KPMG

Channelling the right strategy for profitability and growth

Consumer Packaged Goods (CPG) companies are moving beyond traditional trade to explore new channels – with a keen eye on maximising returns and avoiding risks associated with over-reliance on few customers and increased competition from new market entrants.

The marketing and sales divisions within CPG companies have more channels to choose from than ever before. The days of a single path to purchase via the primary grocery channels are over, and there are new opportunities to capitalise on. These include the emergence of 'microchannels' with the click-and-collect model made popular by the pandemic. However, channel diversification comes with costs. Choosing the right channels to maximise profitability without compromising core business is essential. Determining whether a channel is truly profitable, inclusive of all costs to service is key.

An omnichannel strategy often makes sense for a variety of reasons. Consumers tend not to be loyal to one channel: over the course of the week, they may use different platforms and touch points. The purchasing journey should be seamless across different devices and online and offline platforms. Eliminate friction wherever possible and make the brand available.

Before investing in a new channel or changing their channel mix, CPG companies need to be mindful of considering how this might impact its core retail business, as well as its internal operations. Offering different sizes or packaging bundles of products may be a way of honouring existing business arrangements and avoiding a perception of eroding business streams with major supermarkets. Keep potential channel conflict top of mind, as taking a misstep could hurt the bottom line.

Direct-to-consumer

There is a great deal of excitement around direct-to-consumer (DTC) and subscription models. Much commentary has focused on double digit growth in DTC, and many CPG companies have some kind of digital purchasing platform. While there is no doubt that DTC is growing rapidly, profitability will not necessarily flow for all. Digital platforms come in all shapes and sizes, but most DTC strategies lack the sophistication and ease that many consumers have come to expect.

The appeal of the DTC model is the convenience it provides to the customer and the companies that excel in DTC strategies often skyrocket in growth, take Amazon for example.

Further, A DTC model removes intermediary involvement from the promotion, sale and distribution of a manufacturer's products and services and enables a brand to interact directly with its consumers, providing priceless customer insight opportunities, and to be agile in responding to consumption behaviour changes. It is also an innovative way to boost resilience as pressures on the margins of manufacturing organisations continue to spike.

The unexpected shortcoming of many CPG companies that attempt to adopt the DTC model is the large costs that impact the company's budget. Many brands assume that overheads are lower than for offline channels and fail to factor in higher shipping and advertising costs. Furthermore, a deep time commitment is needed to increase scale, with new capabilities typically required to set-up and manage customer portals/websites and deliver last-mile fulfilment, as higher volumes lead to better margins. Dealing directly with the end consumer brings with it additional customer service requirements, with CPG companies now required to be able to answer to an increased volume of issues and queries. DTC profitability remains elusive for countless CPG companies in Australia.

©2022 KPMG, an Australian partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved. The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organisation.

Liability limited by a scheme approved under Professional Standards Legislation.

Additionally, deciding which products make the cut on the DTC model requires deep insights into who the product's customers are as well as the *true cost to serve*. The type of product will also be informative: for example, the wine industry experienced exponential online sales growth in 2020, largely due to the global pandemic. In the first year of the pandemic (2020-21), Australian wine DTC sales grew by 17% in value and 14% in volume, outperforming other sales channels, according to Wine Australia's *Wine Direct-to-Consumer Report 2021*. Continuing to drive the growth in the DTC wine purchases in 2022 were the millennials and Gen Z's. These demographics favour the convenience offered by DTC models, enjoy the personalisation of their orders, and view the brand identity of the DTC wine companies as an expression of their own personality. For instance, the wine subscription service Good Pair Days offers an online palate quiz to understand the tastes of its consumer to personalise their wine box and presents a unique and youthful brand to attract younger consumers.

Wine is a commodity that is suited to the DTC model given it is a frequently repeated purchase, and it appeals to the demographic who regularly use DTC services.

Foodservice

The foodservice sector has become a channel of increasing importance to the financial health of CPG companies given the evolving market dynamics (the rise of delivery and at-home consumption), and enduring pandemic-related behaviour, such as hybrid work models. In response to this, CPG companies are starting to focus attention again on emerging sub-sectors of the foodservice channel.

The foodservice sector is presenting a lot of growth, thanks partly to the increase in away-from-home and at-home consumption over the past few years. In addition to the channel's growth, the foodservice channel allows CPG companies to continue executing their grocery and branding strategy, while also receiving an alternative stream of revenue by selling to consumers and B2B customers who may be outside of their historical target market.

Through a foodservice channel, CPG companies have limited control over the pricing, promotions, and other commercial levers. This is because the product is not necessarily the end-product to the consumer. In this channel, the product branding does not carry as much weight as the foodservice sector operates more as commodities than branded products. This can lead to elusive brand loyalty within the foodservice channel, as different brands of the same product are interchangeable. To overcome this, CPG companies can differentiate themselves, for example, changing the breadth of products offered adapting formats and packaging or improving their operational performance, capacity, and supply-chain agility. Foodservice customers are typically distinctly different from traditional retail channels, with different purchase and service needs which may not be fully met by existing sales structure and capabilities.

Independent grocers

In addition to supplying products to the larger grocery players, CPG companies also look to supply to smaller, independent grocers and specialist retailers.

One of the most attractive features of suppling to an independent grocer is their nimbleness in operations. Independents have more authority at the store level than a larger grocery chain. This allows more control over what is bought into the store, and therefore requires fewer approvals when bringing on new products and vendors. The speed at which independents can on-board and sell a product makes them an attractive channel to CPG companies. The nimbleness of change also enables the independents to cater to the community they serve, and their evolving needs. CPG companies can benefit from the local knowledge that independents have as the smaller grocers already know what products will sell in the community. Additionally, independent grocers appeal to the growing class of younger buyers who have the ethos of supporting local business.

Independent grocers have the perception of being more expensive than the commercial grocers. In the current economic climate with higher interest rates and inflation, this perception may prove true. Basic products such as meats (particularly beef), fresh fruit and vegetables have all been subject to price hikes in the recent months due to the increased inflation. This has caused independents to further increase their produce prices to maintain margins and profitability. The relative decision-making autonomy of independent retailers also makes them a potentially more competitive channel, with greater need to regularly service via an active (and costly) field sales team, with typically smaller purchase volume also putting pressure on logistics costs.

Trial and experiment

The multitude of channels available for CPG companies to distribute through require trial and error to determine the most profitable for the brand. It may also be the case that an organisation is ill-equipped to execute certain channels and the new supply chains that come with it. Within Australia's CPG sector there is much trial-and-error underway, and many brands are learning that new capabilities across their workforce and operations are needed to be successful. A brand that cannot increase customisation or tackle the challenges of missed revenues and excess inventory will deliver a negative customer experience that may send loyal consumers to rivals. This often requires a change in organisational mindset, to adopt a more entrepreneurial approach often at odds with common CPG structured and ways of working.

A channel strategy must determine more than just which products fit within the right channels and who to target. It isn't simply a matter of uploading a catalogue listing onto an online platform, or vice versa.

Getting the strategy right

Ultimately choosing the best mix of channels requires an understanding of consumer behaviour towards the product being sold, as well as, maintaining relationships with the channel of distribution. It is important that CPG companies select channels that best caters to the frequency at which a product is bought by consumers, as well as consumption expectations such as immediacy. For example, DTC is best utilised for products that have short sales cycles and predictable usage patterns, such as the feminine hygiene products. Products with a longer sales cycle, such as lipstick, are potentially better distributed through commercial retail channels.

In relation to the partnership with distribution channels, CPG companies should ensure they have a portfolio of products that nurture the connection with the channel. This is especially relevant in the foodservice sector where products are often treated as commodities, rather than the singular brand they serve.

Finally, many CPG companies are hindered by inadequate user experiences which drive frequency down, stemming from the fact that CPG companies do not traditionally have direct touchpoints with the consumer in grocery channels. This is especially relevant in the independent grocer channel where CPG companies may have to deal directly with the store's owner. An improved partnership between CPG companies and the channels they distribute to lead to an increase in product sales, as shown by a Gartner study where 96% of consumers are disloyal to high effort brands lacking coherent purchase arrangements.

In summary, the best consumer strategies are based on facts rather than assumptions.

Today's bold moves

- **Be purposeful in choosing your channel mix. Make sure that you know how, when and where your customers like to shop.**
- **Understand channel profitability and true cost to serve. Respect existing commitments with traditional retail channels by minimising direct replication of the offering on a DTC platform.**
- **Consider your ability to execute and scale in channel, including any new skills, capabilities, structures, and technology required, as well as the underlying organisational culture.**

KPMG is specialised in helping CPG companies. From defining and operationalising customer driven strategies, to driving improvements and growth across end-to-end operations, we work with our clients to ensure they're able to not only respond, but thrive, in today's dynamic market.

Connect with us

Georgie Aley
National Sector Lead
Consumer Goods
KPMG Australia
E: galey@kpmg.com.au

Lisa Bora
Partner in Charge – Corporates
Management Consulting
KPMG Australia
E: lbora@kpmg.com.au

Peter Marczenko
National Sector Lead
Mid Market Food & Beverage
KPMG Australia
E: pmarczenko@kpmg.com.au

Robert Poole
National Sector Leader
Consumer Goods and Food
KPMG Australia
E: robertpoole@kpmg.com.au

KPMG.com.au

The information contained in this document is of a general nature and is not intended to address the objectives, financial situation or needs of any particular individual or entity. It is provided for information purposes only and does not constitute, nor should it be regarded in any manner whatsoever, as advice and is not intended to influence a person in making a decision, including, if applicable, in relation to any financial product or an interest in a financial product. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

To the extent permissible by law, KPMG and its associated entities shall not be liable for any errors, omissions, defects or misrepresentations in the information or for any loss or damage suffered by persons who use or rely on such information (including for reasons of negligence, negligent misstatement or otherwise).

©2022 KPMG, an Australian partnership and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved. The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organisation.

Liability limited by a scheme approved under Professional Standards Legislation. August 2022 905890353CORPS.