not necessarily in building a well-known and respected brand with consumers in the digital world. In these cases, they have to acquire expertise in digital marketing to consumers. They need to understand how consumers conduct online searches, what a smooth path to purchase requires, how to reduce cart abandonment rates, and more, either by building an in-house team or engaging with an external digital agency.

One e-commerce software executive interviewed for this report noted a common mistake that brands new to D2C make when they do not first acquire expertise in digital marketing to consumers. On their new D2C websites, they use the same product spec sheets they send to retail partners, without making any changes to them. It's important to realize that retailers often invest in enhancing these lists with more detailed product information, pictures, and video, in order to make them more attractive to consumers. Manufacturers will need to take on this task for their own D2C sites, which may mean adding product information management (PIM) software to their infrastructure if they have large and complex enough product ranges.

Get over fear of channel conflict

One fear that manufacturers commonly express about D2C is that they will damage their relationships with existing channel partners, since they will appear to be competing directly for the same customers. There may also be internal resistance to D2C from employees in direct sales who have built relationships over a period of years and are afraid their livelihoods will disappear. These are understandable fears, particularly if a handful of channel partners are responsible for a large portion of sales and if the head of direct sales is on the company's executive team.

Fortunately, new partnership models are emerging where brands have managed to maintain strong retail partner relationships and at the same time sell online directly to end-customers. They have succeeded in making clear that they do not want to undercut or exclude the retail channel. Rather, they want to expand the sources and possibilities for purchases so that customers have options to

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use the channels they most prefer, including still having a relationship with their direct salesperson if they choose.

Here are some examples of successful models now in the market:

- **Sharing the gold with partners.** One global sportswear brand compensated its physical retail partners for the first year for online sales.
- **Changing internal incentive structures.** Companies that have seen D2C success have eliminated the competition between direct and online sales by realigning incentives for direct salespeople so that they drive online sales as well.
- **Synchronizing promotions.** One retail conglomerate created a synchronized calendar system with its retail partners so that it would never run promotions at the same time they did, avoiding undercutting its partners on price.
- **Offering unique stock-keeping units (SKUs) not sold in retail stores.** A brick and mortar retailer has finite shelf space and may order only the most popular SKUs in a given product range in order to maximize sales per shelf area. If a retailer sells an item in the three most popular colors, the manufacturer can sell that item in the remaining five colors online, letting customers take advantage of the digital world's "endless aisles."
- **Allowing some wiggle room on price.** Expect that retailers will look for a price advantage. That is OK – a brand's online store does not have to be the cheapest to be successful. For example, online fitness tracker Fitbit grew revenue 149% in FY 2015. The company sells its Fitbit Blaze smart watch on Fitbit.com for $199.95, and third-party sellers on Amazon offer the same model for prices that range between $189.99 and $196.82. Not all consumers are driven solely by getting the cheapest deal possible. And for those who are more price sensitive, manufacturers can offer alternatives on their online stores such as product bundles, free shipping over a certain minimum or for the slowest delivery option, protection and warranty plans, and loyalty programs rewarding frequent purchases.

Nonetheless, manufacturers need to be prepared that working through change, even if necessary, is not always smooth sailing: Somewhere along the line, someone in a channel is probably annoyed. However, several e-commerce executives interviewed for this report said channel conflict is frequently less of an issue than manufacturers expect – one noted that it is a "phantom problem" that is perceived to be much larger than it actually is.

The "flagship store" in the bricks-and-mortar retail world provides a model for how online stores can differentiate themselves. Flagship stores are now a common feature of the urban landscape. Niketowns and Apple stores are designed to be

entertainment destinations as well as retail outlets. In these physical stores, consumers expect to see the latest and greatest trends, talk to well-informed floor employees, and enjoy a beautifully designed atmosphere.

The point of these physical flagship stores is not to have warehouse-level volumes of product assortments – in fact, their addresses in some of the most expensive city shopping neighborhoods make extensive product assortments prohibitively expensive even for the richest companies – but to represent a brand and tell consumers how to get the products they want, be it online, through delivery from another store, or another way.

Manufacturers can take this physical world example and conceive of their online stores as their digital flagships. Amazon and other online retailers may have the advantages they are famous for, like free shipping and third-party sellers, but those retailers do not have the advantage of being the "official" source of truth about a manufacturer's brand.

Don't think you need to be Amazon

Amazon is indeed an industry juggernaut with tremendous influence and capabilities in selling to consumers online. But it is not a monopoly, and it has no control over other companies' abilities to be successful in e-commerce. Plenty of brands have found success selling online by doing well what Amazon cannot do: provide the best possible digital experience for their brand with great engaging content, high levels of customer care, unique promotions, personalized service, and rewards for customer loyalty. For example, UK retailer Monsoon Accessorize increased conversion by 10% when it was able to show a shopper whether an item in their size was still in stock, and how many were left.

… and Construction of a Solid Foundation

After adopting a D2C-focused mindset, the next step for manufacturers is to ensure that the right processes and organizational structure are in place to support and scale D2C. Several e-commerce executives interviewed for this report cautioned that they have seen manufacturers skip this important step. Instead, these manufacturers started by purchasing technology and setting up an online store, only to find themselves falling short in other key capabilities necessary for online sales such as customer care, logistics and operations, and web analytics. Failing to establish the necessary foundations for D2C can be more damaging to a brand than not having an online store at all, since dissatisfied customers do not hesitate to take to social media to describe their subpar experiences.

Assess organizational structure and people

D2C requires input and cooperation across business divisions, including marketing, operations, sales, and finance. Ensuring this cooperation means that it is unlikely a D2C initiative run by a single division can get the buy-in and expertise it needs to be a success. D2C success requires a sponsor at the very top of the organization, like a CEO or COO, who has the power to align incentives so that employees in different divisions work collaboratively. For example, a dedicated employee for D2C reporting directly to an executive sponsor is empowered to manage a D2C initiative and introduce the necessary process and employee changes. One place to look for this D2C leader is within a manufacturer's existing channel. A good candidate has e-commerce or supply chain expertise and also understands two key things:

1. why marketing needs a seat at the table, and
2. how all e-commerce business processes tie together.

Sometimes an external third party has to come in to provide an organization with the push it needs. A global music label recognized that with digital streaming services like Spotify and iTunes now acting as major channels to music consumers, it needed to sell and engage directly and more regularly with those consumers to better understand their listening habits and preferences. Middle management executives at the company did all the right things: gathered evidence, identified opportunities, collated an executive brief, signed on the CFO as a corporate sponsor, and even grew D2C to a multi-million dollar business in Europe. However, even with evidence of initial success and top executive sponsorship, the rest of the executive team could not be convinced to give D2C a try in the United States until an independent consultant was brought in to reiterate the opportunity and potential risks of not continuing with the initiative in other geographies.

Identify gaps in processes, operations, and technology

One thing that manufacturers may underestimate as part of building a D2C strategy is that a minimum number of processes and functions need to be in place to operationalize D2C. Customers will not come if they can't find you, and if they do come and have a bad purchasing experience, they are unlikely to return.

To avoid these obstacles, prior to taking any major actions in building D2C, like purchasing new e-commerce platform software, manufacturers should review their capabilities in the following areas:

- **Product information:** It's critical to have the right type and level of in-depth information about each product. Retail partners may accept the manufacturer's list of SKUs in Excel for products to sell on their own websites. However, they then invest in integrating those lists into their product information systems and enhance the listings with additional pictures or other content to increase their attractiveness to consumers. Selling D2C means that manufacturers will need to take over these product information management tasks.
- **Marketing:** Establishing an online presence requires more than simply buying a domain name and setting up and registering a website. Digital marketing, through areas such as email, paid search, and content creation (e.g., articles, videos, and images) will be crucial to attracting consumers looking for more information about a product or brand to an online store, then further smoothing their path to purchase.
- **Customer service:** Providing email and phone access to customer service specialists to answer questions and troubleshoot problems is considered the minimum customer service that an online store needs to offer.
- **Warehousing and distribution:** Warehouses designed to ship pallets to retailers are structured to fit a many-to-one model, and as such are not optimized for online sales, which is a many-to-many model. A thousand orders of one product will need to be shipped to a thousand different customer addresses. Online sales thus requires that warehouses be set up for pick and pack operations.
- **Returns:** Returns are an inevitable part of retail, and problems with returns can result in customer loss. Manufacturers need to make it simple not just for consumers to return products, but also to process those returns so that if they can be resold they are returned to the shelf. Seventy percent of returns are perfectly resalable but almost never monetized.[6]
- **Inventory management:** Inventory management is an essential part of retail but manufacturers tend to be new to the practice.
- **Post-sales support:** A wide range of post-sales support may be needed depending on the product type sold. For example, a toothpaste

buyer will not need help understanding how this ubiquitous household product works or how to use it correctly. The same cannot be said for a product like a bathroom faucet, which comes with multiple parts, requires one or many tools to assemble, needs to be connected to a household's water supply, and so on. Manufacturers that sell complex products need to invest in setting up a customer assistance function for buyers whose purchases require replacement parts or maintenance.

Understanding customer service processes is necessary before making any major technology purchasing decisions, such as buying or upgrading an e-commerce platform, since these business processes must be factored into e-commerce technology requirements gathering. A recent study estimated that for an operation with annual sales of $10 million, the required capital expenditures are $2 million and the required operating expenditures are $4 million.[7] Any further increases to these amounts to fill in gaps in processes and operations later on will only decrease margin for online sales, especially in the initial years.

Manufacturers should not despair if they think their organizations are missing many of the necessary foundations. Marketplaces, digital agencies and consultancies, and technology vendors can provide guidance and assistance on the best entry point for a manufacturer to D2C.

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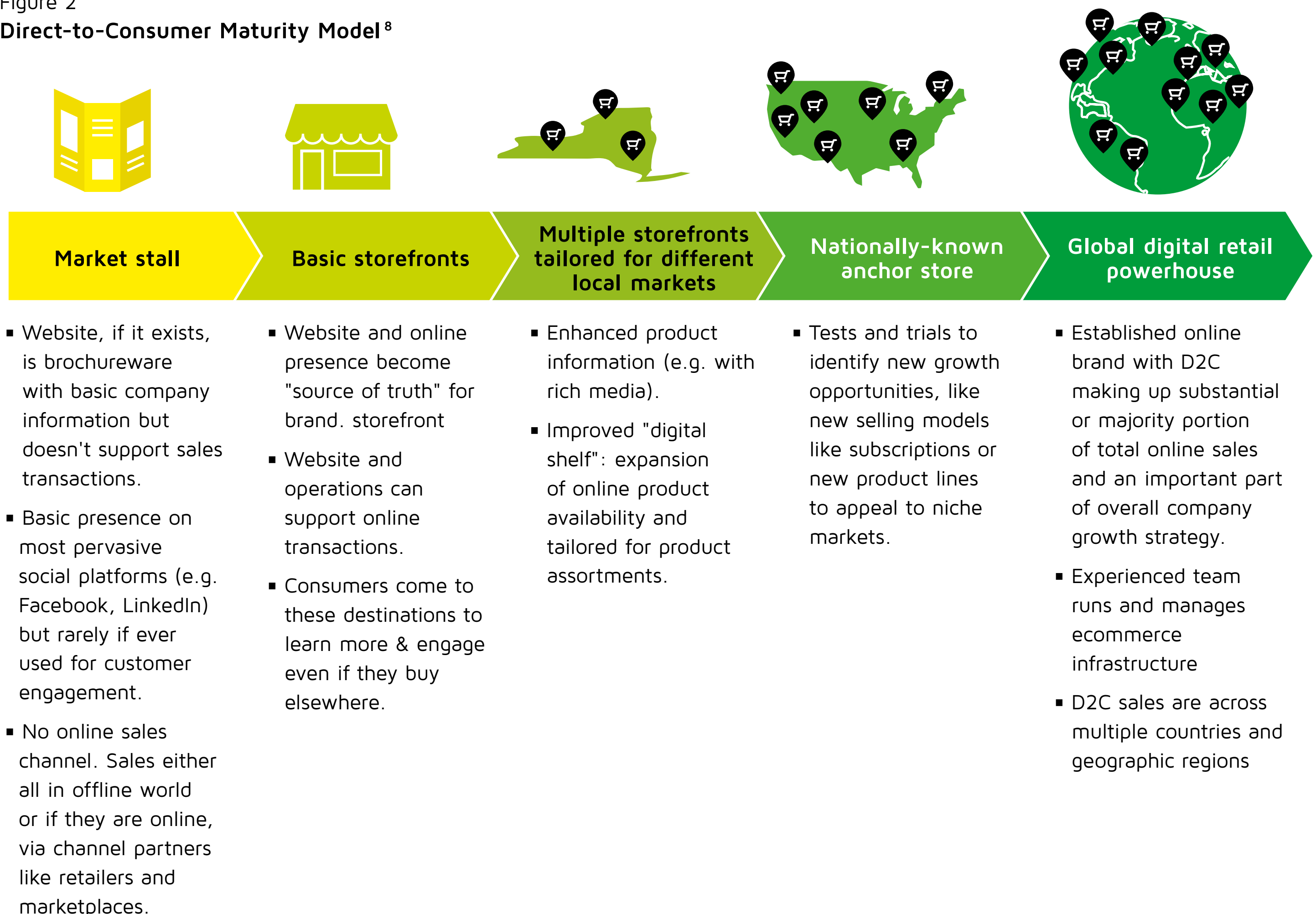
D2C Maturity Model

The following maturity model provides a framework and guide for manufacturers to get started with D2C and understand what actions they need to take to grow their D2C business once it is up and running.

Figure 2
Direct-to-Consumer Maturity Model[8]



Conclusion: D2C is Key To Surviving Amid Digital Disruption in Retail

Today's consumers are far more demanding than ever before. They have access to seemingly infinite amounts of information to guide their purchasing decisions, expect to make those purchases on multiple devices, and are more willing than ever to change suppliers due to subpar customer support, long waits for deliveries, or inflexible return policies.

To meet these consumer demands, brand manufacturers need to expand beyond their long-established retail channels to reach those consumers directly and learn more about their tastes, preferences, and expectations. Implementing a D2C strategy, whether it is simply relying on third-party marketplaces or establishing a branded online store, is becoming increasingly key to staying competitive. The Amazons and Walmarts of the world, despite their market power, are powerless to stand in the way of a brand that offers a tailored and high-quality experience to consumers that iterates and constantly improves over time.

Acknowledgements & Endnotes

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Ally Commerce
CloudCraze
Digital River
eFocus
Razorfish
Unilog
Verndale
Wpromote

1 For background on the origins of Niketown, one of the first "concept stores" opened by a brand, see "Nothing's Like Nike Town." Philly.com, May 28, 1993. http://articles.philly.com/1993-05-28/living/25962324_1_nike-town-crain-s-chicago-business-magazine-tennis-pavilion

2 http://www.statista.com/statistics/309250/walmart-stores-retail-market-share-in-the-us/

3 "Be Direct: Why A Direct-to-Consumer Online Channel is Right For Your Business." Forrester Research study conducted on behalf of Digital River, June 2014.

4 "There really are too many stores. Just ask the retailers." Washington Post Online, April 5, 2016. https://www.washingtonpost.com/news/business/wp/2016/04/05/there-really-are-too-many-stores-just-ask-the-retailers/

5 For more information about how brands can sell online to foreign countries, see "Cross-Border E-Commerce: A Maturity Roadmap and Partner Selection Guide." Digital Clarity Group, October 2014. http://www.digitalclaritygroup.com/cross-border-ecommerce/

6 Interview with Jason Rubottom, CEO of Ally Commerce, March 2016

7 "Cost Plus Value: An Equation for Maximum Return on Your Digital Platform Investment," November, 2015. Sponsored by Demandware.

8 Special thanks to executives at Razorfish and Wpromote, who provided information about the maturity models their companies use with customers that informed the one in this report.

About Digital Clarity Group

Digital Clarity Group is a research-based advisory firm focused on the content, technologies, and practices that drive world-class customer experience. Global organizations depend on our insight, reports, and consulting services to help them turn digital disruption into digital advantage. As analysts, we cover the customer experience management (CEM) footprint – those organizational capabilities and competencies that impact the experience delivered to customers and prospects. In our view, the CEM footprint overlays content management, marketing automation, e-commerce, social media management, collaboration, customer relationship management, localization, and search. As consultants, we believe that education and advice leading to successful CEM is only possible by actively engaging with all participants in the CEM solutions ecosystem. In keeping with this philosophy, we work with enterprise adopters of CEM solutions, technology vendors that develop and market CEM systems and tools, and service providers who implement solutions, including systems integrators and digital agencies.

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