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Kari Alldredge,
Puneet Newaskar, and
Kelly Ungerman

The digital future of consumer-packaged-goods companies

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After lagging behind other sectors with rocketing online sales, consumer-packaged-goods players are at an e-commerce tipping point. Here's how they can succeed.

While e-commerce has disrupted retail with vibrant new marketplaces and shopping tools, one sector was for a long time blissfully above the blast area: consumer packaged goods (CPG). In fact, CPG had so few online competitors that in 2013, online accounted for less than 1 percent of total sales in packaged food and about 3 percent in nonfood areas, according to Euromonitor.

Those days appear to be over: some of the most innovative experiments in e-commerce are now occurring in the CPG sector. In the past year alone, for example, Amazon has rolled out tests of Amazon Pantry, which lets its Prime users fill a box with selections of more than 2,000 products and ship them for a small fee; Prime Now, which offers delivery to the home within one or two hours; and the Dash Button, an Internet-connected device placed anywhere in the home that provides a one-touch way to order refills. And it's not just Amazon that's blazing a digital CPG trail. Regional grocers are finding success with "click and collect" pilots in which products are ordered online and picked up in stores, and Campbell's is customizing soup packages for millennial shoppers.

So what's driving the sudden acceleration in CPG e-commerce? The emergence of mobile devices for Internet access, for one. US mobile devices account for 60 percent of total Internet usage, and earlier this year the number of mobile-only Internet users topped desktop-only users for the first time.[1] Mobile-device owners engage in online research and purchases at higher rates than the overall population, according to McKinsey's 2013 iConsumer survey, and another McKinsey survey on digital consumers showed that CPG categories are particularly popular: for example, the online-research rate among purchasers of cereal is 45 percent, while for soap it's 55 percent and cosmetics 65 percent. It's no wonder, then, that the results of our 2014 Customer and Channel Management Survey, which polled more than 50 leading CPG companies, bore this out. In the survey, online commerce was ranked as the second leading driver of change over the next five years—above other likely game-changing influences such as the rise of value-conscious shoppers, the growth of private labels, and the use of big data.

[1] *comScore Insights*, "Number of mobile-only Internet users now exceeds desktop-only in the U.S.," blog entry by Adam Lella, April 28, 2015, comscore.com.

Successful CPG companies are already skating to where the puck will be, not where it has been (to paraphrase ice-hockey star Wayne Gretzky). Our forecasts show that e-commerce could account for as much as 5 percent of total food sales over the next five years if retailers move aggressively. In nonfood categories such as cosmetics, diapers and wipes, pet food, and skin care, online penetration could reach as high as 10 percent in the same period.

In fact, we believe that online will account for anywhere from 10 to 30 percent of total industry sales growth in the next five years, which equates to a market opportunity of $15 billion to $50 billion. Winning CPG players know that already: our survey showed that while their e-commerce businesses average just $20 million in annual revenue, their online sales are growing three times faster than those of their peers.

Three ways to win in e-commerce

CPG companies obviously need to move quickly. But the trusted guideposts that shaped success in the brick-and-mortar world have seemingly disappeared in the digital arena. Even having an established offline brand has meant little for building success online: of 15 top offline players in the bath-and-shower, fragrances, ready-meals, pet-food, and skin-care categories, only 5 are also among the top sellers on Amazon.[2] When it comes to profitability, 56 percent of companies in our 2014 Customer and Channel Management Survey indicated that Amazon was more profitable than traditional channels two years ago, but only 30 percent believe this will be true two years from now.

Amid this turmoil and uncertainty, there is some good news for CPG players—a road map for success. In our experience, and based on detailed analysis of our survey results, companies emerging as winners in e-commerce engage in three practices: building strong account-management teams to serve strategic retail partners, developing next-generation e-category management, and building their Digital Quotient.[3]

1. Strong key-account management

Leading companies are four times more likely than others to create dedicated teams for top online accounts. These teams include functional specialists in category management, shopper marketing, and shopper insights, and they are empowered to make decisions quickly, at the pace that e-commerce requires. Leading CPG companies co-locate account teams where key partners are based to strengthen relationships with category managers and other decision makers, access rich data that would otherwise be difficult to obtain, coordinate strategic planning more easily, and learn from leading-edge digital practitioners to build their own capabilities. A full 80 percent of winning companies, for example, co-locate with Amazon in Seattle or plan to do so within two years, compared with 14 percent of nonwinners, according to McKinsey research. Also, past surveys on customer and channel management reveal a consistent trend among winners: they invest in high-growth areas ahead of expected returns and away from unproductive programs, channels, or markets. They invested in Walmart 15 to 20 years ago and in dollar stores 5 years ago, and they are investing in e-commerce today.

[2] "How Amazon will transform CPG sales," Bernstein Research, May 15, 2014.

[3] To understand how this new metric measures the digital sophistication of organizations, see Tanguy Catlin, Jay Scanlan, and Paul Willmott, "Raising your Digital Quotient," *McKinsey Quarterly*, June 2015, on mckinsey.com. For more on this topic, see our Raise your Digital Quotient series, mckinsey.com/features/raise_your_digital_quotient.

2. Next-generation e-category management

To capture the value of e-commerce, leaders are rethinking category strategy and management in three areas:

Assortment. "Showrooming," or the consumer practice of comparing prices in store and purchasing at another store online, is still a nagging issue. CPG companies can strengthen relationships with key channel partners by providing online items that cannot be found elsewhere. We found that winners were twice as likely as others to offer new and exclusive stock-keeping units and pack sizes to their key online accounts. For example, L'Oréal offers a recharging hydration hair kit only on Walmart.com.

The best-performing companies also know their customers like family and tailor products to them. For example, stocking up is the primary shopping occasion for consumers hunting for toothpaste on Amazon, while refills and convenience are the most important occasions for Amazon Fresh customers. P&G smartly focuses on bulk and multipack sizes of Crest on the former and single-cycle pack sizes on the latter. At the same time, it takes advantage of the web's long tail to target niche customer segments, as Campbell's does with customized soup packages for millennials and Mars does with Balisto bars from Germany, sold on Amazon to satisfy US consumers with a sweet tooth for European chocolate.

Pricing and promotions. With technology making it easy for consumers to compare offerings, companies are concerned about endlessly cutting prices in a race to the bottom. Leading CPG players counteract this pressure and even expand margins by developing a deep understanding of category pricing dynamics. They encourage their retailers to match or beat competing retailers' online prices for key value items but make margin on background or long-tail items where consumers tend to be less price sensitive. Winners also define and enforce minimum advertised pricing by pointing out noncompliance and working with retailers to take necessary actions, including shutting down unauthorized distributors.

Coordinating promotion plans across channels is important to ensure that they drive incremental sales rather than simply shift traffic among channels. Winning CPG companies analyze data on past purchases of the same, complementary, or competing products to create tailored promotions that have channel flexibility—for example, offering online coupons that can be transferred to a loyalty card and redeemed in stores or using geotargeting to provide real-time deals when the consumer is near a store.

Merchandising and marketing. The best-performing CPG companies are pushing the boundaries of the "perfect page" online by providing rich product information and content that also helps deliver search results that are more favorable to their company. These can include high-quality pictures with rollover notes, detailed product descriptions and reviews, product comparisons, videos, and mobile-optimized sites, which give consumers all they need to know at the point of purchase.

Winning companies are also winning partners: they work extensively with retailers to ensure they receive prime digital shelf space on their websites. Success stories include the Eddie Bauer collection highlighted on Target's main landing page and P&G's store within a store on Amazon, which featured Gillette and Pantene showrooms. Leaders also push for inclusion of their products in "favorites" lists, in recommendations for the next-best purchase or bundled deals, and on personalized landing pages generated by a consumer's profile, purchase and search history, wish list, and so on.

When it comes to marketing campaigns, high performers are exploring new models of investment and focusing on omnichannel campaigns that actively incorporate social-media monitoring for insights about consumer preferences. Some 84 percent, for example, are coinvesting actively with Amazon, compared with only 57 percent of nonwinners, according to McKinsey's 2014 Customer and Channel Management Survey. They are also coordinating campaigns across channels and touchpoints.

3. Digital Quotient (DQ)

Our analysis of companies with a high DQ revealed specific attributes and management practices that drive financial performance. Companies with the highest DQ scores, in fact, achieved a five-year annual total return to shareholders of 42 percent, while those at the low end of the spectrum were at just 16 percent. Here is what it takes to build up your DQ.

Strategy. Some 90 percent of online leaders have digital initiatives fully integrated into their strategic-planning process, not as a bolt-on. They avoid getting bogged down in overplanning and instead focus on testing the viability of a market, product, or segment in near-real time—through limited releases, small campaigns to compare markets, and prototyping with early adopters. For CPG companies, this means addressing the question of what role the digital and online realm currently plays in their business: Is it an engine for sales growth, a marketing platform for engaging consumers and building the brand, or simply a customer-insights learning lab? Importantly, digital leaders have a laser focus on customer journeys, with clear initiatives targeted at meeting customer expectations across all touchpoints.

Culture. While 84 percent of companies in McKinsey's DQ benchmark indicate their culture is risk averse, companies such as Amazon and Google embrace a different mentality: "We think big and are not afraid to fail." Instead of waiting for perfection, digital leaders adopt a fail-fast forward mind-set. They push a simple product into the market, gauge interest, collect customer feedback, and iterate. There is an emphasis on failing often and succeeding early. For instance, Lowe's Innovation Lab, which employs a dedicated team of 20 people, is an initiative that works exclusively on applying disruptive technologies and prototyping new ideas for stores and online. One example was its work with Authentise to develop a 3-D printing solution for its home-improvement customers. Customers can have broken, missing, or used pieces scanned and printed right in the store.[4] While many companies understand the value of speed and agility, digital champions are built to act that way; Amazon Prime was launched in just 60 days by a small team liberated from hierarchy and decision paralysis.

[4] TJ McCue, "Authentise helps Lowe's Innovation Labs build 3D printing experience for consumers," *Forbes*, June 11, 2015, forbes.com.

Organization. Companies with high DQ use nontraditional organizational structures, digital talent acquisition, and management to execute their digital vision. Critically, 65 percent of digital leaders have an aggregated digital budget and sufficient budget allocation to scale their digital initiatives. While no one structure works for all, approaches include separate venture-capital incubators, centers of excellence, and governing councils charged with thinking big and driving senior-management buy-in.

For these models to be successful, however, they need to be part of a plan that integrates the talent, processes, and capabilities back into the larger business. Digital leadership that combines business and marketing savvy with technological expertise and has real authority as part of the company's executive team is important, but midlevel talent is perhaps even more critical. These people are the boots on the ground and can make or break digital initiatives. Digital leaders frequently pluck talent from disparate sectors because they understand that digital competency matters more than sector knowledge in the early stages of transformation.

Capabilities. Digital leaders make decisions based on data and build capabilities that connect people, processes, and technology across all channels that engage with consumers. Some 80 percent of digital leaders effectively invest in their digital IT infrastructure to support growth. That means moving beyond model building to implementing processes that can bring relevant internal and external resources to take action quickly. Reckitt Benckiser, maker of popular cold and flu remedies, used search data from WebMD, a medical website with approximately 32 million monthly visitors, to track the course of a given illness and anticipate where outbreaks were likely to occur. Through targeted geography- and symptom-specific advertising and promotions, sales of cough and cold products during one four-week period grew by 22 percent nationally over the previous year.[5]

Digital is a nonstop force of disruption. In the CPG sector, digital is rapidly approaching a tipping point where emerging winners make an aggressive break from the pack and create tough-to-beat leadership positions. CPG companies can drive profitable growth online, provided they are ready to adapt quickly. ◻

Kari Alldredge is a master expert in McKinsey's Minneapolis office; **Puneet Newaskar** is a consultant in the Dallas office, where **Kelly Ungerman** is a principal.

[5] Emily Steel, "Reckitt targets flu sufferers online," *Financial Times*, November 5, 2012, ft.com; and Jack Neff, "Flu gives Reckitt, Johnson & Johnson a shot in the arm," *Advertising Age*, January 14, 2013, adage.com.

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