A handmade tale

The growth of microbrands threatens consumer-goods giants

Often the giants' best and only response is to acquire them

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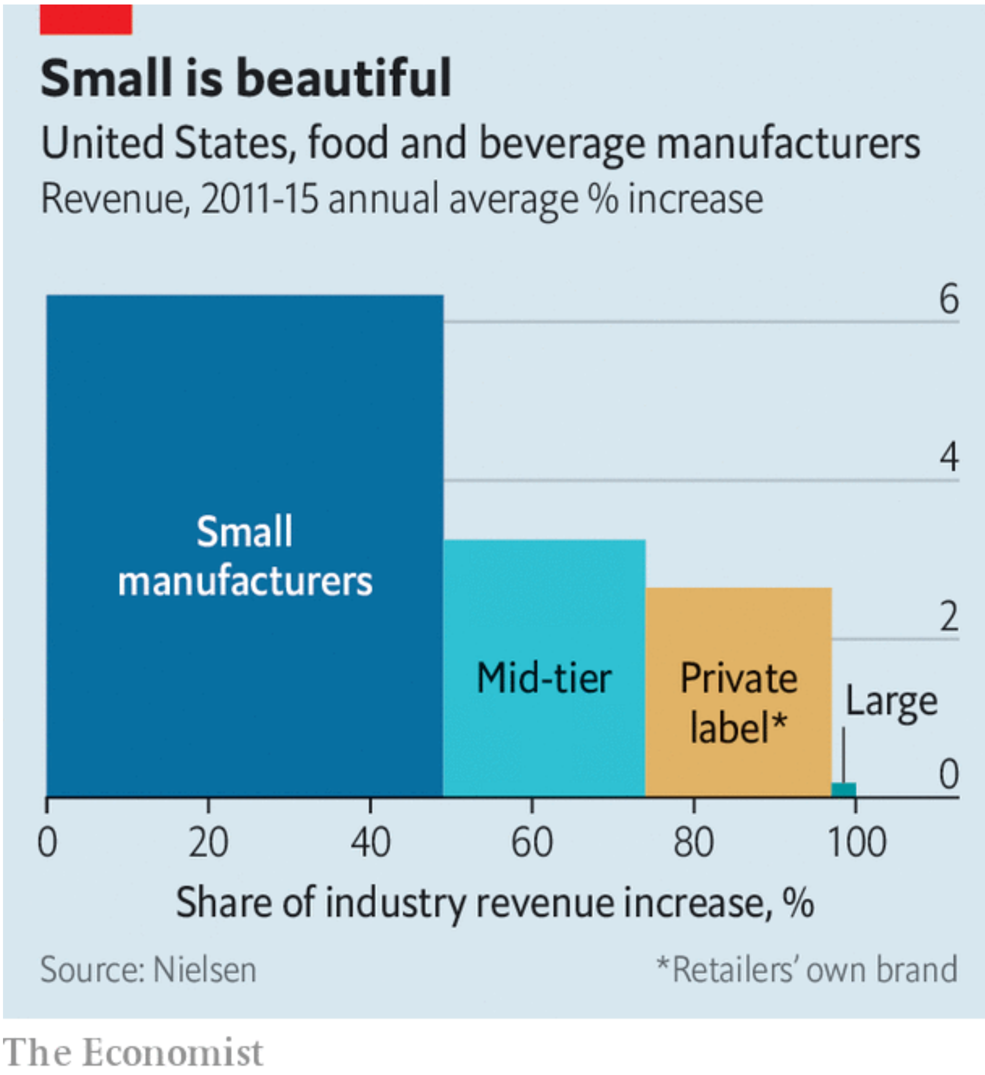
COMPANIES SUCH as Casper, which sells mattresses, Warby Parker, a spectacles brand, and Glossier, a cosmetics firm, were once seen as interesting curiosities. Touting their products online, luring customers with digital advertising and eschewing conventional retailers and marketers, they were anomalies shaking up small segments of retail. In fact, the growth of microbrands—or direct-to-consumer (DTC) brands—represents a profound shift in the consumer-goods sector.

Industry giants took time to begin worrying about the arrival of game-changing newcomers; barriers to entry in their business are high. But by now the incumbents are stagnating. According to Nielsen, a consultancy, the biggest 25 food-and-beverage companies, for example, generated 45% of sales in the category in America but drove only 3% of the total growth in the industry between 2011 and 2015 (see chart). A long tail of 20,000 companies below the top 100 produced half of all growth.

Imagine, 25 years ago, coming up with the idea for a radically better toothpaste, suggests Randall Rothenberg, the boss of the Interactive Advertising Bureau (IAB), a trade organisation for digital advertisers, who studies microbrands. Raw materials would only be available by the tonne. No factory would produce toothpaste for a tiny new player. Ads would be hopelessly expensive so driving demand would be impossible. No large retailer would stock it.



That is no longer true, thanks to shifts in supply chains and data. The growth of "just-in-time" manufacturing means startups no longer need to splurge on inventory. The surge in food startups meant factories had confidence to let him start with a small order, on the condition that future ones would be bigger, says Blake Sorensen, founder of Blake's Seed Based, which makes allergy-friendly snacks.

Other service providers can pass on economies of scale once available only to consumer-goods giants. Lumi, a packaging firm, uses a network of factories to design and produce packaging for small brands. It represents thousands of brands so can get better prices.

Businesses such as ShipBob, a Chicago startup, do something similar with shipping, allowing small brands to offer faster, cheaper deliveries. E-commerce companies such as Shopify provide turnkey online shops from as little as $29 a month. Shopify handles the back-end infrastructure that would have cost hundreds of thousands of dollars to build, says Steven Mazur, one of the founders of Ash & Erie, a brand of clothing for short men. Assembled Brands provides funding specifically to microbrands. It will invest in any kind of manufactured consumer-goods product as long as the company has started trading.

Microbrands can also sell their products through Amazon. The costs are high but it gives them access to the online giant's shipping services and huge user base. Many of the big firms have, by contrast, been reluctant to sell on the giant's website, so feature low in search rankings. More of them have started selling on Amazon in recent years, says R.J. Hottovy of Morningstar, a research firm, but it still represents a small slice of their sales.

Selling directly to consumers means that microbrands boast a wealth of data. Mr Sorensen launched his business online in January 2018. He sold $50,000 of snacks and then, on the basis of data gleaned, Blake's Seed Based changed its recipe and relaunched in September. M Gemi, an online seller of posh shoes, offers new designs weekly so can respond precisely to consumer demands. Their giant rivals, by contrast, use data filtered by retailers.

Online advertising, using platforms such as Facebook, allows brands to target customers with great accuracy. The vast majority of growth in advertising is coming from the digital kind, and a large proportion of this is from small advertisers, says Jonathan Barnard of Zenith, a media agency. Meanwhile many big companies, especially the consumer-goods firms, are keeping their spending flat or reducing it in view of pressure on margins.

Consumer-goods behemoths are well aware of the threat posed by microbrand ankle-biters. One response is to buy them. Unilever bought Dollar Shave Club, a subscription service for razor blades and now-canonical microbrand, for $1bn in 2016, grabbing the market share the upstart had itself snatched from Gillette. The biggest ten consumer-goods firms have all recently invested in direct-to-consumer startups. Nestlé's acquisition in 2017 of Blue Bottle, a hip Californian coffee brand, bought it exposure to new market segments.

Competition is fierce to buy the best microbrands so big firms may overpay for their acquisition, says Mr Hottovy. Explaining its purchase last year of Native, a small deodorant brand, Marc Pritchard, the chief brand officer of Procter & Gamble, explicitly referred to its DTC model, saying it is "where things are going". Other big firms are trying to grow their own brands. Earlier this year Kraft Heinz launched Springboard, an incubator for small, disruptive food and drink brands.

In the long term some small brands will be swallowed up but others will be encouraged, argues Sonali De Rycker of Accel, a venture-capital firm. More will want to remain independent for longer, or entirely, which will mean larger deals or IPOs.

To flourish, incumbents will not only have to acquire these new brands or start their own; they will have to learn from them. And instead of having a discrete set of multi-billion-dollar brands, sold through third-party retailers, they will have to come up with larger portfolios of smaller, more transitory ones, argues Mr Rothenberg. Scale still matters, but it will have to be used more shrewdly.

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