Direct-To-Consumer Companies Spark Strong Investor Interest, But Not All Are Created Equal

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What do Glossier, Everlane, Reformation, Outdoor Voices, MVMT, Away, Casper, Harry’s, Daily Harvest, Rothy’s, Allbirds, Summersalt, and Warby Parker all have in common? They are native DTC (“direct to consumer”) brands that are rapidly growing.

Many of them have also attracted venture capital funding, which represents a sharp departure from the traditional tech and healthcare focuses of the VC class.

VC firms have already pumped an estimated $4 billion into DTC companies, the majority of it within the past two years, and private equity firms are increasingly hungry to join the action as some of these companies grow to $50 million in revenues and beyond.

The Power to Connect Is Key

It’s a sign of how investors are increasingly taking notice of companies that are successfully harnessing the power of the DTC model. These are companies that largely cut out bricks-and-mortar wholesalers, retailers, and other middlemen and go straight to the customer, building buzz around their brand and selling through their own website.

But only the best companies will be able to sustain investor interest by demonstrating they can scale and have the muscle to push their brand to consumers.

Traditional retailers are also scrambling to get on board. WalMart bought DTC clothing firm Bonobos for $310 million in 2017. Unilever snapped up Asian skincare brand Tatcha this year for $500 million. And a specialist hunting apparel brand, First Lite, was recently acquired by outdoors media company MeatEater in a sign of the emerging “content to commerce” business model.

Why the Investment Buzz Is Growing

There are several good reasons for the investment buzz around DTC.

First and foremost, in many retail sectors and geographies, DTC represents the evolution and next generation of retail.

It's no secret online sales continue to grow significantly faster than traditional brick and mortar retail sales. According to the U.S. Department of Commerce, second-quarter 2019 retail e-commerce sales, adjusted for seasonality, were $146.2 billion, representing 10.7% of total retail sales, and an increase year over year of 13.3% (versus an increase of 3.2% year over year for total retail sales).

Second is simple economics. By doing an end-run around retailers and wholesalers, these companies avoid being squeezed by the middlemen on margins and can reduce their costs.

Third is control. Because they are not beholden to big retailers, DTC sellers get to have end-to-end control over their own brand story as well as the making, marketing, and distribution of the product.

The fourth, and perhaps most important element, is the customer relationship. DTC companies live and die by the strength of the bond with their customers. The best ones are able to build a lasting relationship that engenders customer loyalty and repeat purchases.

Customer Data Makes the Model Invaluable

Sell the customer what they want, when they want, and where they want is the mantra — and increasingly the "where" involves online. Interestingly, though, traditional bricks and mortar retail still has its place and high-flying DTC brands Bonobos, Warby Parker, and Ministry of Supply also now have traditional bricks and mortar distribution.

The other immense benefit of this direct relationship is the ability it gives DTC firms to capture all kinds of valuable data about their customers, from basic information like addresses to more sophisticated demographic information and buying patterns.

The more firms know about their customers, the better they're able to capitalize on the relationship and create a virtuous cycle. Happy customers are more likely to recommend the product to friends and family, the best and cheapest form of advertising.

Not Every DTC Model Is Golden

But as excitement builds over the sector and more companies jump into the DTC model, it's also becoming clear that not all DTC firms are created equal. Remember the early days of the internet when any firm with a website was viewed as golden? Investors and companies need to be wary of falling into the same trap by thinking that just having a DTC strategy is enough to ensure success.

There are already signs of a bifurcation, with a handful of the most attractive DTC firms becoming big objects of desire among investors.

The investment community (post-early-stage VC) needs to know that DTC companies are building something of value and that they have an ability to scale. In a nutshell, companies that can demonstrate strong repeat purchase behavior, on a cohort-by-cohort basis, are highly prized and highly valued.

In addition to top-line growth, investors focus intensely on a brand's market and market size, and notably, key performance indicators and statistics such as CAC (customer acquisition cost) and LTV (lifetime value) of a customer.

Those that do get this right will continue to prove exceedingly attractive to investors.

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