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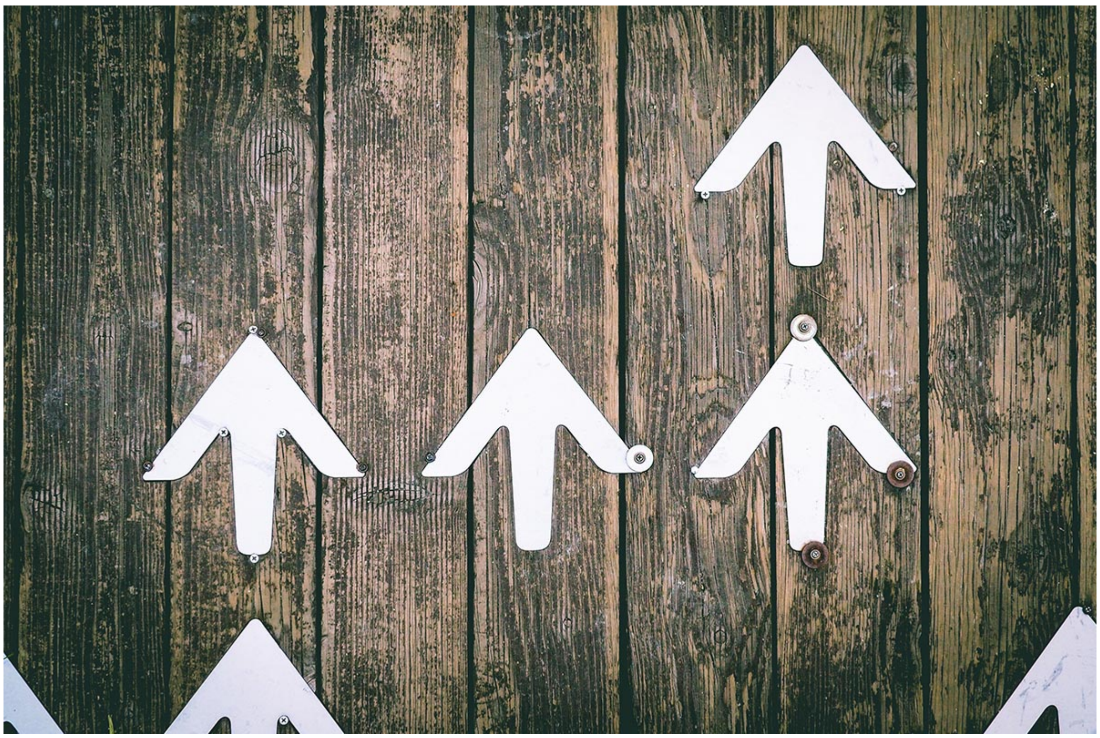
STRATEGY

Strategy in Niche Markets

by Ram Shivakumar



Successful entrepreneurs advocate establishing a tightly-focused niche for dedicated customers.

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Niche markets are everywhere. In strip malls (ethnic grocery stores, alternative medicine, mixed martial arts, etc.). In supermarkets (nutritional bars and drinks, gluten-free foods, sustainable beauty products, etc.). And on digital media (Israeli television shows, K-pop music, true crime podcasts, etc.).

Niche markets are distinct from mass-markets in two important ways. First, niche markets are, by definition, focused and serve consumers with specialized preferences. Some niche markets introduce new categories of products & services while others offer distinct versions of existing products & services. Second, sales volumes in niche markets tend to be small, at least initially. While some niche markets expand rapidly, most struggle to grow. In this column, I examine 6 strategy questions that niche market players must answer.

1. Which niche market?

Consider 10 brands (categories & companies). Chopard Janus Watch (watches by Chopard), Multi-Collagen Protein (supplements by Ancient Nutrition), Oud Wood Eau de Parfum (cologne by Tom Ford), 365 everyday value (food products at Whole Foods), Warby Parker (prescription glasses and sunglasses by Warby Parker), Kendra Scott (jewelry & home décor by Kendra Scott) Shree Restaurant (vegetarian Indian cuisine in Chicago), Teremana Tequila (small batch Tequila), Gracie Barra (Brazilian jiu-jitsu), and Vox Media (explanatory journalism).

It is evident that niche markets and their players are distinct on many dimensions. Some engage in social signaling (Chopard Janus Watch, Oud Wood). Some promise affordable luxury (Warby Parker, 365 everyday value). Some are part of an emerging lifestyle (Ancient Nutrition). And some are personal guru brands (Kendra Scott, Gracie Barra, Teremana Tequila) backed by recognized experts & celebrities. Some are global players (Chopard, Tom Ford). And some are local (Shree Restaurant). Some are digital-only businesses (Vox Media). And some are franchises (Gracie Barra).

The search for a profitable niche market begins with the search for less-than-satisfied customers-those whose needs are not being met by existing offerings. In their book, *Positioning: The Battle for Your Mind*, Al Ries and Jack Trout argue that understanding the customer is the first-step in the battle to create a position in the customer's mind: "…you have to get off your pedestal and put your ear to the ground. You have to get on the same wavelength as the prospect."

If listening is hard, making sense of what one hears may be even harder. As Clayton Christensen notes, “passive data does not broadcast itself loudly, you have to seek it out, put clues together.” Choosing a niche is one of the more consequential decisions that the entrepreneur will make for it commits the firm to a whole other set of decisions (raising capital, people and competences, partnerships, etc.) that entail money, time and effort.

Many successful entrepreneurs advocate starting with a tightly focused niche. Mark Zuckerberg started facebook with a focus on university students. And Reed Hastings at Netflix focused on the US market for digital streaming.

2. Why you?

Stakeholders - customers, employees, shareholders, suppliers and others - want to see evidence that you have the vision and the competency to offer meaningful solutions to problems. Stakeholders want to associate with companies that have a compelling purpose - one that is authentic, personal and emotional.

Impossible Foods (plant-based meat) and Pukka Herbs (organic herbal teas) are 2 examples of companies that passed the litmus test of, “why you?”

The mission of Impossible Foods is to create plant-based meat with the taste, feel and nutritional quality of animal products without the environmental consequences. Patrick Brown, the founder and CEO of Impossible Foods, equates the company’s mission with saving the earth. It helped that Brown was a highly accomplished professor of bio-chemistry at Stanford University and that he had assembled a diverse team of experts. 9 years (after its establishment in 2011) and $1.3 billion in capital funding later, Impossible Foods’ plant-based burgers have gotten millions of US consumers hooked.

Pukka Herbs struck a chord with consumers and investors because its mission to nurture people, plants and the planet has been lent credibility by the company’s deep links to the people who grow, harvest, source and manufacture teas.

For every Impossible Foods and Pukka Herbs, there are hundreds of firms that never get off the ground. The reasons for their failures are myriad. Some fail because their solutions are not perceived as relevant. Some fail because they don't have the required competences. Many fail because they cannot make a compelling case for why they should exist.

3. What is the customer value proposition?

What do prospective customers value and why will they buy (and not buy) your product? Theory cannot provide conclusive answers to these questions. The answers must be discovered by experience, experimentation and evidence.

Economics tells us that price is an important consideration. But it also tells us that it isn't the only consideration. Many other variables influence the customer's perception of value.

Buyers of emerging lifestyle brands care about efficacy. For instance, prospective buyers of Multi-Collagen Protein (Ancient Nutrition) care about the efficacy of the product for health and beauty. And prospective users of Vox Media care about the quality of its analyses of scientific, business and public policy issues.

Of course, buyers of the Chopard Janus watch care about its features (a perpetual calendar, astronomical reading and a tourbillon) and its investment value. And buyers of the Oud Wood Eau de Parfum care about its unique fragrance. But what these buyers particularly care about is signaling to others that they have means and social status. And affordable luxury brands emphasize both quality and value. For instance, the 365 everyday value Brand (at Whole Foods) emphasizes health and good taste at a discount to the independent brands that are also on sale at Whole Foods.

One cannot emphasize enough the importance of brand image in influencing the customer value proposition. Many niche brands become successful because of the people behind the brands. For instance, Teremana Tequila is co-owned and promoted by Dwayne "Rock" Johnson, one of the world's highest grossing actors. And Kendra Scott, the woman behind the brand Kendra Scott Inc., has a hard earned reputation as a purveyor of affordable luxury. Niche market players must know that the customer value proposition (for niche market products) is often in a state of flux. Dramatic shifts in perceived value and, as a consequence, purchase decisions, may occur without discernible changes in the player's actions. So considerable effort is required to continually engage with customers and to communicate the product's source of value.

4. Which channels?

How do you reach the customer? How does the consumer find you?

Warby Parker broke through using a direct-to-consumer (DTC model). But the DTC model did not work for Cocodune and for numerous others.

Warby Parker recognized that the prices of eye glasses in America were high because a single company, Luxottica, controlled the dominant brands and sales channels for eye glasses. By vertically integrating and selling DTC, Warby-Parker reasoned that it could dramatically reduce prices without compromising on product quality or the shopping experience. Its hypothesis was proven right.

But the DTC model did not work for Cocodune (which sold swimwear to men and women) because shipping costs, returns and cleaning costs were too high.

GT Living Foods, Vifuur and Hearth & Hand are 3 examples of companies that have thrived using a channel sales model. GT Living Foods, introduced Kombucha, a Probiotic drink, to the US market in the early 1990s when the internet was still in its infancy and most US consumers were not familiar with probiotics. Its channel partnerships with Erehwon Natural Foods and Whole Foods were critical in introducing the Kombucha to early adopters.

The DTC and channel sales models come with pros and cons. On the positive side of the ledger, the DTC model enables firms to (in theory) have control over customer relationships. On the negative side of the ledger, the DTC model is costly because the firm must make upfront investments in an e-commerce team and/or a retail store, a supply chain and fulfillment team, etc. The early D2C brands that thrived (such as Warby Parker) were the ones that were able to acquire customers at relatively low cost on social media.

The benefit of the channel sales model is that it makes it possible for a firm to be up and running fast without having to make upfront investments. Google's growth can be attributed, in part, to the traction it received from its channel partnerships with AOL and Yahoo.

But most channel relationships end in disappointment and/or failure. They fail because the vendor and the channel partner are not in alignment on missions, priorities & constraints, and the value creation & value sharing objectives of each player.

5. Should you develop your own brand or should you operate as a private-label?

The tradeoffs are clear. A powerful brand is a game changer. But developing a brand is costly and time-consuming. For every Warby Parker, Dollar Shave Club or Casper Sleep, there are hundreds of niche players whose investments in brand building yield meager returns.

Most niche brands depend on channel partners for customer adoption and growth. Elite retailers and resellers will consider a relationship with a brand only if it has some name recognition. And even then, the terms of the relationship will be determined on their terms. Slotting fees, product placement and promotion are likely determined by channel partners. And whether retailers continue to engage with the brand will depend on whether products are flying off the shelf.

A private label model offers many advantages when the partner is the right one. That is, when the partner has a direct relationship with influential consumers and leaves the vendor with a reasonable chance of developing its own brand at a later date.

6. How to grow the niche?

This is the question that has sustained the multi-billion industry of management consultants, brand advisors, market researchers and others.

Anecdotal and empirical evidence show that growing the customer base, rather than increasing sales to existing customers, is vital in niche markets. In many cases, the new customers are current customers of mass-market products.

Some niche markets overlap with other niche markets so there is the potential to draw in users from neighboring niches. And some niche markets are distant from other niche markets which implies that players must put all their efforts into retaining every customer.

A player must establish itself in a core niche market before it tries to add other niche markets. Kendra Scott built a strong base by designing (and selling) jewelry to women belonging to sororities and fan groups before moving on to the general population of women looking for affordable luxury.

The hooks that are used to draw in new customers vary. Sometimes, it is the intangible, such as the power of the brand (and the people behind it), the community of buyers/users, etc. And sometimes it is the tangibles, such as the price, the physical attributes of the product, service, etc.

Tom Ford Inc., the luxury designer of clothing, accessories, fragrances and cosmetics for men and women, is the only American brand to rival the super-luxury French and Italian brands- LVMH, Prada and Kering. Tom Ford Inc.'s growth is tied to Tom Ford. Over a 3 decade career at Gucci and YSL, Tom Ford has developed a cult-like following for his commitment to high fashion, luxury and beauty. Today, Tom Ford Inc. has over $2b in annual revenue, an impressive feat for a company that is 14 years old.

Ducati, the Italian motorcycle company, has grown its user base by emphasizing the company's heritage, its commitment to racing and quality, and the strength of the Ducati user community. And David's Tea, the Canadian specialty tea and tea accessories retailer, has grown its business by opening small stores in prominent locations in major cities in North America and by distributing samples of its teas.

Takeaways

1. Don't define your niche too narrowly. Or too broadly. But know that it is difficult to build a viable business when the total addressable market is small.
2. Your purpose & competency must align with the opportunity.
3. Brand image and personal branding are central to winning customers in niche markets.
4. Your channel partners are your frenemies.
5. Think of private labels as a short-term financing opportunity while you figure out how to directly engage with customers.
6. Look for secondary niches that overlap with your primary niche.

▶ References

Ram Shivakumar Follow

Ram Shivakumar writes articles and columns on innovation and growth strategy and teaches courses on Economics & Strategy at the Booth School of Business at the University of Chicago.