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The battle for the digital consumer

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- **Strong brands are increasingly going digital**
- **Enormous competitive advantage for market leaders**
- **FANG and BAT far surpass the competition**
- **Moving with the times and responding to consumer needs are crucial**

The time when digitization was an activity for technology companies alone has gone. For a while now, technological innovation has no longer solely been the domain of big internet companies and hip startups in Silicon Valley. More and more 'normal' companies, in a wide range of business sectors, are embracing technological developments.

The reasons for this are obvious and of an economic nature: new technologies can reduce costs and help maintain margins, and digitization is *the* way to contact clients directly.

Strong brands are increasingly going digital

Zara and Victoria's Secret are two examples of retailers that understand how it works. While the physical store and online shop are still two separate concepts at many companies, at these retailers they're becoming more and more intertwined. Sports brands like Nike and Under Armour understand this too. By introducing health apps like MyFitnessPal and Endomondo, they are responding to the needs of modern consumers and even forming communities.

Victoria's Secret is performing much better than for example Abercrombie & Fitch or Esprit, and Nike and Under Armour are winning territory from Adidas. Scale is important if you want to be a front runner in brand digitization. Increased sales and profit mean larger free cash flows, which can be invested in technological developments. Global players therefore have an advantage over regional or local ones.

Starbucks – in essence, nothing other than a place to drink coffee – is a textbook example of a non-tech company that embraces technological innovation and uses it to generate customer loyalty. This ranges from their recently launched Mobile Order and Pay service, where you can walk into your local store and pick up your freshly made coffee without having to wait in line, to Twitter try-outs inviting you to 'Tweet a Coffee' to your friends.

In the US mobile payments now account for 20% of all in-store orders. The advantages are clear: the shorter waiting times and easier payment enhance the user experience. These may seem like small steps, but they are actually a sign of 'big thinking' when it comes to digitization. Starbucks is moving with the times – in other words, responding to changes in the consumers' world. It is the best way to stay relevant in a changing world. Stop moving with the times and you're at risk of becoming irrelevant for modern consumers.

'Stop moving with the times and you're at risk of becoming irrelevant'

Magic

At Starbucks they are very aware of the importance of technology. Founder Howard Schultz is arguably more fascinated by technology than by coffee. The same applies to Robert Iger, CEO at Disney – another company that is leading the way in technological innovation.

Its MagicBand gives Disney World visitors priority to a number of top attractions, but also functions as their hotel room key and registers any purchases they make during their stay – which they only need to pay for when checking out. Shorter waiting times and easier payment – with higher sales as a result.

Here, too, customer experience is seamlessly linked to commercial interests. It's no coincidence that a top man like Iger is also on the board of a large technology company like Apple. His passion for technology plays a part in this, but this role also places him close to the action and on the front line of technological innovation.

Fintech is the buzzword of the moment

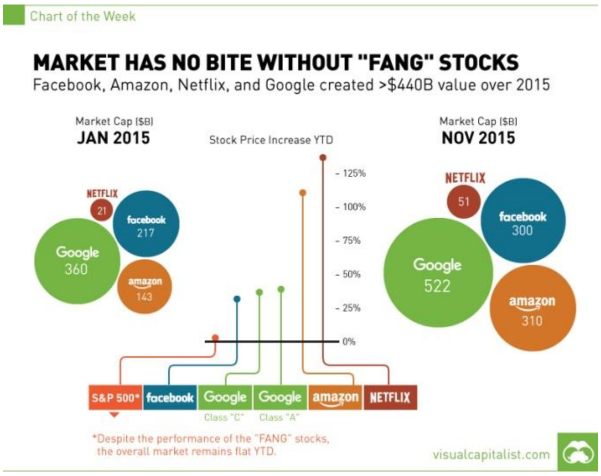
The transition from cash to electronic payment has really taken off in 2015. And it's the smaller players in the digital transactions market that, despite being mere cogs in the wheel, are overcoming the barriers. What is interesting is that the big players – Visa, MasterCard and American Express – have contributed little to this, but are reaping the benefits, because ultimately no one can circumvent these platforms. It is simply further strengthening their position.

PayPal is perhaps the biggest online payment brand for consumers. Yet the same holds true: their transactions take place via one of the three credit card powerhouses. Apple Pay? Although you pay with your phone, this process also involves providing credit card details during registration. The big credit card companies are profiting from the innovation of small players and forming all kinds of partnerships with them. With no disruptor in sight. The much-hyped (in some circles) bitcoin for example is only able to process a fraction of the transactions per second that Visa can.

FANG

Winner take all. This applies not only to strong brands and digital payment transactions, but certainly also in terms of the battle for digital consumers. Facebook, Amazon, Netflix and Google – abbreviated to the acronym FANG – are the victors in this battle – a battle in which more and more challengers like Twitter and Yelp seem to be losing ground. It is a select group of winners and this is not set to change in 2016. The four still have a strong hanwhen it comes to further future growth potential and increased domination.

Facebook for instance owns Instagram and Whatsapp, which in themselves are monster platforms and still offer a great many opportunities. And Google still has plenty up its sleeve, with YouTube, self-driving cars and robotics. In the mobile ad market, eight out of every ten dollars are spent with either Google or Facebook, making them an essential platform for every advertiser.



Of course there are successful niche players as well, in very clearly defined markets where the brand and expertise they have built up prevent them from simply being trampled on. Expedia and Priceline depend to a certain extent on Google's search engine; even so they have managed to claim the market for travel bookings for themselves.

Although Airbnb entered this segment as a disruptor, alongside competition within the market it has also created a wider offering at both the top end (luxury accommodation) and the bottom end (budget accommodation).

There is also room for niche players within segments like second-hand cars and the housing market. Often only the number one player in the relevant niche market is able to justify its existence and the rest may question that existence in the long term. Outside these few niche markets however FANG covers all the key areas of the market.

China has its own FANG too

The number of digital consumers is increasing by leaps and bounds in emerging markets too, and at an even faster pace than in the West. Entire phases are being skipped. E-commerce penetration in China has now exceeded 12% – an even higher level than in many developed countries. And digital ads are taking off there. A very small number of parties dominate the Chinese market, with China's answer to FANG comprising three companies: Baidu, Alibaba and Tencent (BAT).

The fact that the shift to online retail sales is happening at such a lightning pace relates in part to the poor state of bricks and mortar shops and infrastructure in China. Alibaba and JD.com have a firm hold on this market. And while Tencent may be a local player, it owns some the largest social networks in the world (including WeChat, the Chinese version of Whatsapp) and is big in online gaming.

The company also has Uber-style taxi and online food order services. It is a textbook example of an O2O strategy (online to offline), based on which it serves tens of millions of people. The advantage of Tencent compared to Baidu and Alibaba is that its strategy is based on cross-selling partnerships rather than its own investments, making its operations less capital-intensive.

Compared to FANG, the BAT trio has managed to acquire an even more dominant position in its domestic market, China. Yet this is also a matter of concern for the future. The growth potential of Baidu, Alibaba and Tencent within China is considerable, but the question is how far the expansion can continue beyond the country's borders. At least in the internal market they don't need to worry about their US counterparts. Amazon has been trying in vain to gain a foothold in China for years, but without help from the government this is proving impossible. All of these market leaders are well positioned and should be able to further extend their competitive advantage in 2016.

The operational outlook is good and as long as they can retain their lead in terms of technological innovation, they will be able to increase their dominance. Things can always go wrong.

There'll always be new challengers entering the market that take pole position – a threat that will perhaps eventually become a reality for Facebook, Amazon, Netflix and Google too. But there are no signs of this yet. What's more, all of the innovative small players rely on the infrastructure of these four giants.

'There's no sign of new challengers entering the market and taking pole position'

Conclusion

In a world where consumption growth will be moderate at best, it is more important than ever to invest in the market leaders. And it is crucially important to be selective and invest in companies with a structural competitive advantage that understand and respond to consumers' needs. Those companies with the best sense of what consumers are looking for and how their needs change will often outwit the competition. The use of technology can play a crucial role in this.

The current economic conditions – limited economic growth, low interest rates and low oil prices – are favorable for consumer-related companies with above-average growth. The average expected earnings growth for the next three to five years for businesses in Robeco Global Consumer Trends Equities is 15-17%, which far exceeds the expected earnings growth for the market as a whole (8-10%). We expect the above trends to continue in 2016 and that our investments in companies that are well-positioned to benefit from this will once again bear fruit.

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