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Article

Sustainable Corporate Incubation to Create Innovative D2C Value Propositions - A Case Study

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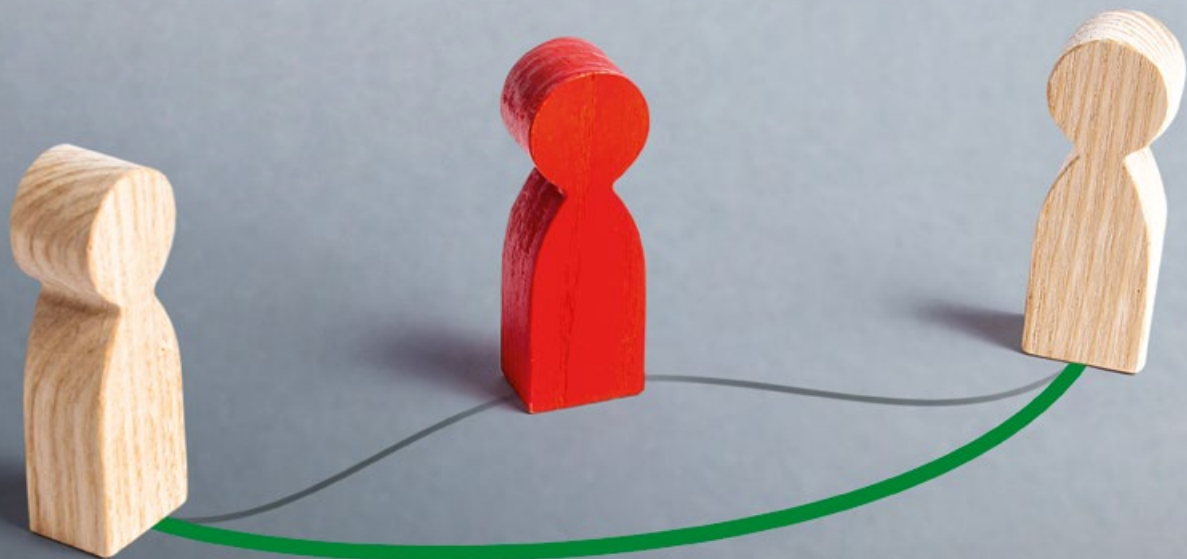
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Direct-to-Consumer-Strategien



Sustainable Corporate Incubation to Create Innovative D2C Value Propositions

A Case Study

Direct-to-consumer (D2C) marketing strategies commonly require large basket sizes to reach profitable growth. Thus, mass-market brands which offer low-price consumer packaged goods (CPG) face particular challenges when pursuing a D2C strategy. Creating a strong value proposition in the light of existing e-commerce platforms is far from trivial. Sustainable corporate incubation offers iterative routes to tackle D2C barriers for such brands. Based on a case study at Henkel, the largest CPG manufacturer in Germany, an explorative incubation approach to identify new ways of D2C business is proposed.

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According to the long tail theory (Anderson, 2008), online distribution channels allow organizations to move away from a reliance on a small number of mainstream products toward a wide number of niches in the tail because digital sales channels enable corporations to penetrate global niche segments in a cost-effective way (Steenkamp, 2020). High costs of acquiring limited shelf space and limited demand in local niche segments have adversely affected business in the past. Nowadays, global niches can be targeted through direct-to-consumer (D2C) channels, creating new opportunities for companies.

D2C business is now entering the mass market, as end consumers are expecting an option to buy directly from brands (Leimstoll & Wölflé, 2021). 43% of American consumers are aware of the principle of D2C and 69% of those have purchased directly from manufacturers (Diffusionpr, 2021) which are operating and controlling a web shop for the sale of their own products (Schacker & Stanoevska-Slabeva, 2021). New market conditions during the Corona pandemic have accelerated the D2C trend (Boumphrey, 2020). Thus, the number of newly created online stores in the US rose by 62% in the first quarter of 2020, while nearly half of all American consumers (45%) shopped in D2C shops they had never visited before (Shopify, 2020; eMarketer, 2020), leading to a D2C e-commerce sales increase of 45% from 2019 to 2020 (eMarketer, 2021).

Consumer packaged goods (CPG) companies have recognized this opportunity. Large CPG manufacturers are investing into this direct sales channel as part of their e-commerce strategy (Internet World, 2021; Business Insider, 2019; MarketingWeek, 2021; Reckitt, 2020). While CPG on-

line sales grew globally on average by 19%, in comparison to a 1% in-store sales growth, from 2013 to 2018, large CPG corporations are lagging in online performance (Smith et al., 2019). Their online market shares are generally 5 to 10 percentage points lower than their conventional retail market shares. This disparity is mainly driven by specific conditions and substantial challenges. First, due to the unlimited digital shelf space, a large number of heterogeneous competitors, such as new emerging brands or international players, are evolving and competing within the digital marketplace (Steenkamp, 2020). Second, CPG companies tend to miss the opportunity to build dynamic e-commerce capabilities (IRI, 2021) that enable them to compete against smaller and more dynamic competitors (Smith et al., 2019). Third, lack of top-of-mind awareness for their brands and of sufficient financial backing to drive traffic to their D2C websites affect their ability to scale digital business (Gielens & Steenkamp, 2019). In addition, products in brand shops are often sold at higher prices than at retail chains to compensate for higher costs (Wang et al., 2009). This may have a negative effect on the success of the D2C shop as consumers do not accept higher prices online than offline (Fastnacht et al., 2016). According to an e-commerce director at PepsiCo UK, the “most significant challenge building a D2C model from scratch is economics. [...] To offset these economics, it’s been crucial to develop the right proposition to meet a specific consumer need and it needs to be supported by the right order value to make it viable” (Easen, 2020). Bashkin et al. (2017) highlight that beyond a value proposition to attract and retain consumers, a D2C business needs a clearly defined strate-

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gic role and a scalable economic model. In this context, the assumption is that a D2C business can be positioned to either maximize sales or to explore new customer insights. Accordingly, CPG companies can deploy D2C sites for different purposes: as an insights and innovation engine, a platform to control user experience, an omnichannel marketing and sales engine, or a pure sales driver (Bashkin et al., 2017).

An adequate D2C strategy depends on the product type, such as low value versus high value, impulse versus replenishment, and commodity versus unique value proposition (Schögel & Lienhard, 2021). Especially in case of commodity products, identifying a strong value proposition is seen as crucial for a D2C business. However, companies in commodity markets struggle to create value propositions that provide competitive advantage (Rau et al., 2017).

Therefore, this case study aims to explore how sustainable D2C value propositions can be generated via methodologies that emerge in the field of sustainable corporate entrepreneurship (SCE). In this context, this research addresses the scientific need to make “entrepreneurial processes inside companies accessible” (Provasnek et al., 2017, p. 532), providing scholars and corporate leaders with insights on how SCE initiatives are conducted within large corporations in order to leverage these processes for successful D2C endeavors.

The Sustainability Niche as an Opportunity Space for D2C Models

25% of enterprises expect the issue of sustainability to create growth opportunities for their business in the next five years (McKinsey, 2021). Consumer ex-

pectations are increasing the pressure on companies to create sustainable offerings (Cho et al., 2018; Martins, 2019; Reints, 2019). While new product introductions by consumer goods manufacturers are accompanied by major marketing activities, a large percentage of new products or services fail in the first year (Gielens & Steenkamp, 2007). Recent market insights suggest that sustainable strategies might be beneficial for brand manufacturers (Sustainable Brands, 2018). Targeting sustainability-conscious consumers is an opportunity to differentiate in a niche market (Schacker & Stanoevska-Slabeva, 2021). Before the D2C wave, companies had limited possibilities to convey sustainability information regarding their products or services. This is particularly true for CPG manufacturers, as they are strongly dependent on retailers and have no control regarding the amount of sustainability information offered to consumers. Yet, companies that want to explore how to attract sustainability-conscious customer segments require a certain level of control. For example, nudging theory suggests that consumer decisions can be positively influenced by a balanced product

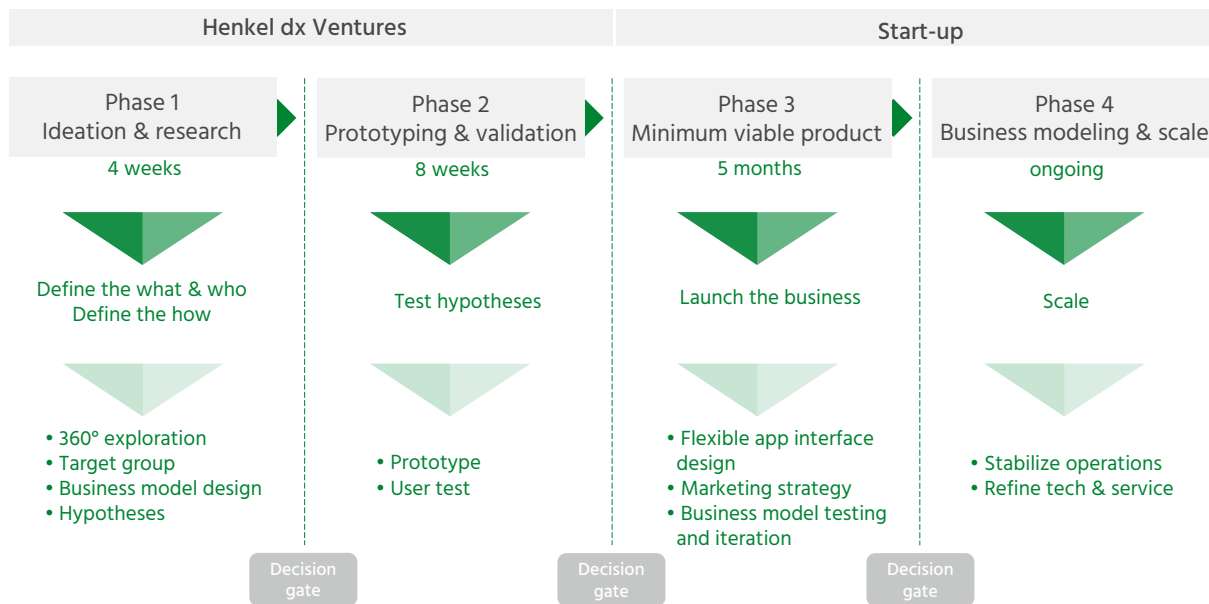
selection architecture and framing of information (Thaler, 2009; Thorun et al., 2017). Furthermore, trusted eco-labels positively resonate with consumers (e.g., Giannoccaro et al., 2019). While consumers rarely notice eco-labels in retail stores (Song et al., 2019), digital channels offer the opportunity to better highlight sustainability information (Jäger et al., 2020). Here, firms can leverage the fact that sustainability-oriented consumers value sustainability attributes above the price (Viciunaite & Alfnes, 2020), indicating their willingness to pay a price premium for sustainable attributes. Overall, these findings suggest that a D2C channel with a sustainable positioning will create added value for consumers.

The Limitations of Internal D2C Models for Large Corporations

Large corporations’ business model innovations are often constrained by a lack of flexibility. This limitation is mainly driven by inflexible predefined technology set-ups (corporate IT security requirements, IT architecture requirements) and time-consuming internal alignments. How can large

Management Summary

Consumer packaged goods corporations aim to enter the growing direct-to-consumer (D2C) market. Sustainable corporate incubation offers the opportunity to target sustainability-conscious consumers by launching an independent D2C shop. Sustainable corporate incubation requires agile processes and iterative learning from building and testing a prototype. A case study shows that the developed value proposition is suitable to attract customers, as evidenced by better conversion rates and larger basket sizes. However, this strategy removes decision-making power from corporations and may lead to higher costs in attracting consumers. Low-price CPG brands can benefit from this innovative D2C strategy in two respects: increase online penetration and generate consumer insights.

Fig. 1: Phased Innovation Approach of Henkel dx Ventures

Source: Own illustration.

corporations manage to overcome these challenges in a corporate D2C structure? While brand manufacturers are increasingly converting their branded websites into direct sales channels (European Commission, 2017), some companies enter the D2C market or reinforce their D2C business by acquiring new entrants (Gielens & Steenkamp, 2019). For instance, Henkel acquired a majority stake in three fast-growing premium D2C brands: HelloBody, Banana Beauty and Mermaid+Me (Henkel, 2020). There is no telling yet whether such acquisitions will be successful in the long run.

In this context, the question may be asked whether there are alternative routes somewhere in between the two extremes (of internal innovations on the one hand and acquisitions on the other hand) that allow large corporations to tap into new markets and new

consumer segments by exploring new value propositions without corporate constraints. For this purpose, the Henkel strategy was explored in the following case study.

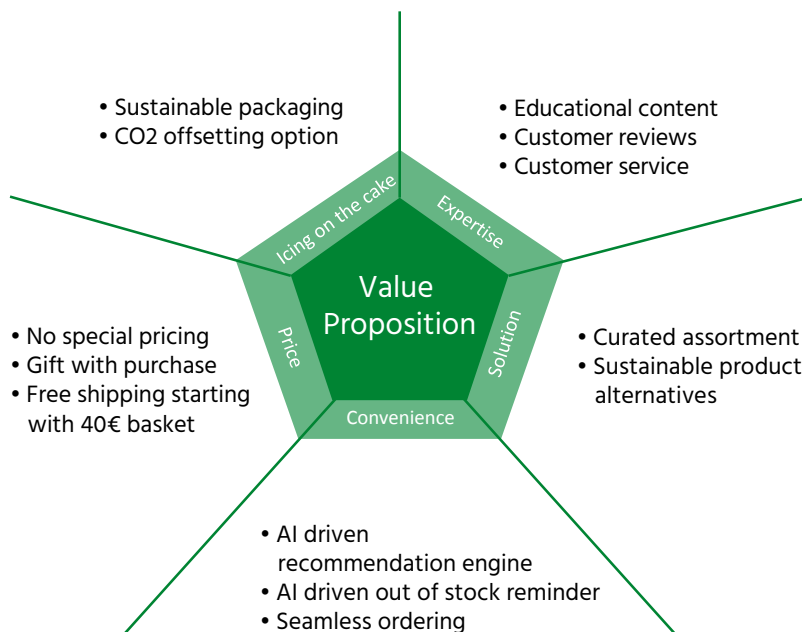
Henkel Case Study

Henkel operates global brands within the three business areas of adhesives technologies, beauty care, and laundry/home care. The company was founded in 1876 and occupies leading positions in the consumer and industrial business as a DAX-30 company. To counter market volatility, the corporation established a unit called Henkel dx Ventures, a department focusing on innovation and incubation opportunities. Through this unit, a new e-commerce business was incubated that focuses on the D2C sale of low involvement consumer packaged goods. This article

describes how the unit incubated a start-up that will allow the corporation to attain several D2C objectives, namely creating consumer insights and increasing online penetration. Concretely, a four-phased innovation process was applied that will be described in the following.

Generating new business requires a high degree of creativity (Lund et al., 2017). A structured venture building approach minimizes the risk of failure. Therefore, the venture unit decided to apply a sustainable business model pilot canvas logic (Baldassarre et al., 2020), which considers, beyond traditional business model elements (Osterwalder & Pigneur, 2011), the definition and measurement of the sustainability impact. Baldassarre et al. (2020) recommend to build prototypes and run small-scale pilots to overcome the design–implementation gap of sustaina-

Fig. 2: E-commerce Value Proposition



Source: Own illustration.

ble business models. The innovation process was structured along the following four phases: (1) ideation & research, (2) prototyping & validation, (3), minimum viable product, (4) business modeling & scaling (based on the model by Osterwalder & Pigneur, 2010; cf. figure 1).

Phase 1: Ideation & Research

In this phase, the main goal of the unit was to develop new business model designs by using design thinking methods. To secure high creativity through cross-functional integration (Im & Workman, 2004), the interdisciplinary ideation team comprised a venture architect, a scrum master, user researchers, brand managers and engineering, e-commerce and sustainability experts.

360° exploration

To identify opportunity spaces in the 'sweet spot' of digital channels and sustainability, the team conducted research sprints comprising a D2C trend analysis, venture capital activity analysis, competitive activity analysis, start-up landscape screening and an internal review of existing assets. After consolidating the generated insights, the specific opportunity areas (e.g., scenarios or triggers) were mapped out as impulses for new ideas. Based on these insights, the team defined potential target groups and conducted initial consumer interviews to complement the 360-degree exploration. Building on this market research, design thinking ideation sprints were performed in order to generate concrete business model designs. Through this

approach, the team established some initial business model concepts (including value propositions).

Business model design

Ten to twenty business model concepts were established during the ideation phase, which were subsequently rated by the team members according to criteria such as feasibility, viability, desirability, and sustainable impact. The value proposition of the selected concept is outlined in figure 2. The main idea is to offer consumers a relevant product mix via a cross-category e-commerce shop under a new branding (i.e., not related to the corporate brand). To enable operational freedom, the company was created as a new entity and by a dedicated founder team. To integrate potential founders even in the preliminary phases, product owners with e-commerce experience were recruited through a corporate innovation third party network, by collaborating with professional venture builders (for examples see Cledara, 2021). To deliver a unique value proposition to a specific customer cohort (high income, sustainability-conscious, with e-commerce affinity), the venture offers a curated product mix comprised of basic products mainly in low involvement categories. The strong concentration on a manageable product range (up to 800 stock keeping units only) should, on the one hand, make it easier for customers to find essential products on the website (convenience), and, on the other hand, help the venture to establish economies of scale more quickly by allowing for advantageous purchasing conditions. Further, a smart recommendation engine and out-of-stock reminding function based on artificial intelligence (AI) should increase the convenience factor for consumers. The AI will be fed with

consumer data coming from a survey poll at the beginning of the user journey. In this survey, new customers are asked to state where they live, how large their household is and which categories they are primarily interested in. In each category, sustainable alternatives are offered next to the top category products. Beyond an AI-empowered search engine, sustainable products are highlighted so that consumers will be able to easily identify them. Apart from the sustainable product offer, the sustainability value proposition is further underlined by using only sustainable packaging technologies. The CO2 footprint resulting from the supply chain and the use of the purchased products can easily be compensated by the consumer (activated with just one click).

Hypotheses

Hypotheses were formulated in order to test them in the course of prototyping (phase 2) and the minimum valua-

ble product launch (phase 3). The following assumptions were made for prototyping testing:

(H1): The communicated value proposition attracts adequate attention from customers.

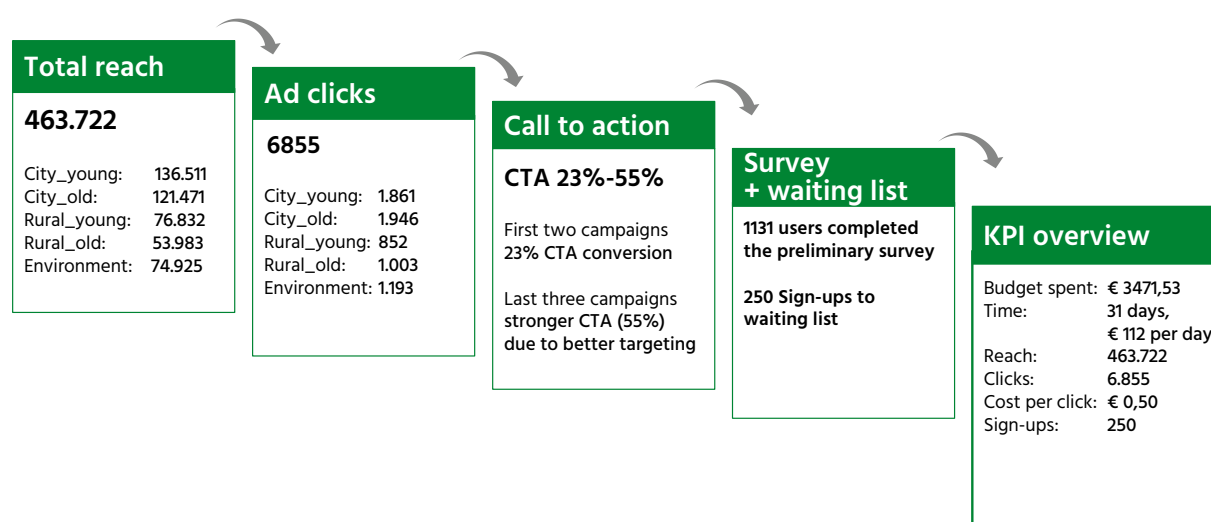
(H2): The value proposition is so compelling that customers proactively put themselves on a waiting list.

(H3): The value proposition is sufficiently captivating for customers to fill in the upstream survey as part of the customer journey.

Main Propositions

1. It is hard for CPG companies to establish successful value propositions in conventional D2C formats.
2. A structured and phased approach to innovation can help corporations explore successful value propositions and validate the desirability, feasibility and viability of the venture.
3. Experimentation in a start-up infrastructure enables value proposition iterations through agile business operations, which may increase the D2C performance, notably sustainable growth and returning customer rate.
4. In order to enable this output, however, corporations will have to sacrifice control and possibly incur higher costs for activating target customer groups.

Fig. 3: Prototype Marketing Key Performance Indicators



Source: Own illustration.

Further hypotheses were formulated to be tested in the third phase:

(H4): The target group accepts higher prices (compared to those of other e-commerce retailers or offline retailers) due to the offered value proposition.

(H5): The target group creates a larger shopping basket than generic D2C consumers.

(H6): The value proposition creates lock-in effects so that, in comparison to other D2C shops, more consumers will re-purchase.

Phase 2: Prototyping and Validation Prototype

For testing the relevance of the value proposition, a social media campaign was initiated (five different formats depending on the target group) which was linked to a non-functional app (click dummy). To validate various aspects such as the future marketing costs, the target groups, the core message and the initial features, key performance indicators (KPIs) such as click-through rate and conversion rate (sign-ups to waiting list) were evaluated and served as a basis for decisions regarding the next phase (figure 3).

First, an above-average proportion of 0.81% of the target group (n = 6855 consumers) interacted with the social media advertisement (clicked on the banner) compared to an average Instagram click-through rate of 0.22% (Chaffey, 2021). Thus, H1 could be validated. Second, n = 250 consumers signed up for an e-mail waiting list (6.7% conversion rate), which is a positive signal considering the average e-commerce conversion rate of 2.22% in Germany (Ogonowski, 2021), lending support to H2. Third, n = 1131 consumers of the interacting target group completed the questionnaire on the landing

page, which can also be read as a positive indication. Thus, H3 was also validated and it was therefore decided to test the business model in the subsequent MVP phase.

User test

To qualitatively substantiate the findings from n = 1131 surveyed consumers within the prototyping and validation phase, a further group of 10

representative consumers was recruited for direct interactions in the form of deep-dive user tests. During a workshop, essential features of the app to be programmed were discussed and documented. Thereby, in-depth insights were generated about the minimum requirements which the service would have to offer in a pilot phase.

Phase 3: Minimum Viable Product

At this point, the corporate venture unit decided to delegate the task of testing the business model to a company founded specifically for the pilot. Experienced entrepreneurs were entrusted with the idea, who then founded a company to perform the pilot.

Flexible app interface design

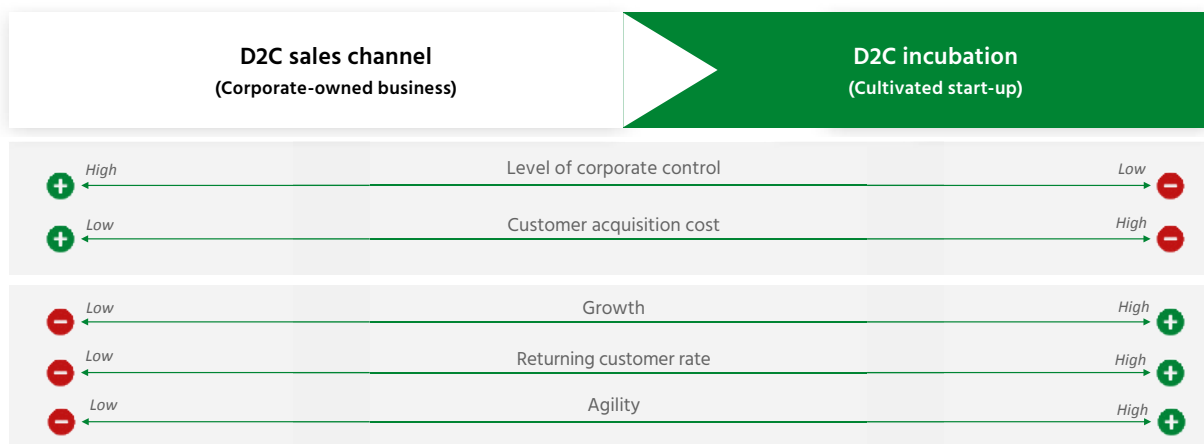
Based on the findings from the preliminary phases, a flexible app interface design was established. To select the best technical structure, particular attention was paid to criteria such as maximum flexibility and scalability. Flexibility was an important criterion, as new findings were expected during the operational phase. A flexible tech stack enables fast implementation to assure best delivery of the value proposition (convenience) and, in consequence, a positive customer experience. A venture studio created the flexible app interface based on a modular e-commerce platform (Shopify), but with data management and business logic (back-end) and external appearance (front-end) technically separated from each other (headless commerce logic).

Marketing strategy

Based on the previous findings, the marketing strategy was primarily planned within the social media regime. The idea behind this: small

Lessons Learned

1. Exploring and validating value propositions across four innovation stages increases confidence in D2C success by testing the feasibility, desirability and viability of designed business models.
2. Early customer interactions play a particularly important role and therefore customer insights should be gathered directly after launching (e.g., survey, operational KPIs).
3. The independency from predefined technological conditions increases the flexibility and thus the agility of D2C ventures, allowing the value proposition to be adapted during the validation process.
4. Corporations need to examine in their own context to what extent it makes sense for them to relinquish control in order to indirectly achieve their D2C goals, namely, to increase online penetration and harvest customer insights.

Fig. 4: Classical D2C Sales Channel vs. D2C Incubation

Source: Own illustration.

budget, but efficient execution. The main purpose of the marketing initiatives during the pilot phase was to gradually reduce the customer acquisition costs to a scalable level (between € 45 and € 85) by testing different advertising campaigns.

Business model testing and iteration

After the app interface and fulfilment operations were set up, the newly created start-up launched the D2C business and started to sell products directly to consumers. To test the hypotheses H4 to H6, relevant KPIs were tracked week by week. Subsequently, the tracked KPIs (during the first two months after the launch) were benchmarked against classical D2C models of the corporation. Despite higher product prices than in competing online shops, the company generated a total of 263 orders with an average customer acquisition cost (CAC) of 125 €, versus 262 average orders at an average CAC of 35 € in a classical D2C business (benchmarked against a D2C business of a known brand of the cor-

poration). Thus, the D2C shop reached comparable order levels, which indicates that the target group has a higher willingness to pay (in line with H4), but at higher acquisition costs. The average order value was 35 €, in contrast to 24 € of the classical corporate D2C business, which confirms H5 (larger basket size). The average returning customer rate was 14.7% and the Net Promoter Score (NPS) reached a positive value of 30 (based on completed surveys, n = 90), measures which were not tracked in the benchmarked classical D2C. The pilot was also successful from a business-to-business perspective: the founders were contacted by brand manufacturers for initiating strategic partnerships.

During operation, various elements and processes of the app were changed in an agile way (fast iterative improvements) based on changing KPIs (e.g., conversion) and direct feedback from consumers (reviews and ratings). For example, the category composition was adapted and the product search was optimized. The rapid

adaptability to real market conditions was highlighted by the D2C project leaders as a winning asset, as classic D2C ventures do not always offer this agility due to technological limitations resulting from predefined corporate technological set-ups.

Learnings and Next Steps

The results reveal that the outlined incubation process is suitable for conceptualizing, exploring, and optimizing a successful D2C value proposition. The incubation approach led to higher output in terms of orders and average order value compared to classical corporate D2C models. The applied modus operandi of entrusting a start-up with the testing of the business model unleashed maximum freedom to operate, though at the cost of losing control regarding business strategy and operations. Maximum operational freedom was ensured as no predefined corporate technology set-ups had to be used. Based on a flexible design of the app interface, it was possible to react im-

mediately to new findings derived from operational insights or direct consumer feedback. As highlighted in this case study, a value proposition should not be seen as a rigid structure, but should be adapted during operations. Thus, operative flexibility is crucial to the growth of a D2C venture. The hypotheses could not be confirmed immediately but were validated after iterative adjustments.

The results reveal that the outlined incubation process is suitable for conceptualizing, exploring, and optimizing a successful D2C value proposition.

In the upcoming scaling phase (phase 4), the venture unit will decide on how to proceed with the venture. Depending on the further results of the pilot, the venture team intends to continue scaling the solution via the start-up. In this case, the corporation will form a strategic partnership with the start-up, acting as a minority shareholder without controlling influence. The strategic partnership will secure a new digital sales channel for the corporation and will offer the opportunity to create deep customer insights.

Potential downsides of independent D2C incubation are increased brand costs, as the start-up has to establish itself as a brand in its own right. Here, the advantage of the corporation's brands cannot be exploited, which leads to increased customer acquisition costs. Furthermore, this approach lim-

its the corporation's control, since, in contrast to classical D2C models, no control can be exercised over the future strategic and operational business activity.

To choose a suitable D2C model, corporations need to prioritize and accept trade-offs between control, customer acquisition cost, growth, agility, and retaining customer rate (figure 4). Despite the downside of losing control and incurring higher customer acquisition costs, the D2C incubation approach shows great potential for gaining valuable consumer insights and increasing online market penetration, thus achieving two D2C objectives (Bashkin et al., 2017). For instance, the pilot itself already provided deep insights into consumer behavior which could not have been collected through pure survey activities. This is because a pilot delivers much higher data validity than surveys which mainly measure attitudes or behavior intention. Especially in the area of sustainable consumer behavior, attitudes often do not correspond with actual behavior (so-called attitude-behavior gap) (Schacker & Stanoevska-Slabeva, 2021).

The case study shows that in addition to exploring the classical D2C routes of transforming brand websites or integrating existing D2C businesses, flexibility and agile innovation processes can be crucial for the successful implementation of a D2C business, i.e. sustainable corporate incubation. Companies should engage along these lines to explore innovative ways of operating digital commerce, as the establishment of a new channel does not only offer opportunities for online penetration and generating customer insights, but positively influences corporate value, especially for firms in highly competitive markets (Homburg et al., 2014).

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