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The big break: How retailers can break habits to support diverse-owned businesses

Our recent consumer survey found two important facts about American consumers. And retailers should take note.

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Loyalty is down. More customers are switching brands and retail channels than they did in 2020 and 2021.[1] In recent months, 37 percent of consumers shopped a different retailer and 46 percent shopped a different brand. Most of these consumers intend to make switching part of their shopping routine.

Omnichannel is up. Across the purchase journey, from product research to purchase, 75 percent of consumers tap both online and in-store channels, and more and more consumers use both in the same shopping trip (for example, buying online and picking up in-store).

Together, these trends make "shopping around" easier than ever and raise the stakes on standing out in the crowded retail landscape, forcing retailers to find ways to differentiate so that they may attract and keep consumers.

The power of purpose and brand

How do retailers differentiate themselves to capture the available pool of consumers? Part of the answer, especially among Gen Z and millennial consumers, who account for $800 billion in retail spending, is purpose. Overall, 57 percent of consumers call purpose—or environmental, social, and governance practices—very important in making purchase decisions.

And further, a leading attribute of purpose for Gen Z and millennial consumers is whether a brand is minority or Black owned. Forty-nine percent of Gen Z and 44 percent of millennials take Black ownership into account when embarking on their purchase journey.[2] Coupled with the fact that many retailers have made pledges to support diverse brands, this suggests that retailers can fulfill their aspirations for racial equity and capture inclusive consumer purchase behavior, particularly in an environment of significant consumer switching.[3] Now is the time for retailers to showcase, sell, and support diverse-owned brands on their shelves.

Scaling in retail: The difficulties faced by diverse-owned brands

It's not new information: retail shelves can be a tough (to say the least) environment for diverse-owned brands looking to scale. This difficulty exists despite retailers' best efforts to support them, and it is clear that work lies ahead to eliminate the many challenges that diverse-owned brands uniquely face.

The average minority-owned, mature small business is 30 percent smaller than its non-minority-owned counterpart.[4] And while the start-up gap—or the gap in launching businesses—is narrowing between minority and nonminority businesses, the so-called "scale-up gap," or the gap in revenue as these businesses scale, has persisted.

Our analysis of Minority Business Development Agency data found that minority-owned small businesses have 32 percent fewer employees and 47 percent lower receipts than non-minority-owned businesses.[5] Limited funding—in the form of lower loan-approval rates and less start-up capital—often means that minority-owned businesses start small and stay small. Their lack of high-powered networks and insider knowledge often keep them from capitalizing on opportunities available to better-connected businesses. And in retail, getting pigeonholed as "only for the Black consumer" can limit the economic potential of brands that might appeal to a wider consumer base. A CEO and founder of a Black-owned apparel brand told us, "One of the other big challenges that a lot of Black founders face is this huge misconception that Black

[1] Kari Alldredge, Tamara Charm, Eric Falardeau, and Kelsey Robinson, "How US consumers are feeling, shopping, and spending—and what it means for companies," McKinsey, May 4, 2022.
[2] Ibid.
[3] Jordyn Holman et al., "Black-owned brands get lift as big retail invests to help them scale," Bloomberg, March 7, 2022.
[4] *State of entrepreneurship 2017: Zero barriers: Three mega trends shaping the future of entrepreneurship*, Ewing Marion Kauffman Foundation, February 16, 2017.
[5] André Dua, Deepa Mahajan, Ingrid Millán, and Shelley Stewart, "COVID-19's effect on minority-owned small businesses in the United States," McKinsey, May 27, 2020.

‘One of the other big challenges that a lot of Black founders face is this huge misconception that Black founders are only creating businesses for Black buyers, Black customers, Black communities. More and more, we’re seeing incredible brands being created that can be—and should be—for everyone.’

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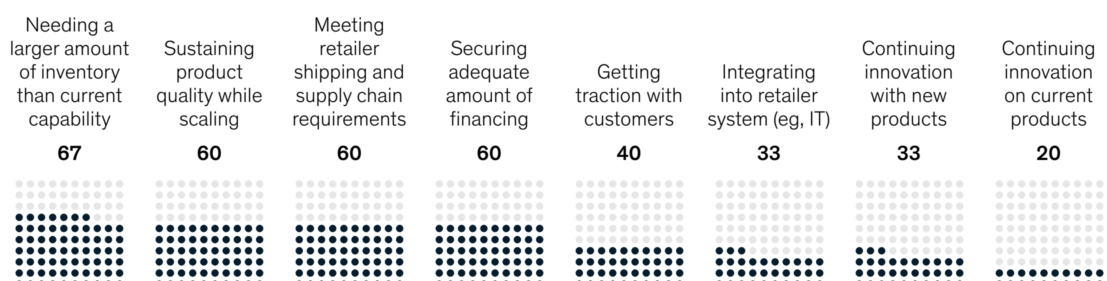
But it doesn’t stop there. Once on retailer shelves, diverse-owned brands continue to face scaling challenges. When asked what pain points smaller brands experience in their stores, more than 60 percent of retailers we surveyed cited difficulty meeting company-mandated inventory and supply chain requirements (exhibit). Challenges sustaining product quality and securing adequate financing while scaling also loom large. Taking into account

Exhibit

Expanding capacity, meeting shipping requirements, and securing financing represent the largest pain points small brands face while scaling.

Pain points of small brands scaling, as identified by retailers,[1] % of respondents



[1]Small brands are defined as brands with less than $5 million in annual revenue.
Source: Anonymous McKinsey questionnaire conducted with 15 merchants from major US retailers

the limited capacity and too often limited pattern recognition of smaller brands, the answer is clear: it's time for retailers to ditch the old ways of working to secure a thriving assortment of diverse-owned brands.

The future of inclusivity in retail

As part of the broader movement toward racial equity that received global attention in 2020, many retailers embarked on a journey to have more diverse and inclusive shelves. In 2020 and 2021 alone, top retailers pledged billions of dollars in support of diverse suppliers and minority- and women-owned businesses.

Many retailers have dramatically increased the number of diverse brands on their shelves—albeit often building on a startlingly low number. Ulta Beauty, for example, pledged to spend $25 million in 2021 to support diversity in its products and stores and has increased its spend to $50 million in 2022, including additional advertising to support brands owned, led, or founded by someone who is Black.[6] Best Buy committed to spend $1.2 billion with diverse businesses and with businesses owned by those who are Black, Indigenous, and people of color (BIPOC) by 2025,[7] and Macy's pledged to allocate 15 percent of its shelf space to Black-owned brands.[8] Cementing the impact from these leading retailers' efforts and making them standard across the industry will require changing the game from today's big-brand approach.

And while we see some retailers starting to ditch the old ways of working, more should follow suit. When asked how they are working differently to support smaller diverse-owned brands, more than 70 percent of major retailers surveyed offer trial periods and phased rollouts. However, only half of these retailers provide any marketing support to help promote these brands while they scale. When asked what would be most valuable for smaller brands that isn't offered today, 60 percent of retailers mentioned product development support and more desirable shelf space. So while most retailers agree that additional support and better shelf space would help smaller brands thrive, the follow-through is lagging behind. And it's worth recognizing that it takes smaller brands at least 1.7 times longer to scale on shelves than it does for larger brands, further underscoring the need for retailers to have realistic forecast expectations and provide one-on-one support that can best position brands to grow their purchase orders sustainably.

When done right, there's game-changing value at stake. A chief merchandiser at a mass retailer explained, "It benefits both the new brand and the retailer to work a little differently while the brand gets its footing in the market." Fulfilling the needs

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[6] "Ulta Beauty announces 2022 diversity, equity and inclusion commitments," Business Wire, February 3, 2022.
[7] "Best Buy commits to spending $1.2B with BIPOC and diverse businesses by 2025," Best Buy press release, June 24, 2021.
[8] "Macy's honors Black history and the brilliant legacies of Black creatives," Macy's press release, February 1, 2021.

of the underserved Black community could tap into an estimated $300 billion of value annually. More broadly, retailers would be fulfilling growing consumer demands for inclusivity and accessing the growing spending power and loyalty of the inclusive consumer market.

Seven habits to break and new ones to adopt to support diverse-owned brands

What, specifically, can retailers do to support and sustain an incredible assortment of diverse-owned brands on their shelves? We found seven practices embraced by retailers at the forefront of driving diversity on their shelves.

Old habit 1: Offering limited SKU trials—instead, trial the full line

Asked what they wish retailers understood about their brands, many Black founders cited their unique value proposition. Especially for brands positioned as being more inclusive (for example, broader range of sizes, diverse makeup tones, nude heels that match all shades), retailer restrictions on trialing a limited set of SKUs prevent these brands from accurately showcasing their value to customers.

Furthermore, their customers can go to the brand's direct-to-consumer website and see products that represent and resonate with them. But they then feel excluded when they find only a limited color palette or size offering in major retail stores. Attracting the inclusive consumer requires offering SKU trials that demonstrate the full value proposition of the brand and collaborating with the brand to determine the right depth of each SKU.

Old habit 2: Enforcing 'one strike and you're out' policies—instead, partner for performance

Small businesses face many challenges while scaling—from building production capacity to dialing up marketing for growth. Scaling inevitably brings unforeseen bottlenecks and bumps in the road. "One strike and you're out" policies exacerbate the challenges.

Smaller businesses, in particular, benefit from performance partnerships with retailers. One Black founder we interviewed said that she would appreciate receiving a "yellow warning" on her brand's performance, which would allow her to work closely with the retailer to fix and learn from any issues. Lacking industry relationships and clear expectations up front, she was surprised to receive a "red alert" without enough time to correct the problem.

Building an appealing and sustainable assortment of diverse brands requires retailers to work side by side with smaller brands to align on expectations, meet and understand the brands where they are, and provide feedback on performance and opportunities for improvement—well before issuing any red alerts.

Old habit 3: Adopting a sink-or-swim marketing approach—instead, offer promotional support

Many of the diverse founders interviewed had built an impressive grassroots following on social media. But their reach often fell short when they had to compete with national household brands and battle for shelf space. And for those brands that are disrupting spaces such as beauty and fashion, they need something extra to get the attention required for consumers to see and understand their value proposition.

Having modest marketing budgets or none at all, these brands need more than the limited promotional support typical of the "big-brand playbook." Many leading retailers are providing millions of dollars in promotional support to showcase diverse brands in pulse moments such as Black History Month and more should follow suit to provide promotional support throughout the year to sustain and grow momentum.

Old habit 4: Bottom-shelf, back-corner placement—try prime space year-round

As one successful Black founder said, "The work wasn't getting on the shelf. The work was getting off the shelf." If Black founders can't find their own products on retailer shelves, how will their

‘If the brands are small, they typically have tighter cash flows and therefore need better terms.’

customers? While 60 percent of the retailers surveyed recognized the power of desirable shelf space to help small brands scale, only 10 percent actually provided it to brands.

So the question is, how can retailers help diverse brands pop up on shelves so customers can find them easily? In addition to featuring these brands at milestones such as Black History Month, many retailers highlight them with specialty endcaps and front-of-store features throughout the year. Some retailers even label their store shelves, add dedicated tabs and filters to their website, or add a tag to business profiles to make customers more aware of diverse-owned brands.[9] Featuring brands through creative labeling and placement can go a long way to showcase an incredible assortment of diverse-owned brands.

Old habit 5: Rigid payment terms—instead, offer faster payment for cash-constrained brands

Limited access to capital poses a major challenge for diverse-owned businesses. When retailers take 30, 60, or even more than 90 days to pay their suppliers, these businesses face crushing cash constraints.[10] “If the brands are small, they typically have tighter cash flows and therefore need better terms,” a chief merchandiser for a mass retailer told us.

Some leading retailers have eased the burden by offering early-payment programs, in partnership with financial technology company C2FO, that let suppliers select an invoice for accelerated payment.[11] More retailers should follow suit to create payment flexibility and minimize associated fees to facilitate efforts to scale.

Old habit 6: Charging high slotting fees—try rethinking fees altogether

Slotting fees are another relic of the big-brand playbook that causes problems for cash-strapped small brands. Some of the Black founders we interviewed called slotting fees alone a major obstacle to securing space and scaling on shelves. While some retailers offer discounts or programs for diverse-owned brands, they don’t always share this information broadly, so taking advantage of the opportunity requires access to certain networks that Black founders are often locked out of.

Retailers committed to attracting more diverse-owned brands should ease, delay, or reimagine slotting fees for these smaller brands and emphasize the support they are providing so other diverse-owned brands can successfully scale in their stores. While a major source of income for some retailers, it’s also a major—if not the biggest—roadblock for many brands.

Old habit 7: Ignoring the lack of access to capital—try closing the financing gap

Besides having to cope with rigid payment terms and slotting fees, diverse-owned brands face a pervasive lack of access to capital. This has significant impact on their marketing capability, product development, production capacity, and more.

[9] “Giant Food introduces shelf labels to spotlight products owned by minority businesses,” Giant Foods press release, December 21, 2020.
[10] Kristin Broughton, “Some companies are taking longer to pay suppliers despite recovery,” *Wall Street Journal*, June 7, 2021.
[11] Megan Crozier and Scott McCall, “Accelerating our commitment to diverse and minority suppliers,” Walmart, April 28, 2021.

‘As a small company with limited resources, when we could, we chose to work with partners that would celebrate us and provide additional display space. We leaned in with those retail partners versus others.’

Retailers who want to excel should get ahead of the problem and respond with nonmonetary and, where possible, monetary support. Many retailers offer or partner with financial institutions to provide purchase order financing and with accelerators or incubator programs that include cash prizes. These retailers realize that lack of capital is the greatest obstacle to building a thriving pipeline of diverse-owned brands and, therefore, to achieving their aspirations for racial equity.

Getting in the game

Most consumers (90 percent) who have switched brands or retailers in the past few months plan to make switching part of their shopping routine. This creates an opportunity for retailers to stock their shelves with an assortment of diverse-owned brands all while progressing their aspirations for racial equity and driving inclusive-minded consumers to their stores. And diverse-owned brands are taking notice—a CEO and founder of a Black-owned food company told us, “As a company with limited resources, when we could, we chose to work with partners that would celebrate us and provide additional display space. We leaned in with those retail partners versus others.”

Success will require dedicating resources to help build and showcase a healthy assortment of diverse-owned brands—brands that face systemic challenges in starting and scaling their businesses. Retailers of every stripe can change the playing field by embracing the seven habits that are already helping highly effective retailers secure and scale diverse brands on their shelves.

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