

Consumer Packaged Goods and Retail Practices

Digital disruption: The rise of eB2B in fragmented retail

Fragmented routes to market are being digitalized around the world. Profitability has been elusive for the disruptors, but a thorough blueprint, the right value proposition, and an ecosystem model can help.

This article is a collaborative effort by Evangelos Athanassiou, Erik Brailovsky, Mark Elkins, Matthieu Francois, and Matteo Zanin, representing views from McKinsey's Consumer Packaged Goods and Retail Practices.



In fragmented retail (independent small grocers, restaurants, and bars), technology and e-commerce have fundamentally reshaped B2C business models and customer engagement—for example, through online ordering and delivery. However, digitally enabled business models have yet to have a similar impact on the B2B part of the value chain, which stretches from the consumer-goods manufacturer to the distributor and wholesaler and finally to the retailer (Exhibit 1). This segment has remained largely unchanged for decades.

Recent developments suggest the landscape may be ready to shift. With a market of more than \$2.8 trillion worldwide (Exhibit 2), fragmented retail

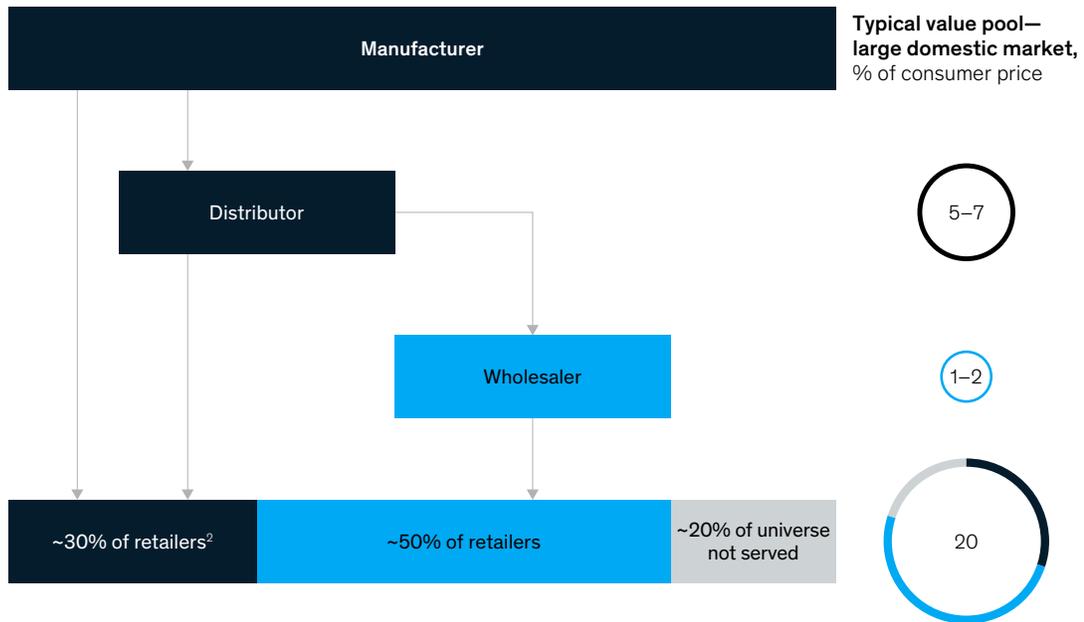
is poised to be transformed by “eB2B” players: portals and applications that replace the in-person sales model for small retailers and restaurants.

For an eB2B offering to make significant inroads, companies must provide compelling solutions with financially viable models that address the specific needs of fragmented-trade retailers. Winners will approach this challenge by thoughtfully solving pain points and ensuring they can extract margin from the efficiencies generated along the full value chain. Key contributors to profitability are, for example, cheaper last-mile delivery economics, an improved supplier–retailer relationship, enhanced store performance through technology, and better data

Exhibit 1

Fragmented-trade distribution models have seen little evolution in the past 50 years.

India leading CPG¹ example



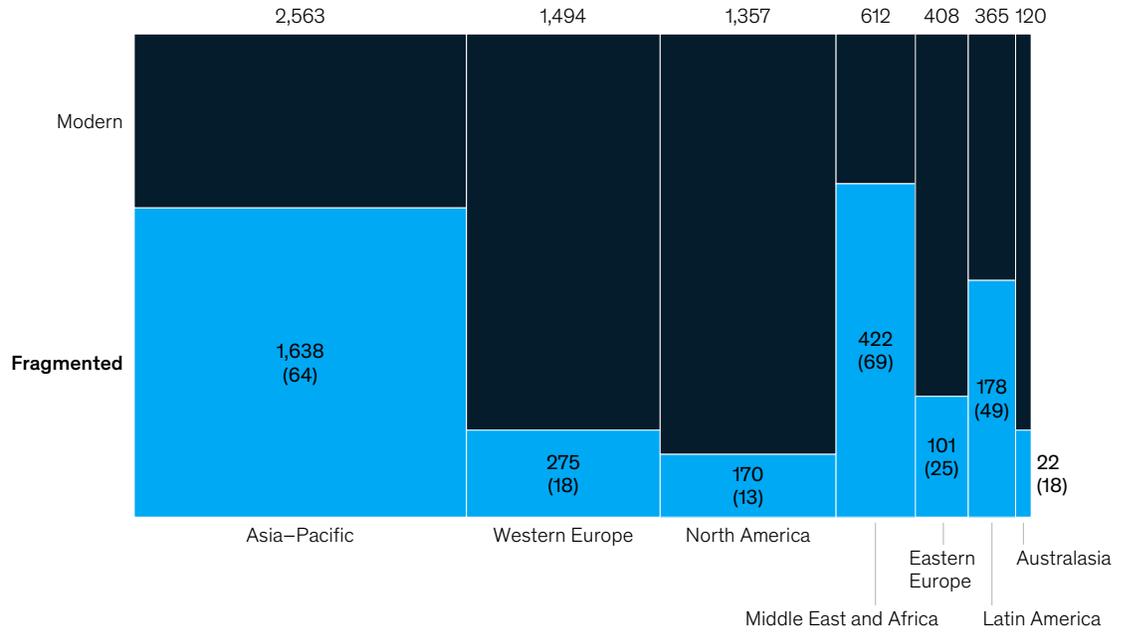
¹Consumer packaged goods.

²Illustrative example representative of a strong food or personal-care brand. Actual breakdowns will vary depending on brand strength and category.

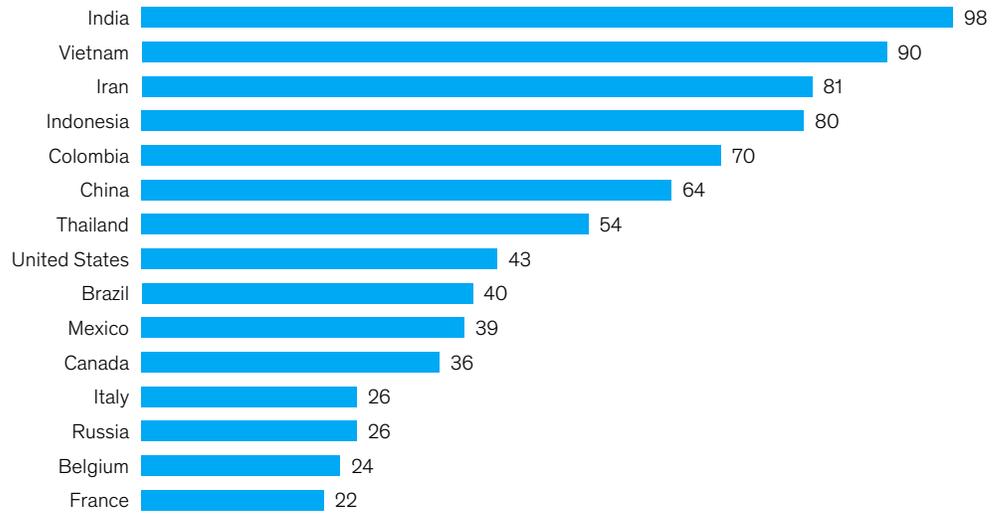
Exhibit 2

Fragmented trade still represents a \$2.8 trillion market.

Estimated market size for grocery items, 2020, \$ billions (%)



Share of fragmented trade in grocery market in the top 25 markets,¹ 2020, % of revenue pool



¹Fifteen most fragmented markets from the top 25 markets by revenue are shown. Source: Euromonitor—retail values (without tax), 2020, current prices

collection for suppliers. By understanding the market structure and properly setting the scale and speed of change, companies can design an eB2B solution capable of disruption.

Help wanted

Fragmented-retail outlets face ever-increasing challenges, making them more open to alternative sourcing options that offer a better value proposition. The rise of modern trade has resulted in greater competition, especially with convenience stores and minimarts offering a better retail environment, fresher stock, and wider variety of services. At the same time, the costs of running a store are growing even as revenues are stagnating. And well-funded B2C e-commerce players are raising consumer expectations for independent retailers by offering large assortments of goods, competitive prices, and convenient deliveries.

Restaurants are facing the biggest challenge to their business model, with delivery aggregators gaining an ever-larger share of the margin pool. They are still struggling to get made-for-channel packs, a reliable delivery schedule, and advice from consumer-packaged-goods (CPG) companies on services and strategies that could help their businesses grow.

Our research shows a high number of fragmented outlets are either underserved (for example, with limited direct coverage from sales reps or low access to promotions) or overserved (with the largest outlets receiving 80 visits from CPGs per week). Furthermore, the COVID-19 pandemic forced distributors and CPGs to reduce in-person interaction, making store owners more open to digital adoption. For example, at the peak of the pandemic, more than 75 percent of Chinese independent stores in Tier 3 cities or below used digital applications to place orders.

Attackers and incumbents alike are fueling the disruption

Around the world, four primary types of companies—both traditional players and new entrants—are

seeking to disrupt the market with eB2B offerings (Exhibit 3):

1. **Digital start-ups.** These companies are trying to capture the distribution margin pool, monetize data, and build their own product offerings in commoditized categories. These start-ups are sometimes an extension of B2C e-commerce companies and often act as marketplaces. Examples include Meicai and Alibaba LST in China, Udaan in India, Bukalapak in Indonesia, and Chipper and Quoco in Latin America.
2. **Cash and carry (C&C) operators.** Operators are investing in eB2B to expand their customer base, enrich their value proposition to customers (for example, with delivery options), and increase their revenues through a marketplace model. They keep high-velocity products in their stores or warehouses but tend to use a dropship model for slower-rotation, “long tail” items. Companies such as METRO (in Europe) and Costco are examples of those operators opening marketplaces.
3. **Distributors and wholesalers.** These businesses are looking to expand their reach and gain efficiency through their sourcing prowess.
4. **Consumer-goods companies.** These companies—especially those with well-developed distribution and a competitive cost structure for direct store delivery (DSD)—are seeking to go digital and create an eB2B offering beyond their own products. This strategy can reduce the costs of sending sales reps to the store and of delivery. Consumer-goods companies also see eB2B as an avenue in which they can achieve vertical distribution (by selling more products in the stores they already cover, thus becoming more relevant for the retailer) and install point-of-sale (POS) systems to gain access to data and execute targeted promotions. Examples include companies such as AB InBev, Unilever, Carlsberg, and Coca-Cola, all of which have tried to pioneer the eB2B space through proprietary platforms.

Exhibit 3

Players start with their strengths, but success will require them to cover gaps.

	Digital start-ups	C&C ¹ operators	Distributors and wholesalers	Consumer-goods companies
Trade relationships		✓	✓	✓
Cost-efficient coverage model			✓	✓
Portfolio breadth		✓	✓	
Competitive pricing		✓	✓	✓
High frequency of interaction with customers		✓		
Capital	✓			
Agility with digital capabilities, advanced analytics, monetization, product development	✓			
Ability to offer services with partners	✓	✓	✓	✓

¹Cash and carry.

Increasingly, these offerings seem to be converging in what they offer and how the monetization plays out.

To date, most eB2B players are relatively young and investing heavily in growth, and few have turned a profit. However, most are valued favorably and have attracted both corporate and venture capital. Investors believe eB2B's economies of scale will drive down distribution costs, and the additional service offerings to stores will boost revenues—and profits—for the winners in each market.

What will unlock and accelerate eB2B?

As investments fuel eB2B's competitive intensity, few players around the world—both traditional players that have ventured into the eB2B space and digital natives—are showing rapid growth while defining a path to profitability. Through these examples, we have identified a “recipe” for successful eB2B ventures.

Digital eB2B attackers: A greater focus on retailer pain points, possible business-model pivots, and unit economics

To gain a foothold with retailers, digital-native eB2B operators must offer solutions that solve customer pain points and are clearly differentiated from traditional models. In our experience, this is not always the case: several disruptors have attempted to scale up before developing and communicating value-add to the users.

In the developing world, the digital maturity of retailers varies considerably. The range of devices and software they use often results in a suboptimal app experience. Therefore, a simple, rapid, and efficient user interface is a key requirement for gaining retailer adherence. An incomplete assortment and inconsistent pricing can also lead store owners to rapidly jettison an eB2B offering. Platforms should typically start by offering fewer, more essential products to gain share of wallet

in the stores and then slowly expand into categories as they have a competitive assortment.

Attackers must balance the need to offer better service levels than the existing routes to market (such as next-day delivery and multiple weekly deliveries) with the need to maintain profitable drop sizes. We believe no eB2B platform can succeed in its early days without offering a better delivery experience to the stores. Platforms must also ensure they give retailers access to supplier-provided offers and promotions.

With these operational elements in place, eB2B disruptors can then enhance their value proposition with additional services: sale of digital goods, the rebrand and refurbishment of stores, promotions, or even a link to a B2C ecosystem (such as a loyalty scheme). Those services can both achieve user stickiness and generate additional revenues, but they cannot make up for failure in one of the basic service categories.

Those elements will ensure that disruptors have a right to play and get the attention of retailers—and, therefore, suppliers. Companies then need to ensure they can generate a profit. Entrants to eB2B have often mistakenly assumed CPG companies would pass on the complete distribution margins—settling, instead, for the wholesaler margin. They also anticipated substantial income from the sales of services and data but, to date, income has usually been less than 0.5 percent of sales. In addition, new entrants typically have higher costs for customer acquisition (with the need to build a sales force from scratch) and delivery, and they need to maintain intense promotions to attract retailers.

In other words, digital players may need to make several adjustments to find a viable, profitable path. They should evaluate several options:

Consider partnering with (or acquiring) local distributors. Digital players can pursue such arrangements to achieve a lower cost to serve by harnessing existing distribution networks and assets. In addition, eB2B players can capture a lower cost of goods sold (COGS) by building on existing relationships with CPGs and getting access to their full portfolios at potentially better

prices in return for access to data and online ad spaces. This strategy can represent a significant pivot—for example, by leading attackers to stop owning inventories.

Treat CPGs as partners rather than suppliers.

Through such partnerships, new entrants can tailor their value proposition to the needs of the CPGs, such as reaching underserved outlets or acting as a complement to the physical visit. This approach ensures eB2B companies generate value across the chain—and not only for the outlet.

Roll out additional products beyond consumer goods. These offerings can include financial products and services or the sale of digital goods (such as phones).

Cash and carry players, existing distributors, and wholesalers: Make better use of competitive advantages while maintaining a distinctive value proposition

Compared with digital attackers, C&C operators, distributors, and wholesalers start the journey to eB2B with significant competitive advantages: these companies have existing assortments of goods and relationships with suppliers, as well as an existing infrastructure. What holds them back most often is a lack of agility, a fear of cannibalization, and the difficulty of accessing digital talent.

In this context, the recipe for existing retail players includes a mix of four key actions:

- Develop a distinctive, customer-backed value proposition (similar to the threshold for digital attackers) and translate it into an ordering portal that meets the basic requirements of users.
- Rapidly harness competitive advantages to increase the assortment of online goods and their physical assets to allow for convenient delivery. This step is similar to developing e-grocery, but it has the advantage of larger drops.
- Scale up fulfillment operations in an economically sustainable way so that they can unlock profitability. Retailers tend to start their eB2B journeys by picking from their stores because it

minimizes capital expenditures, but they can truly maximize their economic benefits once they manage to implement scaled deliveries from dark stores or warehouses.

- Open the marketplace to other sellers, often using a dropship model (in which sellers deliver the goods directly to retailers), after players have achieved a high-performing model with their core assortment.

Consumer-goods companies: Greater clarity along a typical three-pronged approach—digitalize, collaborate, and (possibly) build

In most fragmented-trade markets, large CPG companies have built an efficient service model. It provides them with reasonable influence over the larger stores and an ability to serve the wider market through a network of wholesalers.

While many CPG companies have conducted pilots, only a few have attempted to truly use eB2B to rethink their route to market. The choice is most difficult for successful CPG companies with a large distribution footprint because they can sometimes be hesitant to reinvent an existing, effective model.

For these companies, the solution often lies in finding the right combination between three actions. First,

CPG companies can extract significant value by digitally enabling the existing route to market. Examples include creating a self-ordering customer portal to reduce costs and offering an improved customer experience by serving them directly. These strategies can increase margins or boost sales by improving productivity and harnessing analytics—all while not disrupting the existing route to market. For instance, Carl's Shop from Carlsberg digitalized sales interactions with on-premises outlets.

Second, especially in markets with large established eB2B players, CPG companies could find ways to work efficiently with eB2B platforms to improve coverage, quality execution, and data access. This implies a negotiation with eB2B platforms around trade terms, provides incentives for good behaviors, and ensures data sharing. For example, Alibaba and JD in China and Bukalapak in Indonesia demand the same attention as leading supermarket chains and can hardly be ignored.

Last, companies that have a sufficient competitive advantage (a large distribution footprint, a large share of wallet in the stores, and coverage of key wholesalers) should consider developing their own eB2B platform. For example, AB InBev, Coca-Cola, Philip Morris, and Unilever have all developed digital solutions that use their existing routes to market to distribute consumer goods.

Done right, eB2B platforms have the potential to materially improve both the experience and the economics of most of the players in the value chain.

The path forward

Done right, eB2B platforms have the potential to materially improve both the experience and the economics of most of the players in the value chain: CPG suppliers can access better vertical and horizontal coverage—and, to some extent, reduce their cost to serve. Intermediaries in the value

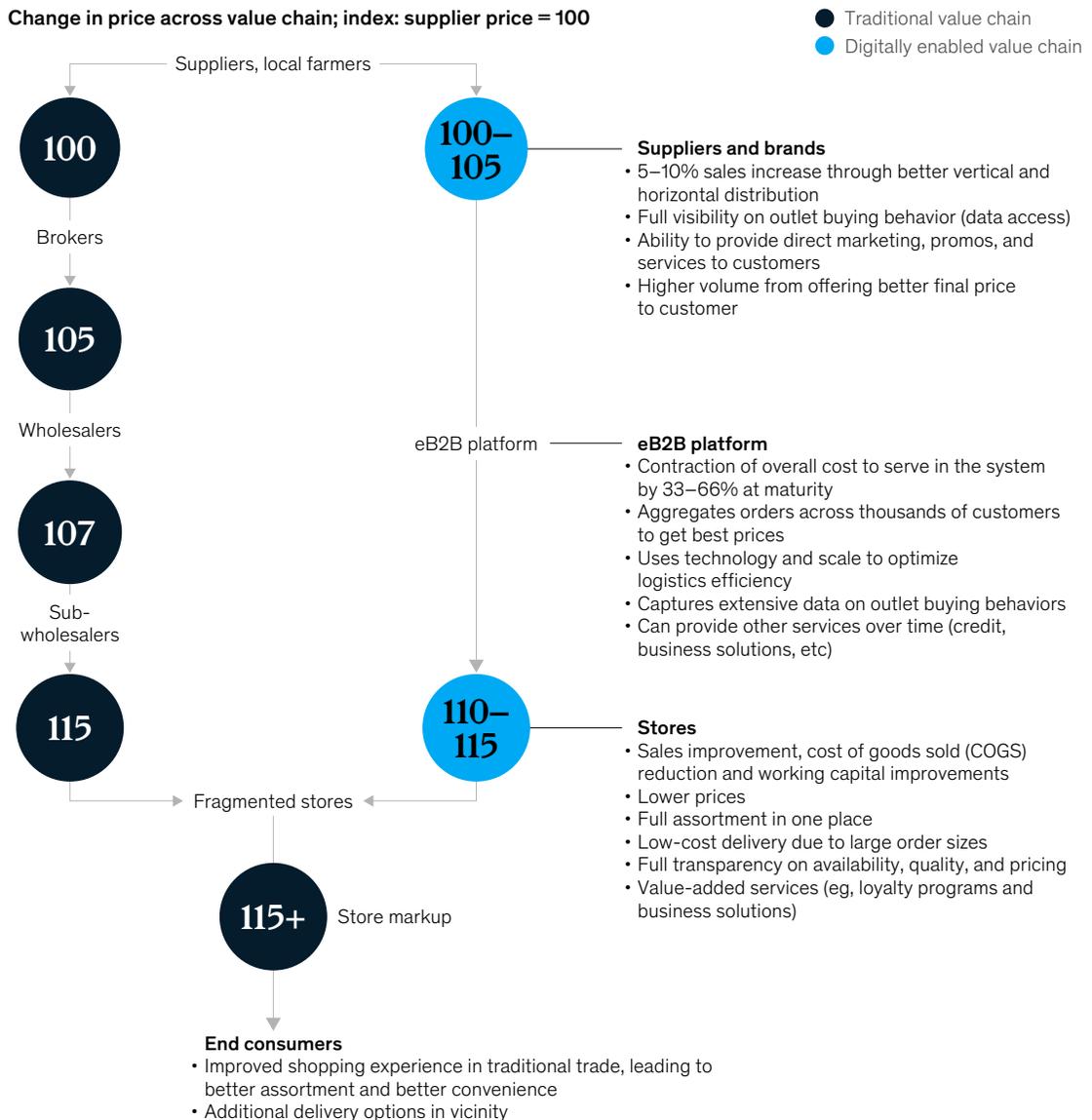
chain gain increased efficiency. And stores see an increase in sales, with less out-of-stocks and better assortments. Even before accounting for additional services that those platforms offer, there is sizable economic value to be captured along the value chain (Exhibit 4).

Exhibit 4

Incorporating eB2B platforms can reduce market inefficiencies and increase transparency in the value chain.

Illustration with fresh products in one select emerging market

Change in price across value chain; index: supplier price = 100



While starting points and imperatives differ across stakeholders, a few success factors apply for any company looking to develop an eB2B platform:

Act fast. As China's experience has demonstrated, the market can't accommodate many players. China has more than six million traditional trade outlets, but only just a few players have managed to achieve significant scale. The quicker companies enter and begin learning, the higher the chances of success. "Wait and see" is a risky strategy because companies might miss their window of opportunity.

Independence is a must. Even for incumbents, the eB2B business should be treated as much as possible as an independent company. This structure eliminates any constraints from the legacy business to ensure agility, speed of delivery, and sufficient management focus.

Stickiness is critical. Many players are entering this space with a similar value proposition to the existing one, which typically is not enough to convince customers to shift their orders to the platform. Thinking carefully about what the customer needs and making sure to provide elements that create stickiness to the platform are fundamental ingredients for success.

The opportunity is out there. If developed quickly and correctly, eB2B platforms can help fundamentally reinvent traditional trade, reduce costs across the value chain, increase product availabilities, and harness the benefits of data analytics for the fragmented stores. The disruption is already well funded; it is only a matter of time before the industry finds a path to a sustainable growth—and companies that act now can participate in this digital revolution.

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