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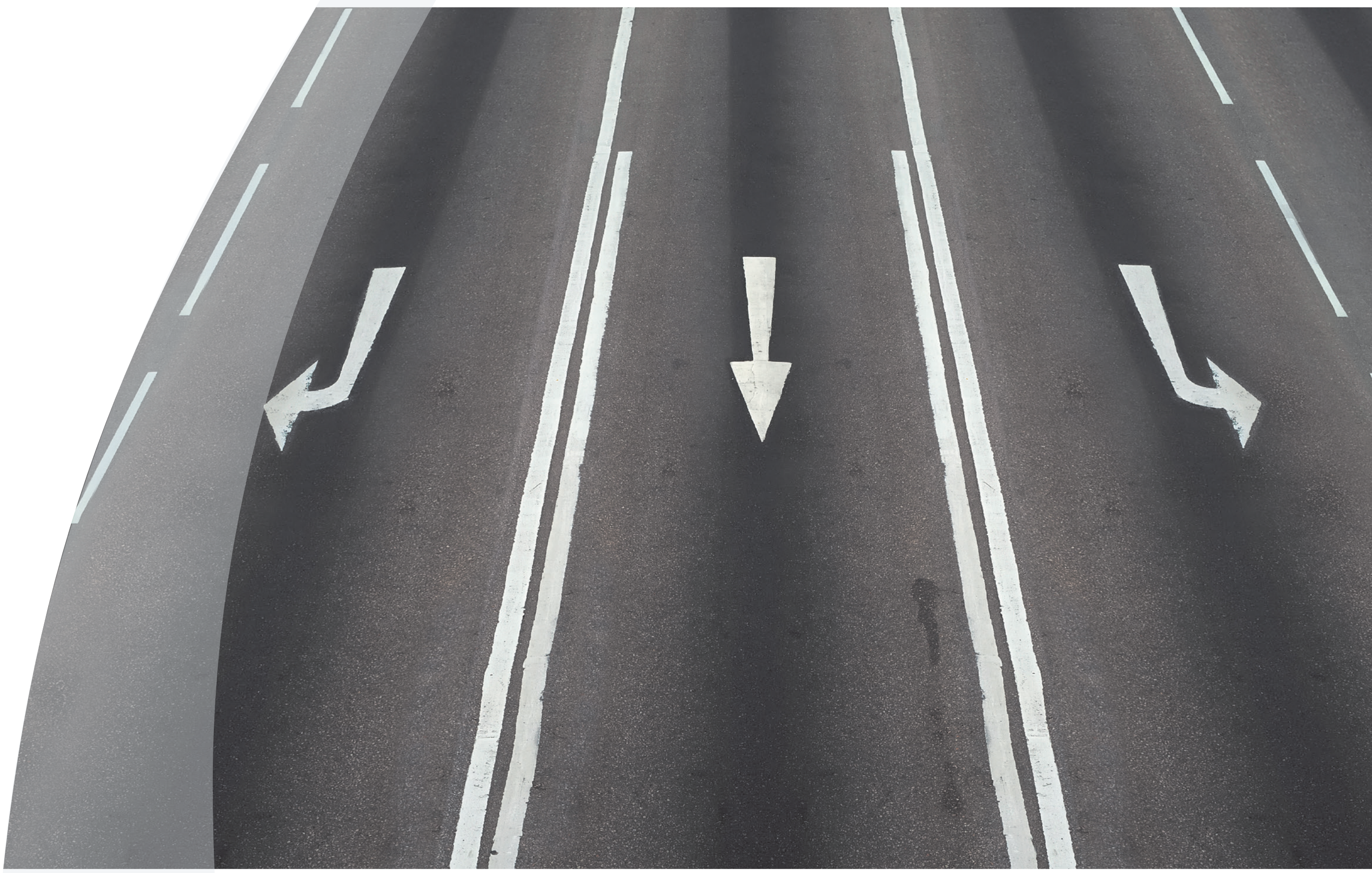
Going Direct

The Journey from Wholesale Brand to Direct-to-Consumer Retailer



Lured by the promise of bigger sales, better access to consumers and even their ultimate survival, wholesale brands are increasingly seeking to circumvent retailers and reach their customers directly.

According to an Economist Intelligence Unit survey, the percentage of manufacturers selling directly to consumers (DTC) is expected to grow 71% over the next year to more than 40% of all manufacturers. And the number of historically wholesale brands on the Internet Retailer 500 is growing too, from 51 in 2008 to 63 in 2012.

The reasons for this growth are clear. First, brands are now facing unprecedented competition. Consider that in 1980, there were six brands of blue jeans in the U.S. and today there are over 800. Second, assortments are growing, intensifying the battle for shelf space. For example, in 1968, Pringles had one flavor of chips. Today, it has 33. And shelf space is becoming even more precious, as many major big-box retailers migrate to smaller footprints in urban areas.

In the midst of this environment, brands are seeing the advantages of carving their own path to sales and setting their own prices. But besides just growing sales, going direct puts brands closer to their consumers, which enables them to strengthen their overall brand image and test out new products and markets all while accessing an incredibly rich treasure trove of consumer data previously controlled by retailers.

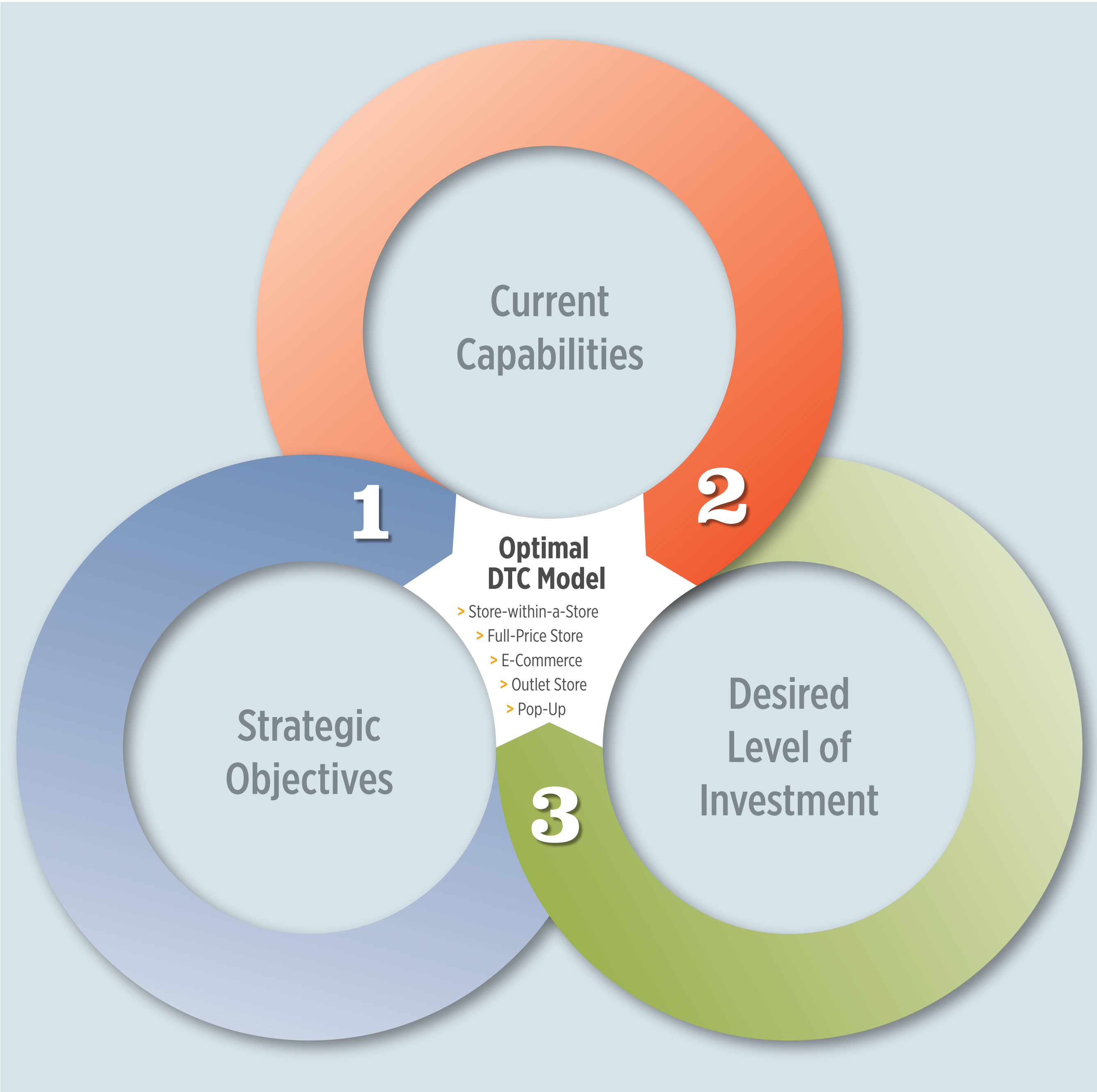
But getting to these benefits is not easy; the road from wholesaler to direct-to-consumer can be long and bumpy. Much of a wholesaler's success or failure hinges on mapping out a clear path to their optimal direct-to-consumer model, one that will mesh with the wholesaler's strategic objectives and current capabilities without being prohibitively expensive. (See Exhibit 1.)

1. STRATEGIC OBJECTIVES

There are many strategic benefits to going direct, but the main objectives include growing sales, gaining control over pricing, strengthening the brand, getting closer to consumers, and testing out new products and markets. The optimal DTC model will vary depending on a wholesaler's primary objective(s).

Growing sales. Wholesalers looking to grow sales by going DTC generally fall into one of two groups. The first group finds itself facing a dwindling number of retail distribution options. This could include wholesalers who sell to an increasingly competitive, and shrinking, set of retailers—think early DTC success stories like Sony, Dell and Levi's—or wholesalers who are getting a smaller and smaller share of the retail shelf, losing out to private-label and other wholesale competitors. This first group is looking to recapture sales by shifting channels.

EXHIBIT 1: Determining the Optimal DTC Model



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The second group, which includes fashion and lifestyle brands like Coach and Burberry, is not facing such an intensely contracting environment, but sees an opportunity to grow sales beyond those at its current retail partners. It's well established that co-location of like stores drives traffic increases at both, and while there may be some cannibalization of current retail channels, the other benefits of going direct far outweigh that risk.

Strengthening the brand. Going direct gives wholesalers a chance to gain control over how their brand is presented to and interacts with consumers, from packaging and merchandising to marketing and the customer experience.

Apple is one of the best-known brands in the world, partly because of its great products, but also because of its direct-to-consumer push. Apple struggled in the mid '90s in part because it relied on big-box electronics retailers with lackluster displays and poorly trained staff. But Apple's turnaround started in 1997 with the launch of its online store, which received over $12 million in orders in its first month.

But Apple still felt at the mercy of big-box stores for the majority of its sales. So it tested a store-within-a-store model in CompUSA—which set aside 15% of each store for Mac products and an Apple salesperson. Apple then opened its own freestanding stores starting in 2001. The stores strengthened the customer experience and the brand. Today, Apple's stores blow all other retailers out of the water when it comes to sales per square foot—$6,050 versus $3,017 at the runner-up, Tiffany and Co.

These efforts will also help elevate the brand's cachet, translating to better sales for retail partners too.

Gaining control over pricing. Wholesalers can easily find themselves at the mercy of dozens of cross-channel retailers with wildly varying price structures. Amazon, especially its unauthorized sellers, can be a particularly acute problem. But many brands are able to exercise greater control over pricing through their own channels.

For example, VF's DTC business sees gross margin rates that are 10 percentage points above average and a more than 20% return on invested capital. That's in part because the direct-to-consumer business is increasingly shifting toward full price. The company estimates that by 2015, 60% of DTC revenues will come from full-price stores, up from 54% in 2010, while only 27% of DTC revenues will come from outlet stores, down from 38% in 2010.

Direct is also more profitable for Coach. Eighty-nine percent of Coach's total sales came through its direct-to-consumer channels in 2012, and these sales were at an average higher price point than its wholesale channels, where it sells past-season products at a lower markup.

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Getting closer to consumers. Historically, wholesalers have often had a wealth of global consumer research, but have lacked considerable insight on local customers.

But as everything from news to music to advertisements to credit card rewards becomes more personalized to individual consumers, those consumers are beginning to expect the same level of individualized treatment from retailers. Brands that can harness consumer data and new technology to create these personalized one-to-one retailing experiences and products will have an incredible competitive advantage.

For these retailers, e-commerce is often the best first step because rich customer data is more easily captured and analyzed in the online world than within the store's four walls. But as in-store technology improves and this changes, it will increasingly make sense for manufacturers to beef up their consumer analytics teams, get their feet wet online and then open stores.

For example, Procter and Gamble sees less than 1% of its sales through its eStore, but it views the site as a valuable way to better understand its consumers, not as a sales driver.

Testing out new products or markets. Setting up a direct e-commerce site or pop-up store is a great way for a brand to test consumer reactions to a new product or see how it fares in a new market.

For example, Williams-Sonoma often launches its brand in a new market via catalog and e-commerce and then rolls out stores if sales are good. This insulates against underperformance and store closure with minimal investment. This policy made the company's recent decision to open a store in Sydney less risky because Australia is Williams-Sonoma's strongest e-commerce market outside of North America. Williams-Sonoma has e-commerce in 75 countries, and its e-commerce net revenues increased 16.7% in Q3 2012 versus a 4.2% increase in retail net revenues.

On the other hand, French designer Vanessa Bruno, who wholesales to around 25 U.S. doors, opened a SoHo pop-up store during New York Fashion Week as a way to test the waters before opening a full-fledged store there or rolling out its e-commerce site to the U.S. Bose has also had great success with its airport pop-ups.

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2. CURRENT CAPABILITIES AND CHALLENGES

Adding a direct-to-consumer element will have far-ranging implications for every aspect of a wholesaler's operations, from product development through customer experience. The degree to which a certain direct-to-consumer entry point makes sense depends on a retailer's current capabilities and willingness to expand them.

Channel conflict. Despite the established benefits of co-location, some retailers can't help but see wholesalers going direct as a threat. And, as a result, some will demand exclusive products—or more of them—from the wholesaler. For example, DFS Galleria began to demand more exclusives when brands it carried like Burberry and LeSportsac opened their own stores and e-commerce sites. This will have significant product development, merchandising and supply chain implications. For starters, this will likely result in a larger number of products, with less of each needed, which will have a considerable impact on costs.

Product development and merchandising. One of the biggest benefits of going direct is access to a wealth of new consumer knowledge. But with that benefit comes the challenge of designing innovative products aimed at that core consumer and developing curated, localized assortments.

Going direct provides the opportunity to expand assortments, especially online. One hardware brand saw its share slashed by home improvement retailers, but was able to restore its full assortment on its website and by opening pop-ups during its two most important sales periods—Christmas and Father's Day.

Finally, wholesale demand planning is vastly different from direct-to-consumer assortment planning, inventory management and markdown optimization. This is especially true if a wholesaler is opening stores and will need to develop allocation and replenishment capabilities. These new merchandising demands will also require different IT systems and processes.

Supply chain. Fulfilling a wholesale order is, of course, drastically different from fulfilling a retail or e-commerce order. A retail order may be more than double the volume of a traditional wholesale order, while an e-commerce order will be only a small fraction of the size of a wholesale order. Wholesalers who are already drop-shipping orders for retailers have the capabilities in place to handle the small orders associated with e-commerce.

Customer experience. This is where wholesalers will have the biggest need to play catch-up. Whether online or in-store, going direct will require creating a compelling, personalized experience that is powerful enough to lure customers away from traditional retailers who carry the same brand.

One of the most effective ways to accomplish this is by creating strong linkages back to the wholesaler's brand. Burberry has recently made a push to improve the customer experience in its flagship stores, some of which feature RFID-tagged merchandise that brings nearby displays to life when picked up. The brand recently announced that its Q4 2012 retail sales, which account for around 75% of its revenue, rose 13%, while its wholesale revenues fell 5%.

3. LEVEL OF INVESTMENT

Level of investment is the final lens through which the path to direct should be viewed. The level of investment will vary depending on the urgency of finding a new distribution channel and whether a wholesaler's share or sales are shrinking. Wholesalers looking to just get their feet wet may be best served by starting with an e-commerce site or, if a physical presence is a better fit with their strategic objectives and current capabilities, a store-within-a-store or pop-up.

Wholesalers can often spend much more time deciding whether or not to go direct than how to get there. But three factors—strategic objectives, current capabilities and level of investment—will help a wholesaler who has already decided to go direct determine how to maximize its sales and emerge a stronger, more connected brand. ❖

AUTHORS

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