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Direct to Consumer Brands

In May 2019, Edgewell, the owner of Schick and Wilkinson razor brands, announced its intention to buy Harry's (founded in 2012) for $1.37 billion. Three years ago, Dollar Shave Club (DSC), another startup selling razor subscriptions, was bought by Unilever for $1 billion. Harry's and DSC were not the only successful direct-to-consumer or DTC startups. Many others such as Allbirds, Away, BarkBox, Bonobos, Casper, Glossier, Honest Company, and Warby Parker highlighted consumer appetite for new DTC brands. By the end of 2019, there were hundreds of DTC startups in every possible consumer category, many valued over $1 billion (see **Exhibits 1** and **2**).

The rise of DTC brands threatened large incumbents like P&G, Unilever, Nike and L'Oréal. These incumbents took years to develop deep insights about consumer behavior, create innovative products and build brands, but now they were faced with a new form of competition. Some saw no other option but to buy these startups, others experimented with their own versions of DTC brands.

Was this a new era of consumer brands or a fad? "Could 2020 be a graveyard for DTC Brands," as a *Forbes* article suggested[1], or were we witnessing a dramatic shift in the consumer goods industry? And how could incumbents prepare themselves for the future?

The Rise of DTC Brands

The trend of selling directly to consumers without brick and mortar stores started with e-commerce players like Amazon (1995) and Zappos (1999). These online companies threatened traditional retailers like Walmart but did not pose significant threat to manufacturers who viewed them as another distribution channel. However, the next decade brought in a new wave of DTC companies that started disrupting legacy brands by building their own brands and selling them directly to consumers.

The industry was grappling with the rise of DTC brands and experts were divided on their future. Incumbents, consultants, venture capitalists and young entrepreneurs were keenly studying them to decode the secret for their success. What was their playbook and were these brands here to stay?

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Bonobos

Founded in 2007 by Andy Dunn and Brian Spaly, Bonobos was one of the early DTC companies that started online by selling men's pants[2]. Two key observations formed the basis for the company – men do not like shopping, and most men have difficulty finding well-fitting pants. The company started by focusing on a single product – a corduroy pant. To alleviate concern of buying online, it offered an easy, no-hassle return policy. Following Zappos, the company put a high priority on customer service, calling its service reps "ninjas." Instead of spending money on marketing, the founders relied on creating a great product and positive word-of-mouth through satisfied customers.

Within six months, Bonobos was doing a million dollars a year in annual run rate. In the first three years the company received over $7 million in funding from angel investors. During this time, it remained focused on a narrow product line and online channel. In 2010, after raising $18.5 million from Accel Partners and Lightspeed Venture Partners,[3] Bonobos expanded into suits, dress shirts and outerwear. Soon it started receiving increasing number of customer requests to "try before buying."

To satisfy these customers, Bonobos could encourage customers to order multiple items to try, but this was expensive for Bonobos and not the ideal experience for customers. Another option was to build physical stores, which were not only expensive but went against Dunn's strong view about physical stores. In a 2009 interview he stated, "We keep men out of retail stores when we know that men fundamentally don't enjoy shopping."[4] In the end, Bonobos opened a few retail showrooms or "guide shops" where customers could try and order products (by 2019, it had 60 guide shops)[5]. These stores did not carry any inventory for sale. In 2017, Walmart agreed to acquire Bonobos for $310 million[6].

Dollar Shave Club (DSC)

In 2005, P&G paid $57 billion to buy Gillette, a century old brand that held the enviable position of the world's number one shaving brand.[7] Over the years, Gillette introduced a series of new products starting with two blades (Trac II), and then moving to three blades (Mach 3) and eventually five blades (Fusion). These new products were supported by heavy R&D and marketing budgets. For Mach 3, Gillette spent $750 million in R&D and $300 million in marketing. This allowed Gillette to charge a hefty price premium. For example, the Fusion cartridges cost Gillette around $0.50 to manufacture and package, but their retail price was around $20, and Gillette took 65% of the mark-up.[8] By 2010, Gillette had almost 70% share of the U.S. men's razor market.[9]

In January 2011, Michael Dubin and Mark Levin met at a party and shared their frustration about over-expensive, over-engineered and over-marketed razor blades. They decided to disrupt the industry by targeting, in Dubin's words, "regular American guys who don't like getting ripped off and who value their time."[10] Using a subscription service with free shipping and no commitment, and razors that were designed and manufactured by a South Korean supplier, DSC offered three types of razors[11]:

- *The Humble Twin*: 2 blades, 5 cartridges per month, for $1/month, $2/month shipping.
- *The 4X*: 4 blades, 4 cartridges per month, for $6/month, free shipping.

- *The Executive*: 6 blades, 4 cartridges per month, for $9/month, free shipping.

To support its launch, DSC used YouTube instead of traditional advertising. Dubin, who had a background in improv comedy, starred in many of DSC's promotional videos. In its first YouTube video in March 2012), Dubin described his razors as "f*king great," and said:

"Do you like spending $20 a month on brand-name razors? Nineteen go to Roger Feder… Do you think your razor needs a vibrating handle, a flashlight, a back scratcher and 10 blades? Stop paying for shave-tech you don't need …So stop forgetting to buy your blades every month and start deciding where you are going to stack all those dollar bills I'm saving you."[12]

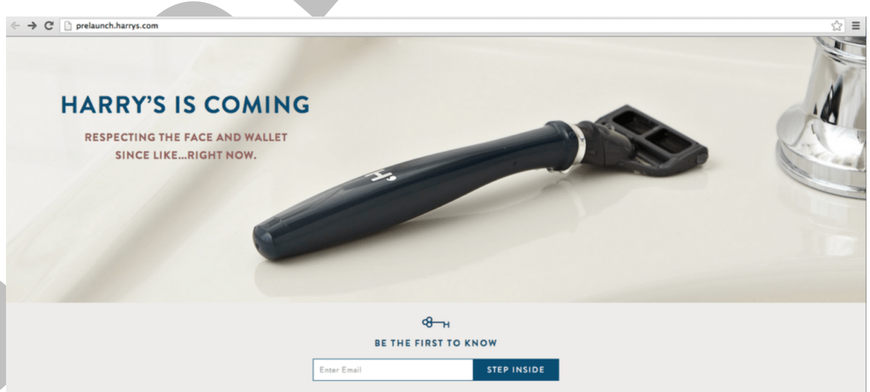
Within two days of this video, almost 12,000 people subscribed to DSC[13]. By the end of 2019, this video was viewed over 26.5 million times[14]. DSC revenues grew from $4 million in 2012 to $154 million by 2015.[15] During this time, Gillette's share tumbled from 70% to 54%. In July 2016, Unilever bought DSC for $1 billion. By mid-2019, P&G wrote down the value of Gillette brand by $8 billion.[16]

Harry's

One afternoon in 2011, while buying razor blades at a drug store near Stanford, Andy Katz-Mayfield was experiencing the same frustration as DSC founders. He wondered why the industry dominated by Gillette and Schick couldn't be disrupted, just as Warby Parker challenged Luxottica. Luckily, he knew Jeff Raider, one of Warby Parker's cofounders, with whom he had worked with at Bain & Company and Charlesbank Capital Partners. Soon the two paired up and in July 2012 they formed Harry's. By this time DSC was already getting attention in the market. Unlike DSC's low price model, Katz-Mayfield and Raider wanted to create a well-designed razor at a reasonable price. They ordered many high-end razor blades from Egypt to Japan and ended up with Croma, an elusive European blade manufactured by a 93-year old German factory called Feintechnik.[17]

To get attention in the market, Harry's created a waitlist of potential customers by pre-launching a web page where people could sign up for the promise of better razors at lower prices (see **Figure 1**). Those who shared the campaign with their friends and social networks got free products. Within a week, 100,000 people signed up.[18]

Figure 1 Harry's Pre-Launch Webpage



Source: CB Insights, September 19, 2019, https://www.cbinsights.com/research/direct-to-consumer-retail-strategies/, accessed January 3, 2020.

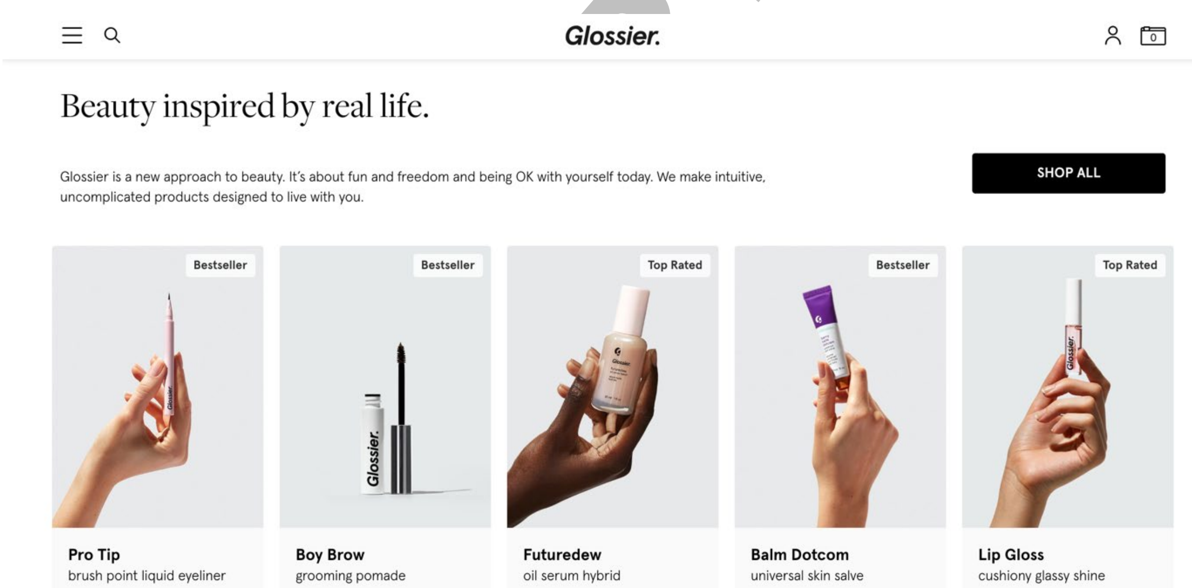
Although Harry's started as an e-commerce firm, Raider realized the importance of physical stores from his Warby Parker experience (which had almost 90 stores in 2019). In August 2016, Harry's started selling in Target and in May 2018 it expanded its retail presence in 2,200 Walmart stores in the U.S.[19] By 2019 its revenues were expected to reach $200 million, half of which would come from retail stores.[20] In May 2019, Edgewell, the owner of Schick razors, agreed to buy Harry's for $1.37 billion.

Glossier

At the age of 18, Emily Weiss moved to New York to study studio art at New York University. During her studies she took up a three-day-a-week internship at *Teen Vogue* magazine. After graduating from NYU in 2007, she worked as a fashion assistant at *W* and *Vogue* magazines. While working there she set up her beauty blog *Into the Gloss* that provided product reviews, how-to tips and daily routines of interesting people. In 2010, Weiss decided to leave her job and devote full time to her blog.[21]

By 2014, her blog was attracting 1.5 million unique visitors and 10 million pageviews per month.[22] This inspired Weiss to create her own beauty products based on consumer feedback. Unlike traditional beauty brands that were designed by experts and promoted by celebrities, Glossier's philosophy was summarized by a tag line on its website: "Beauty inspired by real life" (see **Figure 2**).

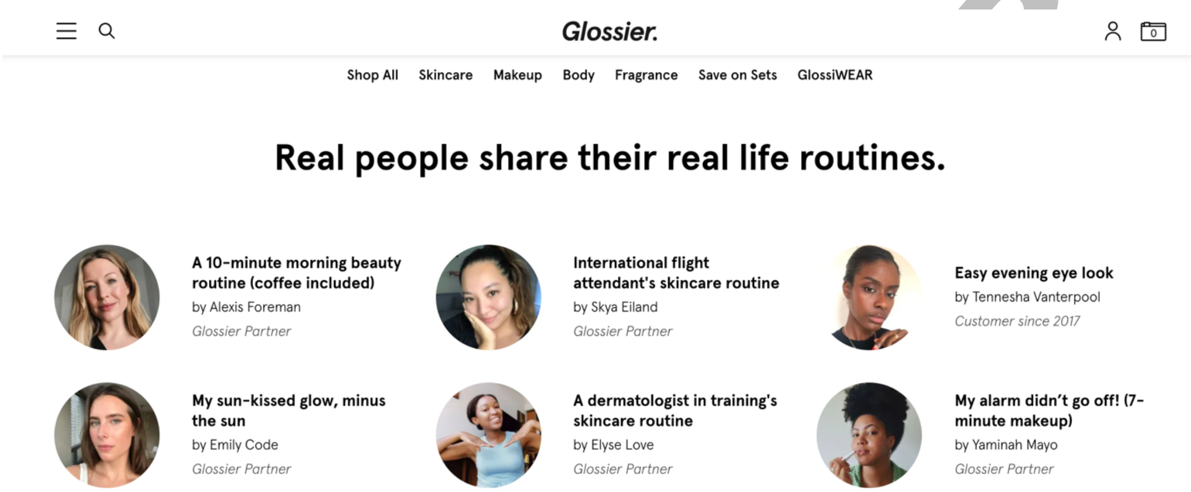
Figure 2 Glossier Website



Source: www.glossier.com, accessed January 3, 2020.

Over the next few years, Glossier developed a strong community of users. Its growth was fueled by innovative and authentic content, a laser focus on user community, and peer-to-peer efforts in promoting its products. The company described its strategy as "born from content, fueled by community."[23] Real-life stories from users were often used as content to drive engagement (see **Figure 3**). By the end of 2019, Glossier had 2.5 million Instagram followers[24] who posted pictures with company products, offered recommendation to their friends and fueled growth through social commerce. The company introduced new brand teasers on Instagram four weeks before launch to build excitement.

Figure 3 Real Stories at Glossier



Source: www.glossier.com, accessed January 3, 2020.

By 2018, Glossier's revenues exceeded $100 million, double its 2017 revenue. It also acquired a million new customers that year.[25] Since 2016, Glossier had been experimenting with pop-up stores in New York, Chicago and a few other cities. Based on their success, in November 2018, it opened its first flagship store in New York. It also owned a store in Los Angeles and London. In December 2019, Glossier decided to open temporary shops in several Nordstrom stores to sell its perfume during the holiday season. Weiss explained this decision: "Fragrance is an extremely personal category – one that people understandably prefer to discover in person – and department stores are the largest channel for fragrance, making up nearly a quarter of all U.S. fragrance sales."[26] In 2019, Glossier raised $100 million in Series D funding round that valued the company at $1.2 billion.[27]

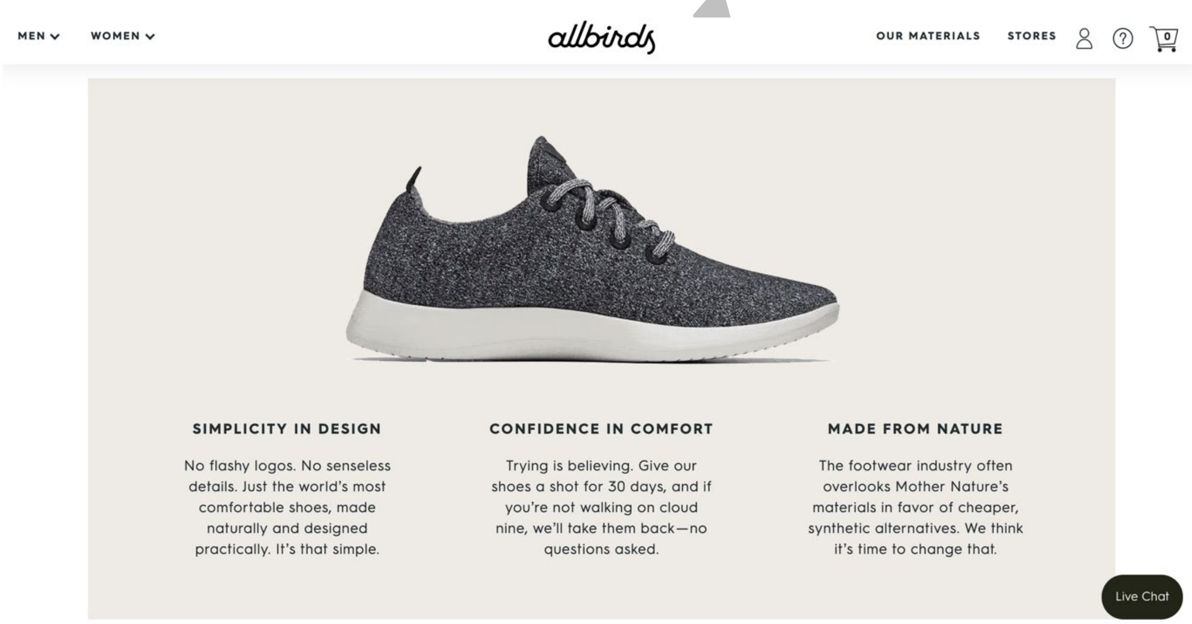
Allbirds

In 2014, the $39 billion global athletic footwear market was dominated by Nike ($16 billion) and Adidas ($8 billion).[28] Nike spent billions of dollars in R&D and marketing and was supported by sports celebrities like Michael Jordan and Roger Federer. It seemed almost impossible for a startup to break into this highly competitive industry dominated by two sophisticated companies with deep pockets. But Tim Brown was never afraid of a challenge.

Brown, a professional soccer player from New Zealand, represented his country in the World Cup in 2010 and retired from soccer in 2012. During his professional career he received many free pairs of shoes, but he was constantly surprised at their over design and cheap material. He wanted something better and simpler, so he started toying with the idea of creating his own. In an interview with CNBC, he said, "I had a very, very simple insight that shoes were over-logoed, over-colored and changed all the time for no reason…it was very, very difficult to find 'simple.' And I set out to solve that."[29] Brown also wanted to create a brand with a purpose and mission – and for him it was sustainability. As a native of New Zealand, which he lovingly called "the land of 27 million sheep," Brown decided to make his sneakers with an all-wool upper (the part that covers your foot and connects to the shoe sole).

After developing a prototype, he launched a Kickstarter campaign in March 2014 to raise $30,000. Within four days 950 investors contributed $120,000.[30] Given this success, Brown reached out to Joey Zwillinger, an industrial engineer whose wife was a former roommate of his wife at Dartmouth. He moved to San Francisco and the two co-founders formed Allbirds in 2015. They used 17.5-micron superfine New Zealand merino wool, which they developed with a premium Italian mill, and the shoes were produced in South Korea. The company officially opened its website for business in March 2016. Soon after its launch, *Time* magazine called Allbirds "the world's most comfortable shoes".[31] Apart from comfort, consumers found Allbirds simplicity and sustainability features appealing (see **Figure 4**).

Figure 4 Allbirds Shoes



Source: www.allbirds.com, accessed January 3, 2020.

Its mission for sustainability appealed to Silicon Valley entrepreneurs. Soon it became the shoe of choice for well-known tech celebrities such as Google's Larry Page, Twitter's Dick Costolo, and A16Z's Ben Horowitz[32]. Hollywood celebrities such as Oprah Winfrey, Gwyneth Paltrow and Jennifer Garner also became loyal fans. Impressed by Allbirds focus on sustainable material, Leonardo DiCaprio personally invested in the company. In March 2018, two years after the company opened for business, it sold its 1 millionth pair of shoes at the typical retail price of $95.

In 2018, Allbirds introduced flip-flops with soles made with SweetFoam that used sugarcane from Brazil. Sugarcane, a fully renewable resource, removed carbon from the atmosphere as it grew. Allbirds also introduced its first line of nonwool shoes called Tree, made with fiber derived from eucalyptus trees.[33] In March 2018, Allbirds decided to sell its shoes in Nordstrom for a limited time. It also owned and operated stores in New York, San Francisco and London, with a plan to open 8 more stores in the near future. By 2019, Allbirds was valued at $1.4 billion[34].

Incumbents' Response

Most incumbents were shocked at the sudden rise of DTC brands. They had spent billions of dollars in R&D and marketing to build brands over decades. They felt invincible with their global supply chains, manufacturing expertise, economies of scale, and powerhouse marketing departments. Suddenly all their assumptions were being challenged. Their response fell into three categories:

Acquire DTC Brands

Witnessing the rise of DTC startups, many incumbents started acquiring them. Unilever bought DSC for $1 billion to compete against its arch rival P&G, owner of Gillette. P&G had also been on an acquisition spree. During 2017-2019, it bought natural deodorant brand Native Cos, beauty company First Aid Beauty, skin-care brand Snowberry New Zealand, maker of health and beauty products Walker & Company, and feminine care brand This is L. Marc Pritchard, P&G's chief brand officer, explained the rationale, "E-commerce and direct-to-consumer are growing. We think the small can help the big get faster, and the big can help the small grow faster."[35]

Acquiring DTC brands was easy, but making them profitable was challenging. More than three years after Unilever acquired DSC, this business was still unprofitable. Unilever executives found that average cost of acquiring a new customer online was about the same as in stores. David Taylor, CEO of P&G, said his company was still figuring out how to turn recently acquired DTC brands into profitable businesses. Taylor summarized this dilemma, "There are many, many launches that grow fast…a business model that makes money is a higher challenge."[36]

Growing E-commerce and Building DTC Brands

To build direct relationship with consumers, incumbents were developing their e-commerce and DTC business for existing products. DTC sales for Nike increased from 16% in 2012 to 32% in 2019 (which included sales through its 384 U.S stores and 768 international stores).[37] However, Nike was an exception and DTC revenue for most companies accounted for less than 10% of their global sales. For example, e-commerce accounted for almost 8% of global sales of P&G and Nestle in 2018-19.[38,39]

In addition to building DTC business for their existing products, incumbents were also creating in-house accelerators and incubators to invent new DTC brands. Anheuser-Busch created ZX Ventures, Visa built Visa Ventures, Kellogg's created 'speed team' and P&G formed P&G Ventures. According to Betsy Bluestone, commercial discovery leader of P&G Ventures, the goal of Ventures was to "create businesses in areas where P&G doesn't compete." [40] Since its founding in 2015, P&G Ventures created four brands – natural insecticide Zevo, digital skin analyzer Opte, skin-care treatment Metaderm, and menopause brand Pepper & Wits. However, sales of most of these newly minted brands remained small compared to multi-billion dollar sales of brands like Tide. It was unclear how much time and investment these new DTC brands would get in the future.

Wait and See

While most executives were inclined to acquire or build DTC brands, there was a growing feeling that DTC might be a fad or at best create only niche brands. Unlike software and service businesses, DTC brands had to build and distribute physical products that made it harder for them to scale.

Adam Valkin, managing director of General Catalyst, a VC firm, argued, "At the end of the day, as glorious as this sounds, underlying economics often come down to a simple equation, which is: 'What is the lifetime value and what does it cost to acquire?"[41] The proliferation of DTC brands had reduced customer loyalty and lifetime value, and acquisition costs were rising with competition.

Some experts also raised questions about the lack of real innovation in the DTC market. Josh Udashkin, the founder of failed DTC company Raden that sold smart suitcases, summarized this sentiment well, "You didn't reinvent anything, you found a new clever way to sell it. And things revert to the mean."[42]

The public markets were also beginning to question the private valuations of DTC startups. Casper, a DTC mattress company that was privately valued at $1.1 billion, went public on February 5, 2020 at $12 a share that valued the company at $470 million.[43] Within two weeks, it's stock was down by almost 20%. Around the same time, FTC blocked Edgewell's acquisition of Harry's.[44]

The Future

The future of DTC brands and the entire consumer goods industry remained uncertain. Were DTC brands just a marketing gimmick or did they create value for consumers in new and innovative ways? Could they scale to become mainstream brands or were they destined to be niche players? Could they grow and be profitable at the same time? And how should incumbents respond to them?

Exhibit 1 DTC Brands for Beauty and Food

Source: Zoe Leavitt, "Disrupting CPG," CB Insights, October 2018.

Exhibit 2 Valuation of Select DTC Brands

Company	Product	Founded in	Valuation
Warby Parker	Eyewear	2010	$1.75B
Glossier	Beauty	2010	$1.2B
Dollar Shave Club	Shaving	2011	$1.0B
Casper	Mattress	2011	$1.1B
Harry's	Shaving	2012	$1.37B
Allbirds	Shoes	2014	$1.4B
Away	Luggage	2015	$1.4B

Source: Compiled by casewriter from Warby Parker https://www.vox.com/2018/3/14/17115230/warby-parker-75-million-funding-t-rowe-price-ipo; Glossier https://www.forbes.com/sites/elanagross/2019/03/19/glossier-raises-100m-and-now-has-a-billion-dollar-valuation/#4e9fb9ee720d; Dollar Shave Club https://fortune.com/2016/07/19/unilever-buys-dollar-shave-club-for-1-billion/; Casper https://techcrunch.com/2019/03/27/mattress-startup-casper-said-to-be-valued-at-1-1b-with-new-funding/; Harry's https://www.fastcompany.com/90347043/harrys-shave-startup-bought-by-schick-razors-parent-for-1-37b, Allbirds https://www.wsj.com/articles/trendy-sneaker-startup-allbirds-laces-up-1-4-billion-valuation-1539281112; Away, https://www.dtcdaily.com/2019/05/away-latest-dtc-unicorn/, accessed January 7, 2020.

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