Craft shows no sign of slowing

US craft spirits have come of age – but can they seize the moment? Alexander Smith discusses the state of the market with Park Street CEO and founder Harry Kohlmann


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Miami-based Park Street is one of a number of logistics providers that have emerged in the US market to cater to the proliferating number of craft spirits producers. The company is credited with fostering a large number of successful craft brands, including Atlantico rum, Aviation gin and Chicken Cock whiskey. CEO Harry Kohlmann set up the company with Chris Mehringer, who serves as its president, in 2003.

Are you still seeing dynamic growth overall and and how is it evolving? It is growing very rapidly. You have to always differentiate the number of suppliers and the volume of the suppliers. The average volume of suppliers has been going down for a while, because there are a number of suppliers entering and not everybody is growing that rapidly. Some, the more established ones, have seen a lot of volume growth and that can be partially due to taking a brand to other states, or taking a brand to global markets. The geographic expansion beyond the home market is one part of the growth story. The bigger part is actually happening at the location, or at the facility, where the product is made, and in the surroundings. I don't think you can foresee that growth ending anytime soon. I would think that we're probably in the first or second inning of that trend.

The growth of craft is obviously underpinned by consumer trends. What are these consumer shifts? An increasing number of consumers are moving away from having one single go-to brand to having a repertoire of brands. Some of the younger consumers are moving even beyond having a set repertoire to a constant exploration of new brands. This trend is slowing down the growth of some of the larger brands and is leading to an increasing level of market fragmentation. Millennials are generally more receptive to new brands and new ideas. They position themselves by what they drink and the exploration is an element of individualism. The badge value of a brand is important as they are trying to message other people in a bar or social setting. An increasing number of younger consumers avoid big brands because it sends the message that they are a 'me too' guy or 'me too' girl. This younger generation feels that they don't have to be like everyone else and they want to find their own thing. Some of these craft brands can also eventually become victims of their own success. As they become bigger and join the mainstream they are then abandoned by Millennials who are on to the next discovery brand. Many of these consumers are also sceptical about mass marketing in general.

It is tough to generalise, but ooking at the supplier side why are new entrants getting into craft? Are they long-term brand builders or speculators? Consider that we have almost 1,600 active craft distillers in the US. You will find within that pool all different types. I've met people that are former professionals – investment bankers, lawyers – that wanted to have a change of pace in their lives and wanted to create something that was real, tangible, that they have a passion for, and they don't think about selling out – they want to create a local business that might have the potential to be a global brand, but the primary focus is a local business, create local jobs and possibly have an affiliated restaurant or bar. For these guys the branded business is secondary. On the flipside, you have players that come in and just look at it from a branded business side. They might have created their craft distillery as an afterthought, because they want to create or evolve a brand, and they were mostly attracted to the business because of attractive valuations, and are trying to build the brand to flip it. And then you have everything in between. There's a bunch of craft companies that are run by investor groups and somebody in the group might be more of this local orientation, and some might be on 'let's develop a global brand' side of the spectrum. You will find a lot of guys now that are pivoting, where they might think we might have initially raised the money to be global brand builders and they've realised they've built a local business and find themselves more preoccupied with making the facility nice, making it a visitor centre, adding the restaurant or the bar operation. Stuff like that.

Craft spirits attract a lot of creative and very driven entrepreneurs. They come in and feel that this is an industry that has attractive margins and is undergoing a fundamental shift right now that provides openings all over the place. We see clients coming in now that have a business pedigree that we would never, or rarely, have seen 20 years ago. There are also a lot more of them.

So you are seeing no slowdown in terms of the rate of new entrants? There is no slowdown in absolute numbers yet. At some point it might happen because there might be an over-saturation, but so far, the numbers don't show it.

You are working with a lot of start-ups. What are some of the calculations that new entrants are making when deciding which spirits categories to participate in?
There's obviously a natural progression if you look at the path of many start-ups. An individual player who wants to be in the Bourbon or whiskey business initially faces a choice: buy a product from [a contract distiller] like MGP or struggle to sustain themselves. If they avoid buying third-party base product, they are looking at up to four years with no cash and just putting product down. They may not have shareholders that are supportive of that. The middle way is to start off with products that don't require ageing. You typically see that these players will initially do a vodka, gin or an apple brandy as a bridge product while the whiskey ages. That is part of the reason why you are seeing so many great gins coming out. From an overall business or industry perspective, a lot of players are in very different stages in their lifecycle. The players that started maybe five or six years ago now have whiskey coming in. They might not have put that much down and consequently might just be selling it on location right now, but they are shifting their focus to whiskey, because that is where the big demand is.

The barrier to entry has come down as well, both with digital marketing, contract distilling and third-party logistics providers such as yourself... That's right, the barriers to entry, in general, have been lowered everywhere: production, back office and marketing. When you look into the democratisation of production, it has been a sea change. It used to be really complicated to produce spirits. You had to have a big facility and economies of scale. That has changed now. Many [contract] producers offer entrepreneurs the opportunity to produce private-label spirits for them. This helps the producer to increase utilisation and the entrepreneur benefits from a much faster and less capital intensive production option. Similarly, the availability of a compliant back-office platform like Park Street's has increased the speed to market and lowered the operating costs. In terms of media, you don't need to take full-page spreads in *Sports Illustrated* anymore. With the fragmentation of media you can actually do targeted campaigns for a fraction of the cost and by doing this, avoid wasting marketing dollars in areas without distribution. So overall, the total costs and with it the barriers to enter have been going down. As a consequence you've got more players entering.

Do you have any sense of how many of these craft brands or companies are actually sourcing it from contract distillers, like MPG? How common is that? Funny enough, you could say that MGP is one of the biggest craft producers in America, because it supplies a lot of the base spirit for so many craft guys. It is like great art. You wouldn't go to Picasso and ask him if he made his own canvas. What mattered is what Picasso did with that canvas. So if you look at craft distillers, there's a lot of craftsmanship that goes into the final stages, but they might not create the base spirit. Some of the MGP base spirit is fantastic or – to stay in the art analogy, a great canvas – but it is the final touch by the craft producers that creates the piece of art. I don't think that the consumer necessarily will push back, as long as people are honest about what they are doing. If craft producers aren't honest about it, it could create a backlash.

The spirits multinationals are getting involved in craft, either acquiring producers or launching craft-style products. What does it mean from a consumer perception standpoint? Could it muddy the waters?
A lot of brands that are owned by large players that have craft credentials are being consumed as craft products. Also keep in mind that once smaller players get much bigger, they will leave that universe of the craft players. I don't know if a large player buying a craft player is necessarily leading to consumer confusion. The confusion comes in when there are many industrially produced brands that start using craft credentials and try to reengineer themselves into craft – even though they might have been around for 100 years and might be 10m cases. There might be consumer backlash at some point. Consumers are using readily available information on their phones to see if a brand is truly authentic. That eliminates some of the confusion. Once the word 'craft' is considered over-used by the consumer, the word 'authentic' might become the relevant differentiator.

The amount of new product ideas is infinite, but the amount of retail shelf or back bar shelf is finite. Are we due a shake-out? That is correct. Not every brand can be represented in every bar and every retail outlet. Some will just be big locally and won't be available anywhere else, or maybe only through some specialty outlets, some kind of internet retailers that will make the product available in other regions. There will be a market for these guys. At the same time there will be a shake-out, because some investors entered the business thinking that their brand could become the next billion-dollar brand and it is now dawning on them that it isn't going to happen overnight. They could pull their investment and these brands will fall out. If you take the baseball analogy, the business might move away from a home run-only business to one that is more like hitting singles, doubles, triples and occasionally a home run. ■