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FROM THE SPEED OF SOUND TO THE SPEED OF LIGHT

ORGANIZING FOR SUCCESS IN CHINA'S E-COMMERCE MARKET

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INTRODUCTION

It is no secret that E-Commerce has been the main growth engine for consumer goods companies in recent years, but what is less clear, is how best to set up your organisations to react to this. China, as the leading digital innovator, provides some valuable lessons on the types of options available. Ultimately however, whilst organisation structure will help, it will not provide the whole answer, and companies will need to make sure they have the right talent, culture and ways of working in order to win.

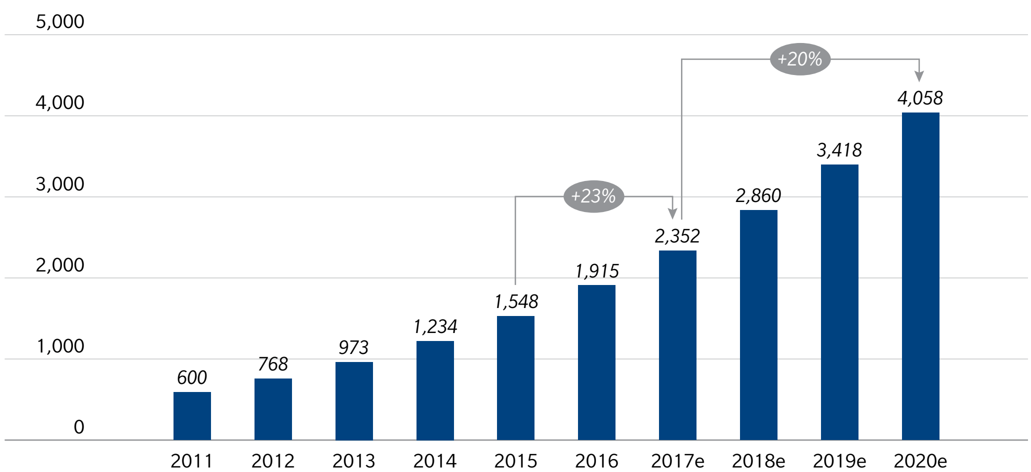
BY 2020, E-COMMERCE WILL BE WORTH US$ 4 TN – IT'S BIG, COMPLEX AND GROWING FAST, REQUIRING A SPECIFIC AND DIFFERENT ORGANISATIONAL RESPONSE

E-Commerce will continue to be an industry game changer, bringing with it its own series of challenges and hence, it requires a more tailored response from consumer goods organisations. Specific types of challenges include:

- **Size and speed of growth**: 23% CAGR in past 3 years with forecasted growth continuing at ~20% – the business landscape is changing at unprecedented speed, requiring companies to be agile and be able to make decisions quickly.
- **Consumer and customer expectations**: consumers can now buy virtually anything online and get it delivered in less than 24 hours, and the available options are endless. E-tailers need to respond to these needs, and will in turn expect a seamless end-to-end service from their suppliers.
- **Concentration of business**: in some markets, the digital landscape is dominated by a few key players, who are increasingly evolving to become more than just E-tailers. For consumer goods companies, your biggest customers may now also be some of your biggest advertising channels – an aligned "platform" strategy, supported by the right internal operating model, is therefore critical.

Exhibit 1: Growth of global retail E-Commerce sales

RETAIL ECOMMERCE SALES, 2011-2020e
IN USD BN



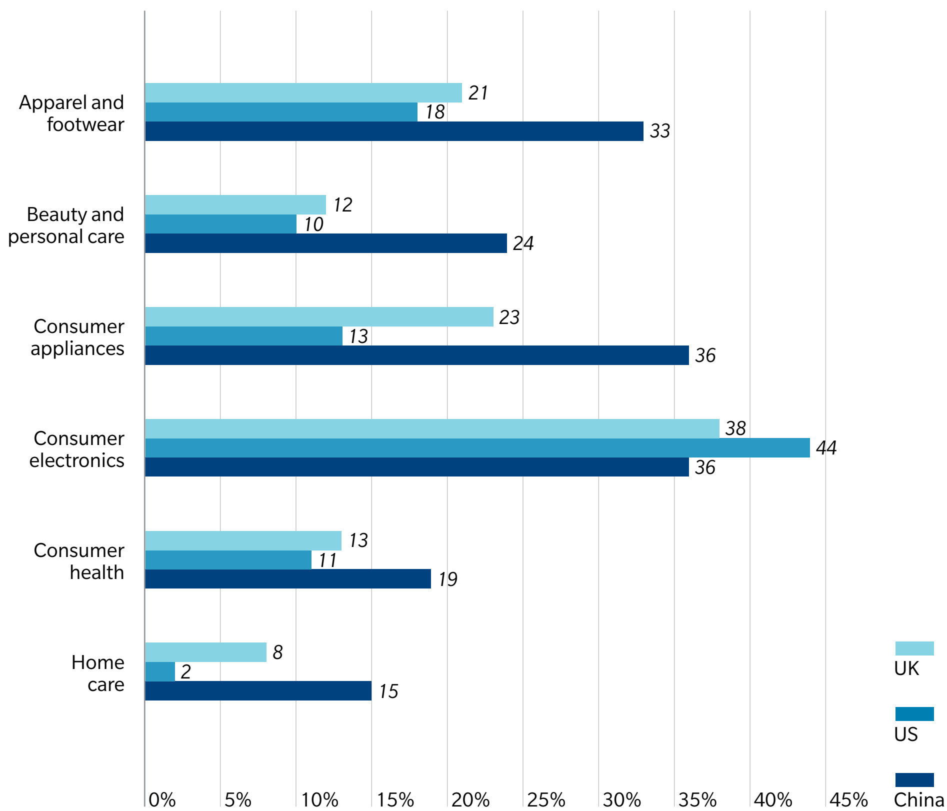
Source: eMarketer, Oliver Wyman analysis

CHINA IS THE LARGEST AND MOST COMPLEX DIGITAL ENVIRONMENT, AS WELL AS THE LEADING DIGITAL INNOVATOR, AND CAN OFFER LESSONS FOR THE REST OF THE WORLD

In the last 10 years, China has evolved from being a simple "copier" of digital trends to a leading innovator. It is now the largest E-Commerce market in the world, worth US$ 700 BN in 2016 (compared with US$ 390 BN in the US) with a consumer penetration rate of 22% (compared with 9% in US).

Exhibit 2: Comparison of online category penetration by country

E-COMMERCE AS % OF TOTAL B2C RETAIL SALES, 2018e

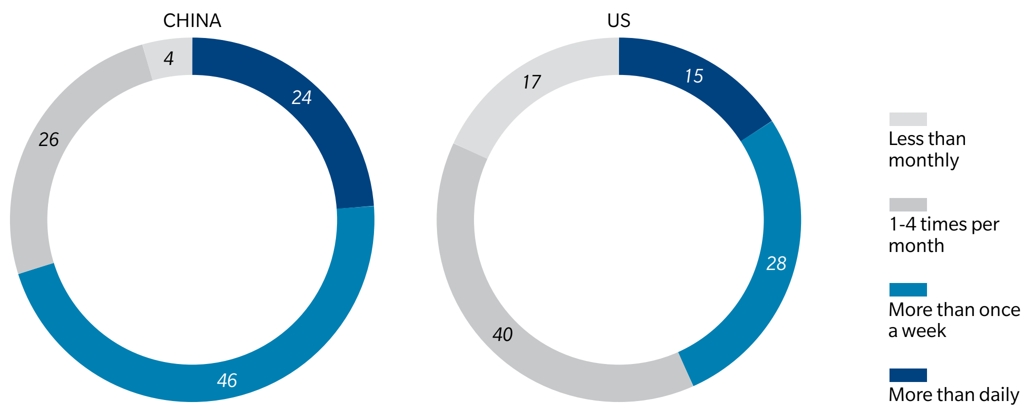


Source: Euromonitor, Oliver Wyman analysis

Chinese consumers are amongst the most digital savvy and sophisticated online shoppers in the world: 56% of total online sales are through mobile phones in China (compared with 18% in US), and 60-65% of Chinese online shoppers buy online more than once a week. E-Commerce players are making it as easy as possible for Chinese consumers to shop online – the average delivery time for JD.com, one of the local E-Commerce giants, is at least half the time of Amazon, and numerous apps now offer grocery delivery within the hour.

Exhibit 3: Comparison of mobile shopping frequency in China vs. US

ONLINE SHOPPING FREQUENCY VIA MOBILE, 2016
IN %



Source: IAB, Oliver Wyman analysis

Exhibit 4: Comparison of delivery statistics for top E-Commerce Players in China vs. US

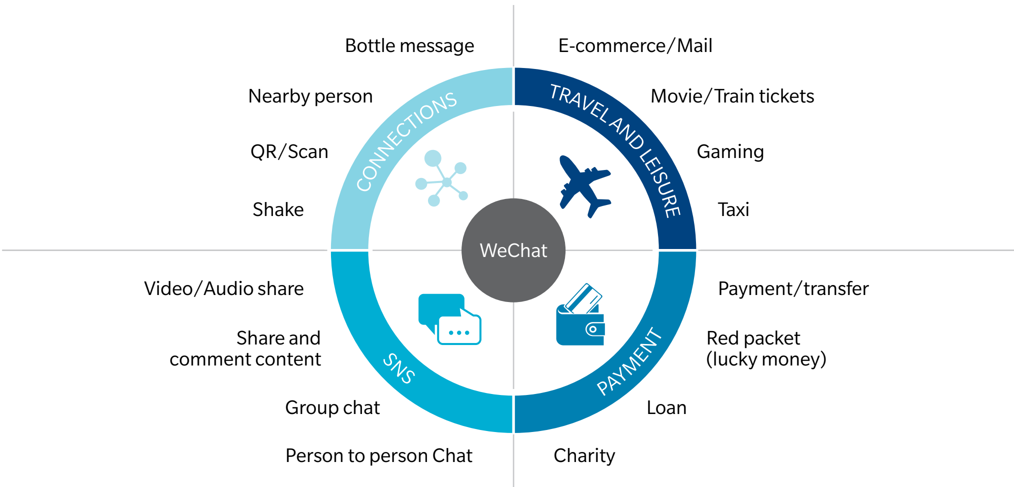
	JD.COM	AMAZON.COM
DELIVERY SPEED	12-24 hr committed to major cities (1-2 hr in some cities)	48 hr committed to Amazon Prime members
DELIVERY COST	¥0-5 ¥0 for order > RMB 79; ¥5 for others	$99 For 12 month Prime membership

Source: Morgan Stanley, Oliver Wyman research, Oliver Wyman analysis

In fact, talking about E-Commerce alone in China does not really make sense, given China's unique digital "ecosystem". For example, through one single app, WeChat, consumers can have access to SNS, payments, gaming, loans, charities, and transportation as well as E-Commerce.

Examining how consumer goods companies are responding in China, the largest and most complex digital environment in the world, can therefore teach us a lot about possible response options elsewhere.

Exhibit 5: Example of China's digital "ecosystem" through messaging app, WeChat



Source: Oliver Wyman analysis

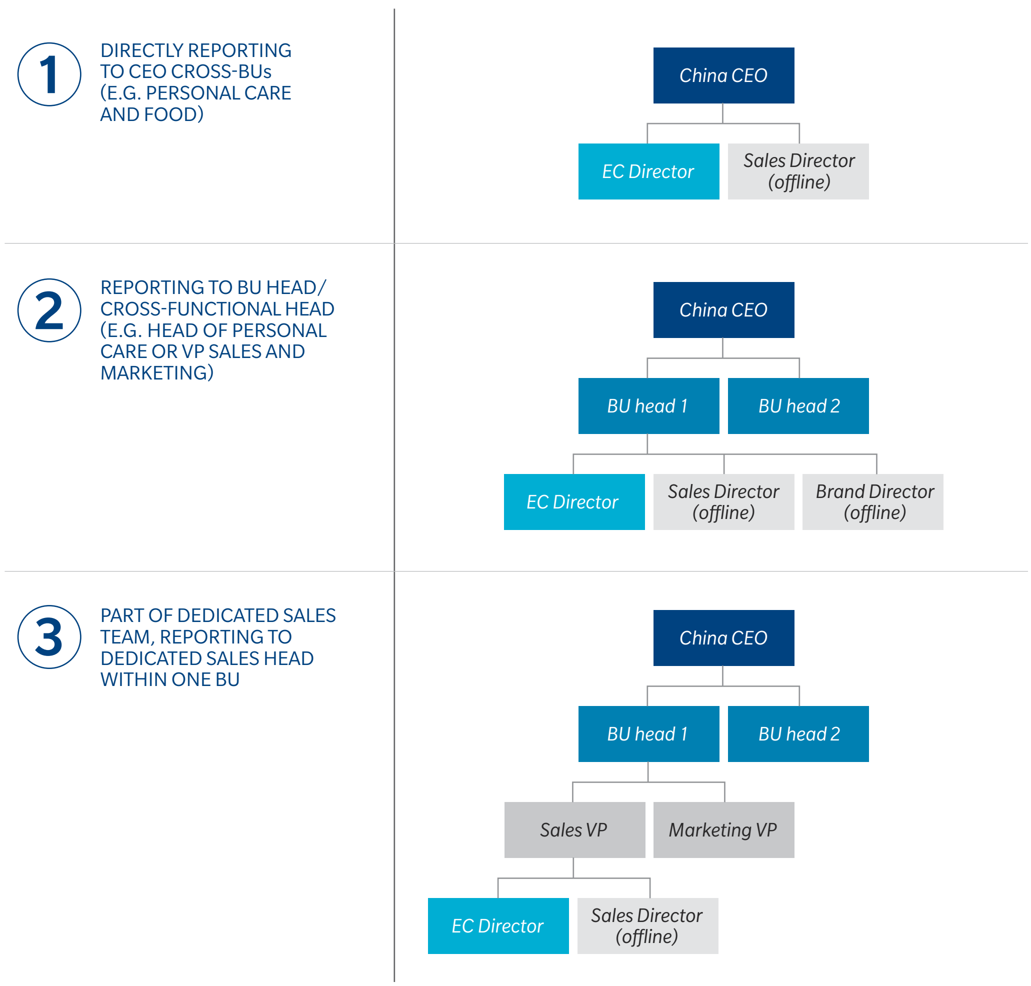
MULTIPLE E-COMMERCE ORGANISATION MODELS ARE VISIBLE IN THE CHINESE MARKET, EACH WITH ITS OWN PROS AND CONS; ULTIMATELY IT COMES DOWN TO A FEW KEY DESIGN CHOICES

There are three main design choices consumer goods companies in China consider when selecting an organisation structure:

1. **Reporting lines**: which level within the hierarchy the E-Commerce organisation should sit – in other words, who should the E-Commerce Head report to
2. **Dedicated functions**: the extent to which there are dedicated supporting functions for E-Commerce, such as Supply Chain, Digital Marketing etc., and the degree to which these functions sit within a separate E-Commerce team. Associated with this is the question of whether to install a "Chief Digital Officer" (CDO) or equivalent, and to what extent their role should include E-Commerce
3. **Outsourcing**: the extent to which particular functions, such as online store operations, are outsourced to a third party/trusted partner ("TP")

Examining some of the top consumer goods players in China, we can see broadly 3 models of E-Commerce reporting lines, from N-1 of Country CEO to N-3 (see exhibit 6). How reporting lines then relate to dedicated functions and extent of outsourcing is not an exact science. As a general principle, the more senior the E-Commerce reporting line, the more likely that supporting functions will be brought in-house (rather than outsourced) and dedicated to the function (see exhibit 7), but this is by no means a set rule. At this stage, outsourcing still remains a popular choice, particularly for functions such as Store Operations, and it's likely this won't change for some time. Within these top players, we also observe that the official role of CDO (or equivalent) is as yet still uncommon: non-existent for pure local players such as Chicmax, whilst being slowly introduced by the larger multi-national players such as Nike. The exact shape and remit of this role, and its relationship with the E-Commerce function clearly is still being defined.

Exhibit 6: Comparison of E-Commerce reporting lines in China consumer goods market



Source: Oliver Wyman analysis

Exhibit 7: Comparison of E-Commerce organisational design models in China consumer goods market

E-COMMERCE TEAM OVERVIEW OF DIFFERENT CONSUMER BRANDS

COMPANY		P&G	CHICMAX	UNILEVER	PEPSICO	RECKITT BENCKISER	NIKE
CATEGORY		Personal care	Beauty	All categories (Food, etc.)	Food	Health & hygiene	Apparel
SIZE OF E-COMMERCE BUSINESS (% TOTAL SALES)		25%-30%	30%	20%-25%	~20%	~10%	~10%
Dedicated function with reporting line within EC team	SALES	✓	✓	✓	✓	✓	✓
	DIGITAL MARKETING		✓	✓	✓	Dotted line	✓
	TRADE MARKETING		✓	✓	✓	Dotted line	
	SUPPLY CHAIN		✓		✓		
	STORE OPERATION	N.A.		N.A.	N.A.	✓	N.A.
	FINANCE/HR/IT						
	DATA ANALYSIS			✓	✓	✓	✓
REPORTING TO		Sales GM Model ③	VP Sales & Marketing Model ②	China CEO Model ①	Sales GM Model ③	China CEO Model ①	Sales GM Model ③
DEGREE OF OUTSOURCING TO TP							

Almost entirely outsourced

Partially outsourced

All in-house except for transport

Source: Desktop research, expert interviews, Oliver Wyman analysis

CHOOSING THE "RIGHT" ORGANISATION MODEL DEPENDS ON SEVERAL BUSINESS CONTEXTUAL FACTORS: BUSINESS COMPLEXITY, E-COMMERCE SIZE AND MATURITY, AND CULTURE

There are four broader factors a consumer goods company should consider when selecting an organisational model – ultimately it comes down to a number of trade-offs for your specific organisation:

- **Complexity of business** – the number of categories a consumer goods company plays in, and extent to which it operates across the same consumer segments will significantly influence the choice of organisational model. For instance, a cross-BU E-Commerce structure (i.e. model 1 in Exhibit 6) on the one hand may provide more negotiation power with e-tailers, but on the other hand requires deep understanding of potentially very different consumer segments.
- **Maturity of E-Commerce** – how mature a company is in E-Commerce will affect its model. Those consumer goods companies that "grew up" in the digital age will tend to have flatter organisation structures with all operations in-house since they have built those capabilities from the start. Whilst those who embraced E-Commerce later, are more likely to still rely on outsourcing and will position E-Commerce roles at a higher level in order to attract more senior talent to kick-start the E-Commerce business.

- **Size and ambition for E-Commerce business** – consumer goods companies where E-Commerce makes up a significant portion of total sales, and/or have strong ambitions to grow E-Commerce, may be more likely to move more towards an integrated organisation model rather than separating E-Commerce into its own dedicated business function. As E-Commerce becomes a significantly more important part of the business, the whole company will need to become more "digitally" minded and cannot afford to isolate its digital talent. Just as key customers such as Alibaba and JD.com become more omni-channel focused, so too consumer goods companies will need to think in the same way.
- **Company culture** – companies that promote a more collaborative culture and transversal ways of working will naturally come together and take a more multi-functional approach to the major E-platforms, without necessarily needing to be organised in this way and hence may prefer to retain the more "traditional" model (model 3 in Exhibit 6).

KEY TO SUCCESS LIES IN A RANGE OF ORGANISATIONAL LEVERS AND UNDERSTANDING P&L STRUCTURE

There is no "one size fits all" answer for organisation model – the examples in China show the range of options available, and each company will need to choose the best fit for them. But even having the best fit organisation structure in and of itself is not a guarantee of winning in E-Commerce. Ultimately, being able to meet the challenges of E-Commerce will require consumer goods companies to be able to align all elements of organisation behind a clear business strategy, including:

- **Talent** – attracting and retaining the right talent is critical, especially in today's talent market where digital experience is at a premium. Investment needs to be made in recruitment and supporting talent with the right training, career path and rewards and incentives.
- **Culture and mindset** – a company's culture will significantly impact its performance. Companies that succeed in the digital age will have a "can do" mindset that is more open to new ideas and innovation, as well as being more agile, flexible and able to adapt to change. In particular, successful companies will be able to react quickly to the latest developments in technology and data analytics; ownership of data and building of in-house analytics capabilities is also a must.
- **Ways of working** – a more collaborative, multi-functional approach will be needed in the future. Gone are the days of front-end negotiations led purely by Sales – as E-Commerce players evolve to become full service platforms and invest more in Joint Business Planning, so too Consumer Goods companies will need to break internal silos in order to better serve their customers, regardless of formal reporting lines.
- **Decision making processes** – this is the central nervous system of a company, critical to effective governance and operations. To address the ever changing face of E-Commerce, information flows and processes need to be as streamlined and efficient as possible to ensure that decisions are made quickly enough.

Regardless of organisation structure, companies need to also fully understand the bottom line impact of E-Commerce for their P&L, and plan accordingly. The structure of the P&L for E-Commerce can be significantly different from offline, particularly in lines related to promotions and advertising – how companies plan their promotions and the amount of media spend by platform can significantly impact overall profitability. To fully understand these nuances and gain more control, it may well be worth considering having a separate, dedicated E-Commerce P&L.

Exhibit 8: Comparison of indicative P&L structures for offline vs. online channels within consumer goods

P&L LINES	RELATIVE PROPORTION FOR OFFLINE	RELATIVE PROPORTION FOR E-COMMERCE
Gross Sales	100	100
Promotional spend	(45)	(40-50)
Net Sales	55	60
COGs	(20)	(20)
Gross Margin	35	40
Advertising and promotional bundles	(20)	(15-25)
Store staff and promoters	(2-5)	(0)
SG&A	(5)	(5)
Operating Profit	5-8	0-20

Costs can vary significantly depending on types of promo schemes chosen, and by platform

Source: Oliver Wyman analysis

CONCLUSION

E-Commerce is big, complex, fast and always evolving, and this is not going to change any time soon. Organising yourself to be able to best meet these challenges will be critical for success. There is no "one size fits all" approach, as we see from examples in China, but there are common factors to ensure you are set up to win, and the time to act is now.

Oliver Wyman is a global leader in management consulting that combines deep industry knowledge with specialized expertise in strategy, operations, risk management, and organization transformation.

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