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E-Commerce Companies Bypass the Middlemen

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When the founders of a start-up that sells eyeglasses online, Warby Parker, began investigating why designer glasses cost several hundred dollars, they discovered that everyone in the process was taking a cut: designers, manufacturers, brands, wholesalers and retailers.

But what if they left out most of those people? “I had been to the factories and knew what it costs to manufacture glasses and knew the cost didn’t warrant a $700 price tag,” said Neil Blumenthal, a founder of the company. Inspired by glasses they found in their grandparents’ attics, the founders sketched a few frames, hired the same Chinese factories that make designer glasses and started selling directly to consumers online. By doing so, they eliminated enough of the cost to charge customers just $95 a pair.

Warby Parker is part of a wave of e-commerce companies that are trying to build premium brands at discount prices by cutting out middlemen and going straight to manufacturers. They make everything from bedding (Crane and Canopy), to office supplies (Poppin), nail polish (Julep), tech accessories (Monoprice), men’s shoes (Beckett Simonon) and shaving supplies (Harry’s).

The result is generally cheaper products for consumers and higher profit margins for the companies.

Big retailers discovered long ago that controlling the supply chain benefited their bottom lines, which is why companies like Wal-Mart and Whole Foods sell many products under their own brands. At Macy’s and Kohl’s, such “private label” brands make up almost half of their sales.

Start-ups have traditionally struggled to match those efforts. They do not have as much brand recognition as big retailers, and persuading consumers to take a chance on, say, Warby Parker eyeglasses instead of Prada’s can be difficult.

“The challenge is, if you’ve never heard of the brand, you wonder, ‘Should I buy it when it’s 20 percent cheaper?’ ” said Raj Kumar, a supply chain consultant at A. T. Kearney. “Or should I buy a brand I trust?”

What is empowering the upstarts now is the Web's ability to reach lots of consumers without the costs of operating physical stores as well as a change in manufacturers' willingness to work with small brands.

The founders of Deal Décor, whose model was to sell furniture directly to customers, worked at Target and Home Depot Direct before starting their company. They said they saw an opening after the recession hit.

As home sales in the United States declined, and furniture sales went with them, Chinese furniture factories had excess capacity, said Craig Sakuma, co-founder of the company. Where the factories had previously been unwilling to take small production orders, they were now eager for business — but they were concerned about getting paid, as they were already chasing down payments from errant retailers.

So Deal Décor approached manufacturers with an appealing proposal: it would pay them as the products were shipped, rather than a month or more later.

Unlike traditional furniture retailers, Deal Décor's model was to sell couches or bookshelves on its Web site before they were in production. It timed the deals for when a factory was producing similar items for other clients and could easily add Deal Décor's order. Deal Décor ordered the exact quantity it had sold and had the items shipped straight from the factory to customers eight to 16 weeks later.

Because they are not dependent on third parties, these e-commerce companies can also introduce products much more quickly.

Crane and Canopy, for example, releases new duvet covers and sheet sets every other week and designs textiles based on current trends on Pinterest and elsewhere, instead of planning collections seasons ahead of time like most brands, said Karin Shieh, its co-founder.

"We want consumers to get those products immediately, so we connect our customers directly with the factories that are currently making bedding for Bloomingdale's, Neiman Marcus and high-end brands," Ms. Shieh said.

But Crane and Canopy sells the bedding without all the extra costs. A queen-size white pintuck duvet cover on its site, for instance, is $119, while a similar one by DKNY is $400 at Bloomingdale's.

These direct-to-consumer companies are raising large sums from investors, who see great potential in the idea. In February, Julep raised $10.3 million from Andreessen Horowitz and Maveron.

This year, Warby Parker raised $42 million from investors including American Express and the chief executive of J. Crew. The company declined to disclose its valuation, but said investors value it as a lifestyle company, which is worth more than a typical e-commerce company.

In some cases, the online brands are choosing not to discount, keeping the extra profits from cutting out the middlemen for themselves. At Poppin, an office supply company, the staplers are $14, while staplers from other sites can be bought for as little as $3 (though they do not come in lime green and hot pink like Poppin's).

People are willing to pay more for a unique product, said Randy Nicolau, Poppin's chief executive. The company's gross margins are more than double the typical margins in the industry, he said.

"You can buy the same Swingline stapler at OfficeMax, Office Depot, Walmart and Amazon," he said. "The only way these folks can differentiate is on price, so they're just beating themselves up on margins."

The start-ups also use their manufacturers as research and development centers, getting tips on what bigger brands are doing.

Julep, for instance, made lengthening mascara in part using techniques that the factories had developed with bigger brands that had not yet brought their products to market. Last year, it introduced 180 shades of nail polish in response to trends like the colors that models wore on the runway.

Jane Park, Julep's founder and chief executive, said manufacturers were eager to help because small e-commerce companies brought many more new products to market than big brands did since they were not hampered by shelf space and a complex supply chain. Mr. Sakuma of Deal Décor said the manufacturers "have incredible amounts of intelligence on what's being sold and what's popular."

Still, managing a product's entire supply chain has challenges. One, said Mr. Kumar, the supply chain analyst, is controlling quality at factories abroad. Another is avoiding design patent conflicts when working with factories that also work with big brands (though Mr. Sakuma said making minor changes to designs, like a different leg on a sofa, was enough to avoid conflicts).

Deal Décor learned this firsthand recently. After 10 months in business, it was on track to have $2 million in revenue this year, and its margins were 20 to 30 percent, said Gregory Lok, a co-founder. However, marketing costs to attract customers to an unknown brand were too expensive. Deal Décor is shutting down operations, and Mr. Lok is working on a new business.

“Going to factories in China is the easiest part of the process,” Mr. Blumenthal of Warby Parker said. “The hardest part is building a brand that stands for something and will resonate with customers.”

To do that, Warby Parker’s founders gave article ideas about the company to fashion magazines instead of tech blogs or optical trade magazines, he said. They spent months arguing over details like whether they would describe the glasses as “collegiate” or “preppy.” (“Collegiate” won, Mr. Blumenthal said, because it implies worldliness, while “preppy” signals a specific socioeconomic class.)

Even though selling online, and avoiding the costs of bricks-and-mortar stores, is one of the central tenets of e-commerce strategy, Warby Parker has found that many potential customers want to touch and hold its products. The company, based in New York, has contracted with boutiques in several major cities to display sample glasses, and it is also opening a stand-alone showroom in Manhattan this spring.

Similarly, Julep sells nail polish in Sephora and QVC to try to build brand recognition.

“It adds gravitas,” Mr. Blumenthal said.