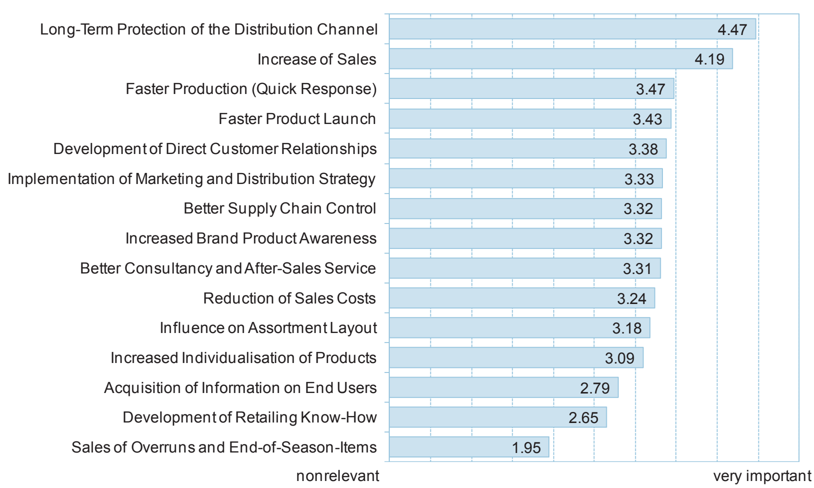
5 New Competitors - Vertical Strategies of Manufacturers

The objectives of this Chapter are to describe the role of controlled and secured distribution systems within the channel strategies of manufacturers and to examine the impact on retail competition. Specifically, suppliers are becoming competitors for their customers and this will lead to a new form of channel conflicts.

5.1 Channel Innovations as Driving Forces of Competition in Retailing

The retail industry is changing rapidly. Some of the most important changes involve the growing diversity of retail formats, including non-store retail formats, as discussed in Chapters 2, 3 and 4, and the new vertical marketing systems or new distribution arrangements of many manufacturers and verticals/vertical retailers (see Chapter 6).

Figure 5.1 Motives/Objectives of Verticalisation



Source: Zentes/Neidhart/Scheer 2006, p. 12.

New players in the world of retailing are, to an increasing extent, manufacturers operating in **secured distribution systems** (fully integrated systems) or **controlled distribution sys-**

J. Zentes et al., *Strategic Retail Management*, DOI 10.1007/978-3-8349-6740-4_6,

tems (contractually-based systems). In both types of vertical marketing systems, the manufacturer can exercise power in the distribution channel (Zentes/Neidhart/Scheer 2006). **Figure 5.1** illustrates the motives or goals of manufacturers implementing vertical marketing systems. The various distribution arrangements with differing degrees of **channel control** are described in this Chapter.

In addition to this **verticalisation** tendency of manufacturers that have operated traditionally with independent wholesalers and/or retailers in **independent systems**, other approaches can be identified. **Verticals** are firms that perform all production and distribution functions right from their founding ("born verticals"). To exploit the competitive advantages of verticals, traditional retailers are modifying their **value chain architectures** by upstream verticalisation (**vertical retailers**). These facets of modern retailing are discussed in Chapter 6.

5.2 Secured Distribution Systems

5.2.1 Overview

In secured distribution systems (fully integrated systems), a manufacturer performs all distribution functions. In addition to traditional direct selling, new kinds of secured distribution systems are emerging, including electronic selling and equity stores.

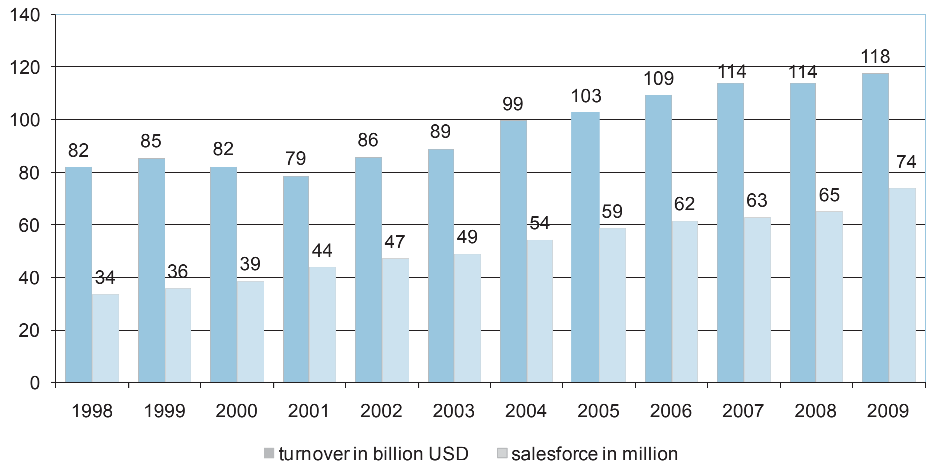
5.2.2 Direct Selling

Direct selling is a traditional vertical marketing system "in which salespeople, frequently independent businesspeople, contact customers directly in a convenient location, either at the customer's home or at work; demonstrate merchandise benefits and/or explain a service; take an order; and deliver the merchandise or perform the service" (Levy/Weitz 2009, p. 57).

In such a fully integrated system a firm "emphasizes convenient shopping and a personal touch, and detailed demonstrations can be made. […] direct selling has lower overhead costs because stores and fixtures are not necessary" (Berman/Evans 2010, p. 158). Direct selling is employed by manufacturers such as *Avon*, *Tupperware* and *Amway*.

Figure 5.2 illustrates the development of the economic importance of direct selling in terms of turnover and sales force. Overall, the worldwide total turnover generated by direct selling has grown by roughly 40 % in the past decade and the total sales force is growing constantly. **Table 5.1** shows the importance of the sales force in direct selling systems of leading manufacturers in this field.

Figure 5.2 Development of Direct Selling (worldwide)



Source: World Federation of Direct Selling Associations 2011.

Table 5.1 Sales Force of Leading Direct Selling Firms

Company	Country (HQ)	Sales People/Partners
Avon Products	USA	6.2 million
Amway	USA	3.0 million
Vorwerk	GER	0.5 million
Mary Kay	USA	2.0 million
Tupperware	USA	2.4 million

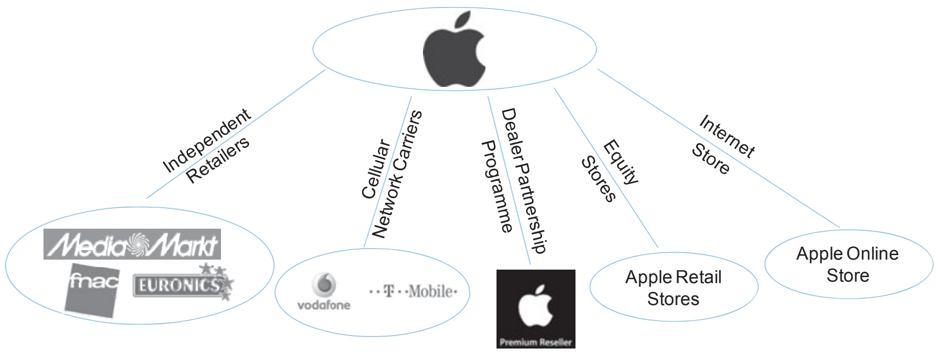
Source: Direct Selling News 2010.

5.2.3 Electronic Selling

Electronic selling (through the Internet (e-commerce or m-commerce) or TV shopping) is a technological variant of direct selling. Manufacturers communicate with customers and offer products and services for sale over the Internet or television, for example. The rapid diffusion of Internet access and usage has stimulated not only **bricks-and-mortar retailers** to create Internet shops, but also pure electronic retailers (**pure players**) such as *Amazon*.

Manufacturers have also discovered this distribution channel within the framework of a **multichannel approach** such as *Apple* (see **Figure 5.3**) or as pure players.

Figure 5.3 Multichannel Distribution – Apple



To a growing extent, manufacturers from all industries are "discovering" this form of secured distribution by online selling. A recent example is *Procter & Gamble*, selling its products, e.g. cosmetics, hair care, shaving and home care products on their Internet store (see **Figure 5.4**).

Figure 5.4 Internet Selling Portal of Procter & Gamble

Source: Procter & Gamble 2011c.

5.2.4 Equity Stores

Equity stores are a bricks-and-mortar approach of secured distribution. The manufacturers operate store retail formats. The major types are concept stores, flagship stores and factory outlets (see **Figure 5.5**).

Manufacturers, especially in the apparel industry, shoe industry, jewellery industry, sports equipment industry, and home equipment industry often operate **monobrand concept stores**. These stores, located usually in traditional shopping streets and shopping centres or malls, can be classified as **monobrand specialty stores** (see Chapter 3), offering the total assortment of a manufacturer by an instore marketing which communicates the "fascination" of the brand. Under the ownership of the manufacturer multiple store units are managed as a **retail chain**. The manufacturers exert strong control, decision-making is centralised, including **price fixing**.

Manufacturers from all industries are "discovering" equity stores. For example, the Swiss company *Nestlé* actually operates about 200 *Nespresso* shops in key cities around the world. These combined retail outlets/coffee shops are exclusively managed as equity stores and they generate approximately 30 % of the company's sales.

In **flagship stores,** manufacturers offer their total production programmes using high quality presentation (lifestyle presentation) in top locations of large metropolitan markets, e.g. *Gucci*, *Nike* and *Apple*. Kozinets et al. (2002) identified three characteristics of flagship stores:

- They carry only a single brand of product;
- they are company-owned; and
- they operate with the intention of building brand image rather than solely generating profit for the company.

Factory outlets, operated as isolated stores (freestanding retail outlets) or integrated in **factory outlet centres** (FOC), are viewed by manufacturers "as an opportunity to improve their revenues from irregulars, production overruns, and merchandise returned by retailers. Outlet stores also allow manufacturers some control over where their branded merchandise may be sold at discount prices" (Levy/Weitz 2009, p. 54).

As an example of a multichannel distribution system, *Nike* sells its products through different types of channels: independent retailers or retail chains such as *SportScheck* in Germany, *Foot Locker* in the United States, Canada and United Kingdom or *Finish Line* in the United States; flagship stores, as in New York, Miami, San Francisco, London and Berlin; factory outlets, for example in factory outlet centres in Zweibrücken, Herzogenaurach, Metzingen (Germany), Oregon (USA), Queensland (Australia) and Alicante (Spain); and an online shop.

Figure 5.5 Equity Stores of GUCCI

GUCCI Store Hamburg

GUCCI Flagship Store New York

GUCCI Factory Outlet
Leccio-Regello/Florence

5.3 Controlled Distribution Systems

5.3.1 Overview

The structure of controlled distribution systems is extremely diverse and varies from industry to industry. In general, these so-called contractual concepts can be broken down into **contractual dealer systems**, **franchise systems** and **commercial agent/commission agent systems**.

5.3.2 Contractual Dealer Systems

Contractual dealer systems or **dealer partnership programmes** are (long-term) partnership contracts in which the manufacturer offers a limited support package, including, for example, marketing, advertising, training and IT to participating dealers. "In most of the programmes the dealer also benefits from a common branding. In return, the dealer predominantly markets the brands of the manufacturer. The concepts are often viewed as customer loyalty programmes for independent dealers through which the company can rapidly increase its retail presence" (Uellendahl 2002, p. 208).

There are dealer partnership programmes, for example, in the apparel industry as **shop-in-shop concepts** and **corner concepts** (Zentes/Neidhart/Scheer 2006), or in the tyre business (replacement business) as dealer partner concepts. As an example, the *Goodyear Dunlop Company* runs outlets in Germany through the retail concepts *HMI* and *HMI plus*, in the United Kingdom by *Hi-Q* and in France by *Vulco*. Contractual dealer systems in the fashion or apparel industry include support towards instore marketing, assortment or category/merchandising management as well as supply chain management, as discussed in Chapters 16 and 17, e.g. vendor-managed inventory (VMI).

5.3.3 Franchising

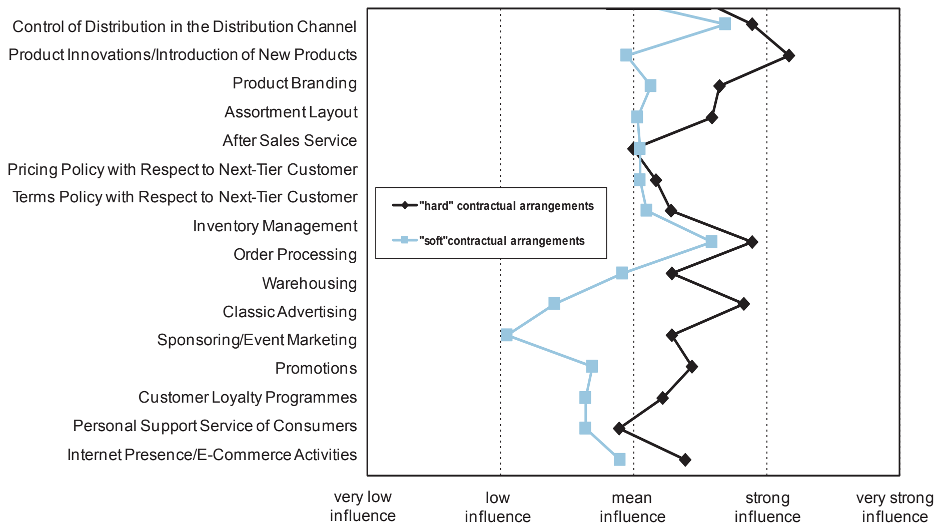
Franchising (see also Chapter 7) involves a contractual arrangement between a franchisor (e.g. a manufacturer) and a (retail) franchisee, "which allows the franchisee to conduct business under an established name and according to a given pattern of business" (Berman/Evans 2010, p. 108). Linked by a common business interest, each partner makes his or her contribution to the cooperation. Thus, both partners (franchisor and franchisee) benefit from the strength of the other. Uellendahl (2002, p. 208) described the structure of the *Goodyear Dunlop* franchise systems ("*Premio*" and "*Quick*") operating in the German tyre replacement market:

- The franchisor contributes the complete business know-how and organisation (e.g. full support package including marketing, sales promotion, training, IT, autoservice, CRM, national advertising, business counselling, business planning, common branding, financial support, etc.).
- The franchisee contributes his individual effort as an independent businessperson in the local market.

As controlled distribution systems, franchise systems are operated in many industries, for example by car manufacturers (auto/truck dealers), by auto accessory manufacturers (auto accessories stores), by consumer electronics manufacturers (consumer electronics stores), hardware manufacturers (hardware stores) and by apparel manufacturers (specialty stores). Examples in the apparel industry are *Palmers*, *Rodier*, *Benetton*, *Boss* and *Marc O'Polo*.

Figure 5.6 illustrates the differences in the influence of manufacturers on distribution channels in "hard" contractual arrangements (e.g. franchising) and "soft" contractual arrangements (e.g. contractual dealer systems).

Figure 5.6 Influences of Manufacturers on Distribution Channels in Hard and Soft Contractual Arrangements



Source: Zentes/Swoboda/Morschett 2005, p. 683.

5.3.4 Commercial Agent/Commission Agent Systems

A third category of contractual arrangements is commercial agent systems and commission agent systems. A retailer operating as a **commercial agent** or a **commercial representative** "is constantly entrusted with the task of arranging transaction on behalf of another business person (i.e. the manufacturer) or concluding such transactions in their name. The arrangement of transactions in the name of a third party distinguishes the commercial representatives from a **merchant** who concludes transactions in his own name for his own account" (Committee for Definitions of Terms in Trade and Distribution 2009, p. 23).

In commercial agent systems, manufacturers are allowed to control the retail prices of their goods and services. In the other forms of controlled distribution, e.g. contractual dealer systems or franchise systems, **vertical price fixing** is not allowed (in the European Union). Besides equity stores, such an agent system is the best way to fix consumer prices.[1]

[1] Another possibility is consignment selling, whereby the manufacturer owns the items until they are sold by the retailer. This contractual arrangement can be combined with controlled distribution systems. Empirically, this combination is rare because of legal restrictions (in the EU).

A **commission agent** is a commercial operator who undertakes the sale of goods in his or her own name for the account of the principal. The commission agent bears the risks resulting from the commission contract with the customer (Committee for Definitions of Terms in Trade and Distribution 2009, p. 23).

Commercial agent and commission agent systems are well-known in the oil distribution business as well as in food and non-food retailing. Global oil companies such as *BP*, *Esso* and *Shell* operate with networks of equity stations and petrol stations operated by self-employed commercial agents. Another example is the German company *Tchibo* that operates equity stores and cooperates with retailers and bakeries through commercial agent contracts (see **Table 5.2**).

Table 5.2 Structure of Distribution Network of Tchibo

Sales Channel	Germany	International
Equity Stores	850	300
Commercial Agent Contracts (Depots)	38,000	7,000
E-Commerce (Online-Shops per country)	1	17

Source: Tchibo 2010.

5.3.5 Concession Shops

Concession shops are positioned between secured and controlled distribution systems. "A concession shop refers to a cooperative space concept in the trade in which a concessionaire rents a selling area from a trading company and manages it. As in the case of shop-in-shop concepts, the concession area is separate from the rest of the shop by its own design and corresponding shopfitting elements. The concessionaire sells its goods for its own account, i.e. bears the merchandise risk. A concessionaire normally operates the shops with its own personnel. Marketing activities and merchandise-management processes such as e.g. shop design, assortment planning, price policy or merchandise procurement and control are normally within the area of responsibility of the concessionaire" (Committee for Definitions of Terms in Trade and Distribution 2009, pp. 60-61). The retail company acts as a **lessor**, receiving not only a flat rate to cover the operating costs of its services but also turnover-related remuneration (a **concession fee**). In this way, the retailer bears part of the sales risk, in contrast to purely letting space.

There are two different variants of **shop-in-shop concepts**: concession shops on the one hand and, on the other hand, certain parts of the assortment can be highlighted by a special atmosphere and presentation to profile the collections of leading manufacturers. This variant is a form of contractual dealer systems, in which manufacturers support retailers in assortment planning and instore marketing.

5.4 Advantages and Disadvantages of Secured and Controlled Distribution

Secured, controlled and independent distribution systems are presented in **Figure 5.7**, which characterises these systems in the context of the market-hierarchy paradigm of **transaction cost economics**.

Figure 5.7 Vertical Marketing Systems and Transaction Cost Economics

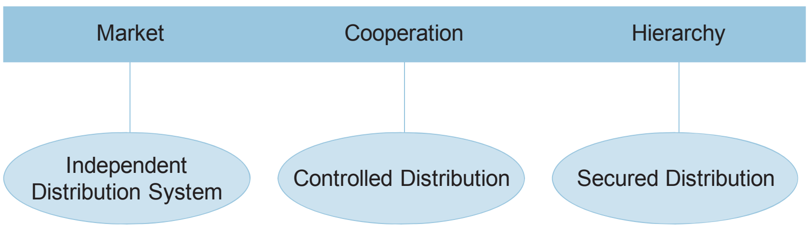


Table 5.3 provides an overview of the main advantages and disadvantages of the different concepts of controlled distribution and secured distribution. The "high degree of control" in secured distribution systems (equity stores) and commercial agent systems includes retail pricing.

Table 5.3 Advantages and Disadvantages of Secured and Controlled Distribution Concepts

	Strengths	Weaknesses
Equity Stores	♦ high degree of control ♦ organisational control ♦ brand/promotional control ♦ guaranteed distribution	♦ high capital costs ♦ huge operational costs
Franchising	♦ limited capital costs ♦ less ownership risk ♦ guaranteed distribution ♦ low fluctuation	♦ limited control
Commercial/Commission Agent Systems	♦ high degree of control ♦ organisational control ♦ brand/promotional control ♦ guaranteed distribution	♦ low capital costs ♦ limited operational costs
Contractual Dealer Systems	♦ relatively low-cost solution ♦ rapid expansion	♦ little control ♦ high risk of losing partners ♦ less stability

Figure 5.8 illustrates the distribution system of the German manufacturer *MUSTANG*, which operates retail partnership concepts, franchising and equity stores. **Figure 5.9** shows the distribution system of the *GERRY WEBER Group*, which managed the turnaround from an apparel manufacturer into a vertical fashion and lifestyle supplier using multiple heterogeneous distribution channels.

Figure 5.8 Controlled and Secured Distribution – MUSTANG

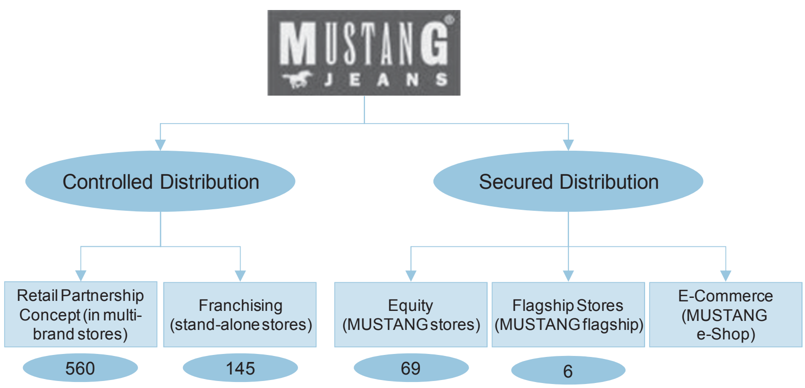
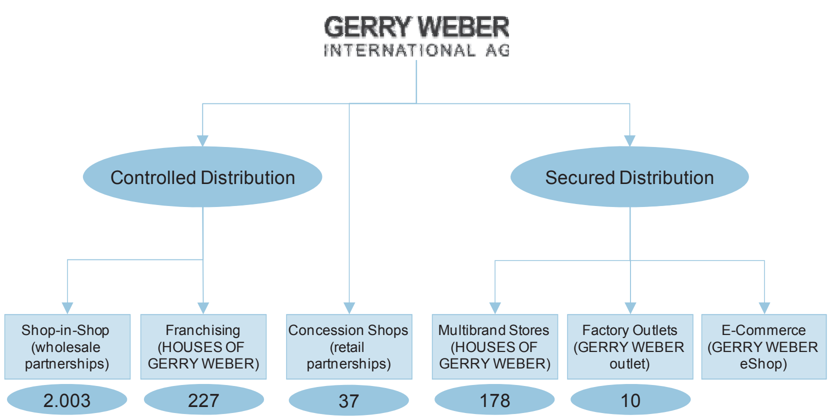


Figure 5.9 Controlled and Secured Distribution – GERRY WEBER



5.5 Channel Conflicts

The development of controlled and secured distribution channels – as possible sales channels for a manufacturer – is a core element in the marketing strategies of many manufacturers *(***downstream verticalisation***)*. While secured distribution used to involve the development of equity chains (owned by the manufacturer), the situation has changed considerably. Over the Internet, a manufacturer can sell directly to consumers without bricks-and-mortar stores, and through contractual dealer systems or dealer partnership programmes and franchising, manufacturers can be engaged in contractual distribution systems, which means cooperating with independent dealers. Technological developments and contractual arrangements enlarge the potential for controlling distribution channels.

The main challenge for manufacturers is to manage the conflict in multichannel distribution systems between independent retailers, selling products from a particular manufacturer, retailers, cooperating in a contractual system with this manufacturer, and equity stores or other direct distribution channels from this manufacturer as competitors.

Conflicts in distribution channels or **channel conflicts** are not a new phenomenon in the consumer goods industry. **Conflict theories** in retailing explain retail change in terms of the rivalry between new and established retail institutions (see Chapters 1 and 2). This approach refers primarily to **horizontal conflicts**, i.e. conflicts between different retail formats, but can be transferred to "vertical retail institutions" as new players (see e.g. McGoldrick 2002, pp. 24-25).

Vertical channel conflicts are the result of **shifts of power**. Traditionally, the distribution of consumer goods was characterised by a manufacturer-centred view of channels: retailing has been a relatively passive link within the channel of distribution from manufacturers to consumers. The abolition of **resale price maintenance**, in 1964 in the UK and 1974 in Germany, the concentration of retail trade, the development of store brands and retail branding have shifted the power from manufacturers to retailers. This development of **retailer power** can be illustrated by the relative weakness of manufacturers in negotiations with these customers. The dependence of suppliers on major retailers has initiated the development of new vertical systems in order to control or even secure distribution, including the intention of building brand image. By verticalisation, manufacturers are rebalancing the power within the distribution channel. This rebalancing by verticalisation leads to a new type of channel conflict. Manufacturers are suppliers of the retailers as well as of their competitors.

5.6 Conclusion and Outlook

Managing multichannel distribution systems and conflicts in distribution channels are the main challenges for manufacturers with regard to the demand side. Upstream, they are also restructuring their value chains by outsourcing production activities and concentrating on "intellectual" activities such as innovation and quality management. Finally, this leads to new **value chain architectures**.

By contrast, retailers are to a growing extent integrating upstream activities into their value chains: developing store brands, produced by contract manufacturers ("controlled production") or by its own production sites ("secured production"). This strategy leads to a higher degree of **upstream verticalisation** ("vertical retailers"; see Chapter 6) and finally means a convergence of the value chain architectures of manufacturers and retailers (see Chapter 1).

Further Reading

COUGHLAN, A.T. et al. (2008): Marketing Channels, 7th ed., New Jersey.

KPMG (Ed.) (2001): Verticalization in the Trade: Effects in the Future Sales Channel Structure, Cologne.

ROSENBLOOM, B. (2004): Marketing Channels: A Management View, 7th ed., Mason.

5.7 Case Study: Nike[1]

5.7.1 Profile, History and Status Quo

Nike is the world's leading designer, marketer and distributor of authentic athletic footwear, apparel, equipment and accessories for a wide variety of sports and fitness activities, including basketball, football, golf and running. The success of the company is built upon a long history of practical experience in running as well as shoe manufacturing and distribution.

Before there was *Nike*, there were Bill Bowerman, *Nike's* future co-founder and legendary track and field coach at the University of Oregon, and Philip H. Knight, a middle distance runner on Bowerman's track team. In the late 1950s, Bowerman was eagerly experimenting

[1] Sources used in this case study include the website http://www.nikebiz.com, NIKE Inc.'s annual report 2010, information from http://www.textilwirtschaft.de and statistical data from http://de.statista.com as well as explicitly cited sources.

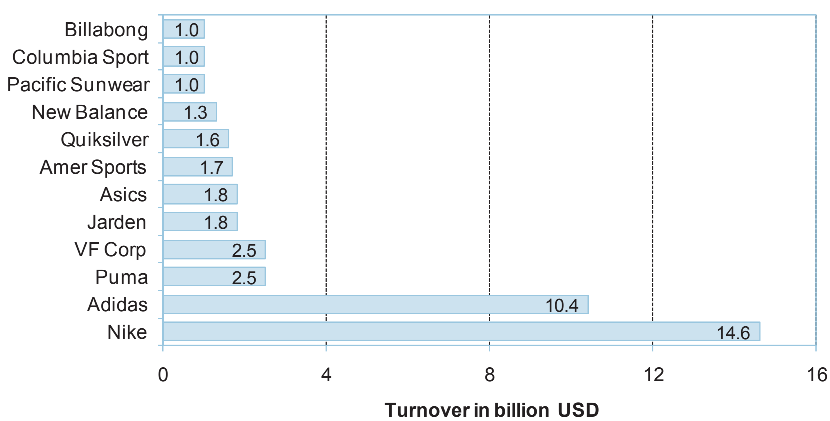
with shoes: he was convinced that an ounce off a running shoe could be enough to win a race. In 1962, in the process of completing his MBA at Stanford University, Knight asserted in a research paper that the US could recapture the leadership in the athletic shoe industry from Germany by importing high performance, well-crafted, but low priced shoes from Japan. Shortly after graduation Knight went to Japan and persuaded the *Onitsuka Tiger Company*, a Japanese producer of quality athletic shoes, to give him a distributorship for *Tiger* shoes. Returning home, he took samples of the shoes to Bowerman, which laid the foundation for the joint distribution activities with the name *Blue Ribbon Sports (BRS)*.

In 1964, the marketing efforts started unconventionally for that time – by servicing athletes. Knight began to sell imported *Tiger* running shoes out of the back of his car at track meetings, directly to the consumer (**direct selling**). A year later, Jeff Johnson, a former competitor of Knight on the track, agreed to work on commission as *Blue Ribbon Sports'* first employee. This form of controlled distribution complemented the existing secured distribution efforts. It wasn't until 1966 when they expanded their direct selling efforts by opening a retail store.

Knight and Bowerman developed their own shoe in 1972 and, after a dispute with *Onitsuka Tiger*, decided to manufacture it themselves. In 1978, *Blue Ribbon Sports* officially changed its name to *NIKE Inc.* This was the beginning of an era of product innovation, marketing campaigns and the constant extension of the **distribution network**.

What was once only the athletic shoe industry now is an industry expanded far beyond its original focus. The former US-based footwear manufacturer today is a global marketer of athletic footwear, apparel and equipment that is unrivalled in the world. **Figure 5.10** shows the leading position of *Nike* in terms of global turnover.

Figure 5.10 Top 10 International Manufacturers of Sportswear 2009



Source: Statista 2010.

In the past decade, *Nike* has established a strong **brand portfolio** with several wholly owned subsidiaries, which are subsumed in the *NIKE Inc.* group, including *Cole Haan*, which designs, markets and distributes luxury shoes, handbags, accessories and coats; *Converse Inc.*, which designs, markets and distributes athletic footwear, apparel and accessories; *Hurley International LLC*, a California-based surf, skate and snowboard apparel brand that designs, markets and distributes action sports and youth lifestyle footwear, apparel and accessories; and *Umbro Ltd.*, a leading United Kingdom-based global football brand. *Umbro*, with over 70 years of experience and heritage, helps expand *Nike's* **global leadership** in football. *Umbro* designs, distributes and licenses athletic and casual footwear, apparel and equipment, primarily for the sport of football. The subsidiaries are operated on their own authority and their distribution activities are mostly autonomous.

For the fiscal year ending May 2010, *NIKE Inc.* reported total revenues of 19,014 million USD (a 1 % drop from 2009) and, therefore, is ranked 124th in the Fortune Top 500, the most prominent annual ranking of America's largest corporations (Fortune 2010). The *Nike* brand accounts for 16,509 million USD in revenues, which is attributable to three major product lines: footwear (63 %), apparel (31 %) and equipment (6 %).

Besides its financial success, *Nike* is one of the most heavily advertised and best-known brands in the world. According to *Interbrand's* "Best Global Brands 2010" ranking, the **brand value** of *Nike* is estimated to be 13,706 million USD and ranks 25th among the world's most valuable brands (Interbrand 2010). By contrast, the German competitor's brand *Adidas* is worth 5,495 million USD.

The *Nike* world headquarters is located in Beaverton, Oregon. So while the Pacific Northwest was the birthplace of *Nike*, today the company operates in more than 170 countries around the globe. Through their suppliers, shippers, retailers and other service providers, *Nike* directly or indirectly employs nearly one million people. That includes approximately 34,400 *Nike* employees across six continents, who all contribute to *Nike's* mission, "to bring inspiration and innovation to every athlete in the world".

In the fiscal year 2009, the company initiated a **reorganisation** of the *Nike* brand into a new model consisting of six geographies. In the fiscal year 2010, the most important geographic segment in terms of revenues was North America (6,696 million USD), which accounted for 42 % of total revenues. Within non-US sales, Western Europe played a key role (3,892 million USD), while Central and Eastern Europe (1,150 million USD) were less relevant in absolute values. The contribution of Japan (882 million USD) was rather volatile and of lower importance. Looking at emerging markets (2,042 million USD) and Greater China (1,742 million USD), these segments, despite a relatively low absolute contribution, have constantly gained in importance over the past two years with sales growth above 25 %. Business in China is profitable in particular with a share of sales of 11 % but an EBIT accounting for 28 % in *Nike's* fiscal 2011 second quarter.

5.7.2 Nike's Multichannel Approach

Today, *Nike* sells products primarily through a combination of independent retailers, through *Nike*-owned retail including different store formats (bricks-and-mortar) and Internet sales and through a mix of independent distributors, franchisees and licensees. Historically, the channel strategy has focused on independent retailers, or **retail accounts** in *Nike's* terminology, which have played an outstanding role in terms of turnover. On the one hand, these activities are complemented by **controlled distribution** in the form of sales to franchisees and licensees. On the other hand, *Nike*-owned retail is at a low level but is constantly gaining in importance. This business comprises the three major types of **store-based secured distribution** (concept stores, flagship stores and factory outlets) as well as an e-commerce division.

All these retail activities result in the multichannel distribution system of *Nike* that contains various different channels:

- *Nike* retail accounts (independent retailers)
- Franchising and license agreements
- *Niketowns* (flagship stores)
- *Nike* stores (monobrand concept stores)
- *Nike* factory store (factory outlets, off-price stores)
- *Nike* online store, *NIKEiD*, *Nike* women online store (Internet stores/e-commerce)
- *NIKEiD* apps (m-commerce).

Independent Retailers

Indirect distribution with the help of independent retailers represents the most important form of distribution, with a share of sales of **more than 85 % of *Nike's* total turnover**. The **retail account** base includes a mix of athletic specialty stores, footwear stores, sporting goods stores, department stores, skate, tennis and golf shops and others. Among the biggest global retail accounts are *Foot Locker*, an American sports and footwear retailer operating in approximately 20 countries worldwide, and *Finish Line*, operating over 600 stores solely in the United States (Bloomberg Businessweek 2007).

As of May 31, 2010, the *NIKE Inc.* group had around 23,000 retail accounts in the United States and approximately 24,000 outside the United States (excluding sales by independent distributors and licensees). Hartley (2009, p. 314) described the relationship to customers, especially the large retailers mentioned, as *Nike's* most controllable success factor within its relevant competitive environment. Additionally, *Nike* utilises 19 sales offices in the US to solicit sales and nine independent sales representatives to sell golf and skateboarding equipment as well as outdoor products.

Controlled Distribution

In addition to the retail account business, *Nike* operates **franchising.** The terms of the franchise contract are handled rather strictly. Therefore, the contractual arrangement allows the company to exert a high influence on the choice of location, for instance. Franchisees have to bear the predominant risks, and only the commodity risk is shared in partnership. However, neither initial payment nor franchise fees are known.

The complex implementation of franchising can be illustrated using the example of the German market. The adaptation of the European franchise concept to German market conditions started in 2001, and it should have been worked out in detail together with potential partners. Owing to a lack of interested parties, the process lasted for two years until the first franchise store was opened in Hamburg. The franchise partner was the newly found *Add Value GmbH & Co. KG*, a partner experienced in both retailing and franchising, who was selected with the intention of stabilising the concept. In the end, despite its cautiousness, the first German franchise was not fruitful. While the store in Hamburg remains operated by *Nike*, in Germany there only exist two franchise agreements in Nuremberg und Munich, both of which were signed in 2007.

Additional potential sales volume (105 million USD) and marketing impact are opened up by **licensing**. *Nike* offers license agreements that permit unaffiliated parties to manufacture and sell certain *Nike*-branded apparel, electronic devices and other equipment designed for sports activities. The licensing business is primarily represented in the global brand division, a segment managed centrally and devoid of operating costs such as those for product development or supply chain operations.

One of the latest examples is a deal that makes *Nike* the sole maker and distributor of National Football League-branded apparel and uniforms. The licensing deal, signed in October 2010, will bring an estimated 300 million USD in additional revenues from 2012 (Bloomberg Businessweek 2011).

Secured Distribution

In recent years, *Nike* has increased its power in distribution through integrating retail activities downstream. This has resulted in strong control over the vertically integrated channels and the flexibility to decide about the concepts of the stores, such as the product offer, in-store marketing and price fixing. Above all, *Nike* can combine its production capabilities as a traditional manufacturer with distribution activities, and thus it is able to create totally new shopping experiences.

Nike operates a great variety of fully integrated secured distribution channels from **factory outlets** on the discount side to standard **stores** and **flagships** on the high end. Even though this form of distribution accounts for a relatively small part of turnover, it is gaining in importance as will be described later in this Chapter. The development of *Nike's* global retail outlet network reveals the constantly growing number of *Nike* factory stores and *Nike* stores outside the United States (see **Table 5.4**).

Table 5.4 Development of Nike Retail Outlets

Retail Outlet		2007	2008	2009	2010
Nike factory stores	US stores	102	121	140	145
	Non-US stores	126	141	184	205
Niketowns	US stores	12	12	11	11
	Non-US stores	3	3	4	2
Nike stores	US stores	14	14	16	12
	Non-US stores	33	46	61	55

Source: Nike Annual Report 2010.

Nike's distribution strategy aims to offer consumers access to engaging, exciting and innovative retail spaces. Flagship stores are most suitable to creating such a retail experience even though huge investments are necessary to build them. *Niketowns* are operated to build brand image rather than solely to generate profit for the company, and they can be categorised as a marketing vehicle transporting the world of sports. The focus is on selling newer and exclusive footwear and apparel and showcasing manufactured products. *Nike* offers a high quality production programme in top locations.

Averaging more than 30,000 square feet of selling space (approx. 2,800 m²), *Niketowns* attract millions of customers every year. The first *Niketown* store opened in 1990 in downtown Portland, Oregon. This first store, with athlete-driven and award-winning design, set the standard for future consumer environments. With regard to non-US retail activities, Germany plays a crucial role as a bridgehead into Europe. This is based on the requisite to set off in a highly competitive market where the strongest competitor *Adidas* is headquartered. Therefore, the first *Niketown* outside the US was built in Berlin in 1999 followed by the second *Niketown* in London.

Nike stores are operated as **monobrand concept stores**, either as equity stores that are owned by *Nike* or as concession shops. In the latter way, *Nike* operates a concession area that is located in a store owned by an independent retailer, which leads to a hybrid structure between controlled and secured distribution. One example is the concession shop at *Peek & Cloppenburg (P&C)* with a separate entry from the main shopping street Zeil in Frankfurt.

In accordance with *Niketowns*, *Nike* stores also focus on top locations in major cities and a total production programme is offered. But, on the contrary, *Nike* stores encompass a smaller selling space and communicate the fascination of the brand in a more conservative way, which leads to lower investments. However, owing to the financial strength of the group, *Nike* is able to open up locations that a single retailer would never be able to finance, such as the *Nike* store on the Champs Elysées in Paris, one of the most expensive shopping streets in the world. Additional *Nike* stores are located in Vienna, Zurich, Hamburg and at the airport in Frankfurt.

Meanwhile, there exist derivative *Nike* store concepts, such as *Nike* women stores that focus on footwear, apparel and equipment especially developed for women's needs. The first one of these stores outside the United States was the 1,200 sq. ft. store in Munich (approx. 120 m^2) that opened in 2005.

Factory outlets (**off-price stores**) in general are used to improve revenues from irregularities, production overruns and merchandise returned by retailers. *Nike* factory stores carry primarily overstock and close-out merchandise and they are mainly located in factory outlet centres. Consumers will not find the current product line in *Nike* factory stores. Instead, they sell products left over from last season at discounted prices. The factory stores stock casual apparel as well as products for sports such as running, football, athletics and basketball (Olivarez-Giles 2010). The average size of a *Nike* outlet is about 10,000 sq. ft. (approx. 930 m^2) (Olivarez-Giles 2010).

Despite the discount-minded orientation, *Nike* holds opening events to attract customers, with gift cards, giveaways and an autograph and question-and-answer session with well-known athletes.

Electronic Selling

At an early stage *Nike* realised the potential of the Internet and started to communicate and offer products and services for sale over the web in the United States in 1999.

Consumers use the websites of sporting goods manufacturers both as information channels prior to purchase and as channels of purchase. Particularly during major sporting events, a higher attendance of the websites of sporting goods manufacturers can be noticed, making the Internet an important tool for the sporting goods industry (ECC 2010). However, the decision on whether to focus on online sales or bricks-and-mortar stores is of strategic relevance. How this choice differs from the perception of branded sportswear manufacturers was analysed in the ECC-Monitor study in 2010. Whereas *Nike* and *Puma* plan to focus on online direct selling, *Adidas* is rather strengthening its dealer network.

Nike's positioning is built upon the belief that the balance of power between retailers and consumers undergoes a fundamental shift and that consumers are gaining in power. In 2007, the challenge for *Nike* was to find a way to deal with the fast-changing behaviour of their digitally driven consumers.

Given this situation, the European *Nike* online store was launched in January 2007, offering products for sale in 19 European countries plus Switzerland. The store is differentiated by language and country-specific sports preferences, but is identical in structure. Besides the traditional product offer and some online functionality, www.nikestore.com is characterised by an innovative approach.

Figure 5.11 Strategic Focus on Dealer Network vs. Online-Direct-Selling: Top 10 Manufacturers of Branded Sportswear 2009

Source: ECC 2010.

Nike combines the company's position as a leading sporting goods manufacturer with its retail activities and offers a **mass customisation concept** called "*NIKEiD*". It is possible to customise products such as shoes or sportswear and decide about on the colour, material and individual size or finish the item off with a personal ID. This concept less targets impulse-driven, price-oriented shoppers but rather untypical, youthful customers that like to wear individual products (Erlinger 2010). Furthermore, the *Nike* women online store offers products created for women's needs and is linked to a women-oriented *NIKEiD*.

The redesigned *NIKEiD* website, www.nikeid.com, is complemented by *NIKEiD* studios, for instance in Beijing, Shanghai, New York and London – instore set-ups where customers can work together with design consultants on designs and discuss the latest trends. This way the border between online and store business is fading.

The latest trend is built upon the enormous diffusion rate of web-compatible smartphones. The development of mobile apps, the *NIKEiD* mobile apps, available for the iPhone, iPod Touch and iPad is the next step in this technology-oriented sales channel.

5.7.3 Nike's Global Growth Strategy

NIKE Inc. introduced its 2015 Global Growth Strategy in 2010. The company announced a revenue target of 27 billion USD for 2015 and plans to expand its global retail activities by opening 250 to 300 new company-owned stores within the next five years. Still, retail accounts are expected to account for more than 80 % of the company's overall business by 2015. *Adidas* counterattacked with its strategic business plan, Route 2015, which aims to provide the basis for taking over leadership in sporting goods manufacturing. The plan is to grow faster than its key competitors can. Herbert Hainer, CEO of *Adidas*, is aiming for a sales growth of 45 % to 50 % in the next five years. With company-owned stores, *Adidas* held a 17 % share of sales in 2008, but it wants to strengthen retail activities by expanding the company-owned store network and e-commerce activities (Adidas Group 2010).

Geographic opportunities for the *Nike* brand exist in all of its six geographies including growth through expansion in its developed regions of North America, Western Europe and Japan. But sporting goods manufacturers are suffering from slowing consumption in the United States and from lower returns in Western Europe because of the weak Euro. So, with the weak market in the US, which is the core market, *Nike* has to look for profitability elsewhere (Bloomberg 2010). Growth potential, targeting low double-digit growth, is seen in the developing markets, especially Brazil, India and China.

Adidas also primarily wants to invest in developing countries, where the network of sporting goods retailers is less close. With regard to geographic importance, *Adidas* has identified North America, China, Russia, Latin America, Japan, the UK and India as important growth markets. Furthermore, the company will expand into focal cities in well-established countries (Adidas Group 2010).

5.7.4 Summary and Outlook

In recent decades, *Nike* has managed to establish the leading position in the sporting goods industry. This success is, to a large extent, supported by company-owned retail activities that strengthen the perception of the brand in the eyes of customers and leverages additional sales potential. Hainer points out that today's competition for **global market leadership** centres on two players (Adidas Group 2010). That is a reason for *Nike* to be aware of *Adidas'* strategic actions. As both companies want to push **vertical integration**, this will lead to increased competition. Future efforts have to be geared towards the exploitation of potentials within the retail channels that can be derived from socio-economic drivers as well as between the different brands of the group.

Questions

1. List the possible motivations for the implementation of secured distribution activities from a manufacturer's perspective and apply the insights to *Nike's* situation in detail.
2. Describe potential channel conflicts for a manufacturer adding a new company-owned retail channel and use *Nike* to illustrate some examples. Please elaborate on ways that are suited to manage channel conflicts.
3. Given the company-owned retail activities of *Nike*, assess the contribution of the current development to the long-term success of the company.

Hints

1. For a general overview of motivations for secured distribution from a manufacturer's perspective see Tsay/Agrawal 2004.
2. Take channel conflicts between a manufacturer's and an independent retailer's channel and between manufacturers' channels into consideration. See the discussion in Bucklin/Thomas-Graham/Webster 2004 for potential channel conflicts and a framework to manage them.
3. Transfer Hauptkorn/Manget/Rasch 2005 on the success factors of verticalisation strategies, for example, to the current situation of *Nike*.