Southeast Asia’s direct-to-consumer revolution may be underway

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Businesses seem to be growing more discontented with the world’s biggest internet platforms.

Media companies relied on Facebook to build their empires, only for the social network to turn on them with an algorithmic tweak. Merchants made good money within various online marketplaces, only to be sucked into a race to the bottom.

Direct-to-consumer (D2C) companies, which make their own products and then sell and distribute them through their own digital channels, are taking back control. They’re cutting out the middlemen – the third-party aggregators and retailers – and reaching directly into your wallets.

Image credit: Love Bonito

In the media world, it’s led to successful efforts by *The New York Times*, Netflix, and Disney+ to gate their content.

In ecommerce, companies like Casper, Dollar Shave Club, and Warby Parker are making a killing in the US without relying on Amazon. They’re becoming massive, with Warby Parker now worth a little over US$1.7 billion.

Southeast Asia is still catching the wave. But the region has been developing rapidly, with rising incomes, shifting consumer tastes, and maturing infrastructure all possibly culminating in a coming D2C boom.

Slogging in the background

To understand how we've gotten to this point, let's trace the history of ecommerce in Southeast Asia.

Pioneering D2C brands in Singapore were launched in the late 2000s. Furniture store FortyTwo, for instance, was founded in 2006, while fashion firm Love Bonito has been designing its own clothes since 2010.

Ecommerce marketplaces emerged in 2009, with Tokopedia, Qoo10, and Bukalapak sprouting up in rapid succession. A game-changer was the entry of Rocket Internet's Lazada and Zalora and the hundreds of millions of US dollars that came with them.

Following the inflow of money, D2C upstarts mushroomed as more investors and entrepreneurs opened their eyes to ecommerce's potential. Thailand's Pomelo Fashion, Singaporean companies Secretlab and Castlery, as well as Indonesia's Fabelio were started between 2013 and 2014.

Photo credit: Fabelio

For years, marketplaces hogged all the attention as they outraised one another like players in a high-stakes poker game. Shopee is a great example. A latecomer that launched in 2015, it surprised many people by blitzscaling its way to become a leading – but highly unprofitable – contender in Southeast Asia.

The capital raising was arguably necessary, however. There's only room for a few players in the winner-takes-all segment of ecommerce marketplaces.

D2C brands, meanwhile, went the old-fashioned route of slowly building up their businesses. They had the luxury of time.

“In the D2C space, it’s not a zero-sum game. It’s about having sustainable growth, year in, year out,” says Dione Song, who joined Love Bonito as its chief commercial officer after stints at Zalora and Sephora. The company has grown its revenue three times between 2016 and 2018, its public filings show.

“For the majority of the years, we’ve been able to hit that growth with an EBITDA-positive margin, which means minimal burn, minimal discounting as well,” Song adds.

It’s been taking calculated risks when launching physical stores in new markets, often starting pop-ups first to gauge demand and footfall before committing to a long-term lease.

Photo credit: Secret Lab

For D2C brands, profitability is important. Secretlab, which sells chairs for gamers, is perhaps the largest of such firms in Southeast Asia. The *Business Times* reports that the company has been profitable for years and is on track to hit US$73 million in sales in 2019. It’s currently worth at least US$150 million.

Indonesian furniture seller Fabelio, too, has been building its business warehouse by warehouse. “A lot of things we did were in contrast with what investors wanted,” which were asset-light, capital-efficient, and high-margin startups, says the company’s co-founder Christian Sutardi.

No massive D2C brands in Southeast Asia?

As Southeast Asia increases its number of tech unicorns, it's natural to ask why a D2C company hasn't joined the herd.

This probably has to do with the immaturity of the region's ecommerce scene – the first marketplaces are only a decade old.

Again, looking at history as a guide, it seems ecommerce in the US and China generally followed a logical progression. First came the marketplaces, then came the support functions for those sites: payments, logistics, and software tools. The first two phases provided a fertile bed for the last stage: a blooming of D2C brands.

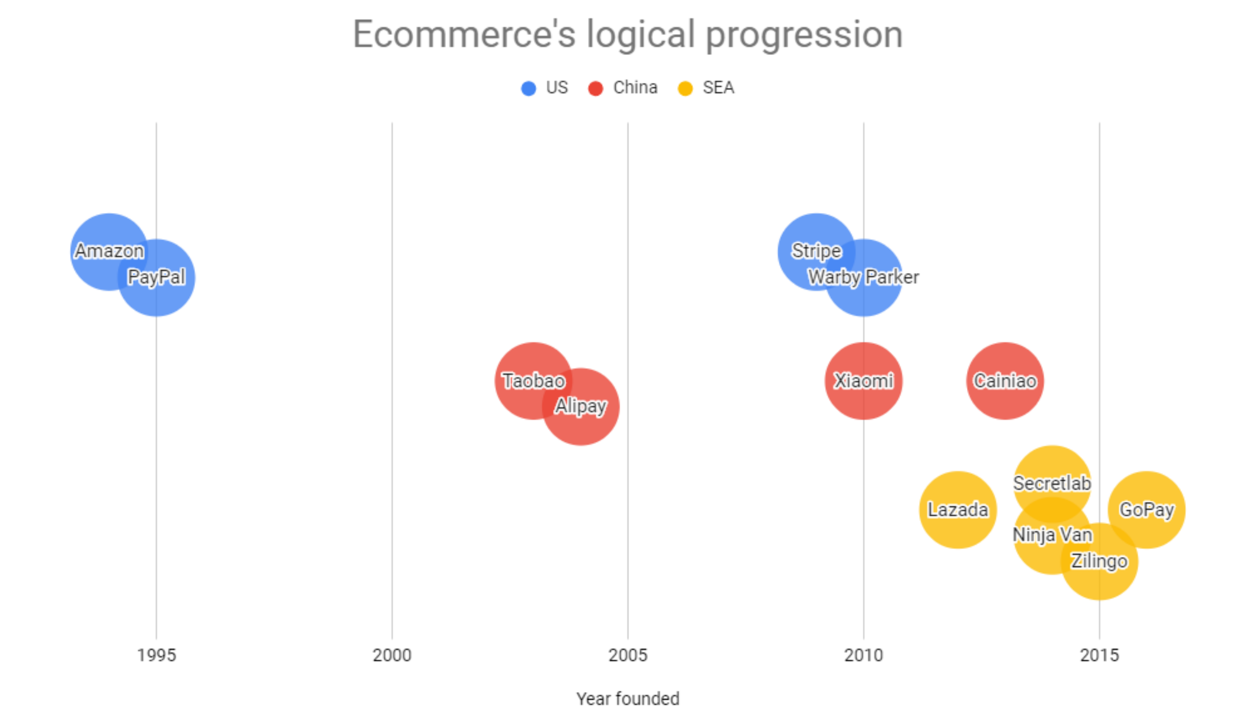

Image credit: Tech in Asia

Another important factor for the rise of D2C brands – which typically compete on value rather than price – is that consumer tastes grow more sophisticated as ecommerce matures.

	Ecommerce maturity	Consumer behavior
Phase 1	Rise of marketplaces	Suspicious, price-sensitive, willing to try
Phase 2	Rise of support functions	Online shopping becomes a habit
Phase 3	Rise of D2C brands	Willing to pay more for premium goods

Southeast Asia may be entering phase three. And it looks to be doing so at a faster pace than the US or China as ecommerce companies in the region are absorbing lessons from those markets.

Supporting players like logistics startup Ninja Van and supply chain platform Zilingo are getting bigger in their own right, and e-wallets are now ubiquitous in many cities.

Marketplaces have not been sitting still, either. Lazada, recognizing that premium brands demand a premium shopping experience, is ramping up LazMall, a curated – as opposed to free-for-all – marketplace where shoppers are guaranteed authentic goods.

See: The future of Lazada

Meanwhile, a couple of prominent ex-Lazadians have started an agency to help social media influencers set up their own ecommerce brands.

They've also noticed a shift in the attitudes of Southeast Asian consumers. Instead of bargain hunting all the time, customers are now splurging on products from brands they can relate to.

It's a sign that the region is entering a "zone of affluence," a term coined by private equity firm Asia Partners that denotes a point in an economy where "spendable income grows from 5% to 15% of total income." In China, this coincided with the public listings of many of the country's tech companies.

But even as the region becomes more attractive for D2C brands, the road ahead remains bumpy.

In contrast to Southeast Asia's fragmentation, US brands can scale quickly and efficiently, as they cater to a homogenous, large, and high-income market with a unified infrastructure.

As such, D2C companies in Southeast Asia tend to do one of two strategies if they want to succeed:

1. Target affluent markets

This was an approach that Secretlab decided to take. After starting from Singapore, it branched out to Malaysia, Australia, and the US, followed by the UK, Europe, and Canada.

Similarly, furniture seller Castlery expanded to Australia after launching in Singapore.

Two-year-old sunglasses brand Rocket Eyewear is following this blueprint, too.

Created by former Uber staff En Ming Ong, the self-funded and profitable company is avoiding the growth-at-all-cost model of Ong's previous employer. It has no plans to raise money as it expands.

While the firm's largest market is Singapore, it's seeing traction in the US, Australia, and Hong Kong. And although the States might be an ocean away, it has seemingly become more receptive to fashion brands from Singapore.

Photo credit: Rocket Eyewear

Call it the *Crazy Rich Asians* effect – a reference to the rom-com set in the city-state. "Our tourism board is doing a kickass job of portraying Singapore as this aspirational city," says Ong, who started the brand with his sister after their mom lost her favorite shades. He's been upfront about Rocket Eyewear being a Singaporean startup, which might have been unthinkable in the past.

Companies targeting affluent markets have a supply chain that crosses continents. In the case of Rocket Eyewear, the glasses are made in China, shipped to Singapore for packaging and additional checks, and then sent to customers.

The economics work despite the complexity: Because they cater to affluent markets, they can price their products accordingly.

See: Direct-to-consumer sneaker brand scores US$13m in seed funding

Another venture, Sequoia-backed personalized cosmetics brand Yours, is also shaped in the same mold. Its products are made in Switzerland and shipped to Singapore, the US, and Australia.

Its strategy is not just about wallet sizes, though. Consumers in those countries demand ethically made products, which Yours commits to by avoiding animal testing and using environmentally friendly packaging.

Keeping this promise can be trying. "Finding 100% recyclable packaging was way harder than I thought [...] It really delayed my production by two to three months," says the company's CEO and founder Navneet Kaur, another Uber alum.

Despite this, she believes that committing to the company's values can lead to stronger customer loyalty in the long run.

2. Target neighboring countries

The first approach is the safer option in some ways; it's about getting products made affordably, and then sending them to people with a propensity to buy premium items.

Other companies take a more hyperlocal approach.

For example, Fabelio's furniture pieces are made and sold in Indonesia, and it's seen no need to expand beyond the country yet. Fashion brand Sorabel is largely focused on the archipelago, too.

The two companies are riding on a growing base of middle-class consumers, and while Indonesia doesn't quite stack up on a per capita income basis, these startups seem to have a clear path to profitability.

Fabelio has a 37% gross margin, which is in line with other furniture retailers including Ikea. Although it's only raised US$9 million in funding, it's been able to, due to that margin, fund its operations using credit. Regardless, it's set to close a series C round before the end of the year.

Sorabel, meanwhile, is profitable in Indonesia on a contribution basis – in other words, after subtracting variable costs like manufacturing. Overall, the business is still not profitable, as it's investing in entering new markets and expanding into non-fashion categories.

See: Pomelo is solving a problem that's plaguing online shopping

However, there are some players like Pomelo and Love Bonito that don't fit neatly into a bucket. Pomelo claims it's already profitable in its core market of Thailand. Singapore will follow soon, while Indonesia might take longer, the company told *Tech in Asia*.

Love Bonito, on the other hand, has storefronts in markets as diverse as Singapore, Indonesia, Cambodia, Malaysia, and Hong Kong.

It's taking this approach because it aims to offer quality clothing that suits Asian women.

Even as D2C brands in the US speed ahead, they are facing stronger competition. Just like how Disney is looking to upend Netflix, major companies and retailers are starting their own D2C ventures – and succeeding.

A similar fate could befall fledgling D2C firms in Southeast Asia as large corporations get smarter about innovation and major brands such as Nike pull out of marketplaces like Amazon.

In addition, the democratization of ecommerce tools is lowering the barriers to selling products online. D2C companies are not only squeezed by large enterprises but also an army of social media influencers and dropshippers.

See: The untold story behind the GMVs of Southeast Asia's ecommerce titans

It's no secret that acquiring customers through digital channels like Google and Facebook has been getting more expensive in Southeast Asia – a reason why many D2C companies seek retail channels in the first place.

"Creating a me-too brand is very hard in today's world," says Dakshita Gandhi, vice president and head of private label at Zilingo. "Going after something niche but high-growth [...] and then investing in conceptualizing the brand" is the way to go, she adds.


The Zilingo team / Photo credit: Zilingo

Zilingo has been spearheading this democratization. It streamlines the entire fashion supply chain by providing software to clothing and fabric suppliers to help them manage their operations and linking them up with fashion brands seeking reliable manufacturers. Its new private-label business works directly with social media influencers and non-retail brands to churn out their own product lines in a snap.

The company is solving a major bugbear for D2C brands. Alibaba may be great for sourcing manufacturers for low-cost items, but it often receives complaints about low-quality work. On the other hand, premium brands with exacting standards and demanding customers have less margin for error.

That's the case for Rocket Eyewear, which assembles its sunglasses by hand. One screw jammed in at the wrong angle could warp the entire piece.

"I got incredibly fortunate to be able to go straight to the top factories that don't really advertise on Alibaba," says co-founder Ong.

Pre-empting copycats

Perhaps learning from their counterparts in the US, Southeast Asia's D2C companies have wasted no time in deepening their moats.

Love Bonito and Pomelo have built networks of retail stores that serve as fitting rooms and collection points. Because customers can try before they buy, return or refund rates have been reduced, saving the companies money.

They're mastering the complicated dance of managing omnichannel retail – inventory needs to move between locations, and stock availability data needs to be synced across online and offline channels.

A Pomelo pickup location / Photo credit: Pomelo

Love Bonito is also employing data science to boost sales and reduce wastage. While traditional retailers can take weeks to gauge demand for a product and use the data to decide how much inventory to replenish, the fashion brand hopes to size the process down to a couple of days, allowing the company to ride on a hot trend much faster and more accurately.

Some D2C businesses, meanwhile, are diversifying. Fabelio, for instance, is becoming more like a marketplace, onboarding third-party furniture makers and expanding into interior design. Pomelo, too, has been stocking inventory from other brands.

Personalization is also a big strategy. The idea is that customized products become stickier, sort of like how the Facebook News Feed works.

Photo credit: Yours

Yours, for example, gets customers to fill out a questionnaire and upload a selfie to help it come up with a subscription-based skincare regimen.

The product mix changes over time as a customer uploads new selfies at regular intervals. "It automatically updates to changing weather conditions and skin needs," says founder and CEO Kaur. "You may have dark circles six months down the line due to a tough phase or a lack of sleep. But you don't have to worry about it," she explains.

Another startup, Thailand's Vitaboost, is taking a similar approach but with vitamins.

Combining media and ecommerce

The next strategy is also perhaps the most unexploited at the moment: the melding of media and ecommerce.

Strategy consultant Frederic Fernandez writes that when it comes to D2C brands, "organic traffic and engaged consumer communities will prevail."

"A well-known illustration is Glossier," he adds. "It started as a beauty blog, it built its audience, and it now reaps the benefits: stellar growth, great consumer engagement, and, looking at the endless queue to get into its Manhattan store, it has a very likely low customer acquisition cost."

It’s probable that we’ll see some major media properties in the region head down this path.

TheAsianparent, a Singapore-headquartered media network for parents, is looking into creating its own D2C line of baby and maternity products. It’s even started to call itself a healthtech company.

One of its notable backers is Fosun – an investor in Chinese parenting site Babytree – which had its own ecommerce operations (although it’s punted that out to Alibaba instead).

Meanwhile, Sociolla, an Indonesian startup that has grown a sizable community of cosmetics users, has stuck to distributing products from other brands. But given that it’s looking into what’s trending within its community, it could potentially launch its own cosmetics line, though it hasn’t said if it’ll do so.

Photo credit: Sociolla

Moving forward, as Southeast Asia’s online shopping scene matures, more D2C companies will likely emerge and even become globally recognized brands.

Aspiring D2C entrepreneurs, however, should focus on categories that general ecommerce players can’t excel in. They should also consider what the supply chain looks like, says Raditya Pramana, the investment manager at Fabelio backer Venturra Capital.

A locally focused startup like Fabelio, for example, makes a lot of sense because Indonesia already has a strong base of furniture manufacturers. Fashion startups can also thrive for the same reasons.

And yet, Indonesia can't compete in electronics with China, which has spawned consumer tech firms like Xiaomi and DJI.

There's also the issue of furniture ending up in a buyer's home in one piece – or many. Fabelio set up its own delivery network because third-party providers couldn't supply workers that could earn buyers' trust, enter their homes, and assemble furniture.

"You wouldn't buy a cupboard from Tokopedia. They'd need special fulfillment capabilities to make that happen," says Pramana.

Editing by Jaclyn Teng

(And yes, we're serious about ethics and transparency. More information here.)

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