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CHANGING THE RETAIL LANDSCAPE

I don't know the key to success, but the key to failure is trying to please everybody.

—Bill Cosby

If there is no differentiation, there is no innovation.

—A. G. Lafley, former P&G CEO

The next three chapters will describe a set of twenty case studies of brands that attempted to develop new categories or subcategories in three industries, some not so successfully. These cases provide a good perspective of the challenges and the complexities of the task plus the huge upside of a successful effort. Collectively, the goal is to gain insight into where ideas come from, the role of trend interpretation and projection, how categories or subcategories are defined, how firms achieved success or why an idea faltered or failed, why competitors fail to respond, and how barriers to competitors are built.

The three industries provide very different contexts and efforts. In particular, Chapter Four (the automobile industry) provides insights on competitor response and how it is intertwined with each competitor's own overall business strategy. Chapter Five (the food industry) provides a look at the complexities and dynamics of a megatrend, namely healthy eating, which should be instructive to any firm trying to interpret and maybe influence a trend in the marketplace. In this retailing chapter, we see up close the power of culture and values and how categories and subcategories are defined.

Retailers have several advantages in creating new categories or subcategories. They have a lot of variables to work with, including product selection and pricing, product presentation, store ambiance, and ways to involve and interest customers. Further, a retailer can refine the new concept while still under the radar. Pret A Manger, the enormously successful U.K. sandwich chain, refined the concept over five years when it was still a single storefront. Finally, a retailer can experiment, try out many concepts with modest investments, and wait until one hits. The Limited tried out many concepts within an existing store and created chains, such as Bath & Body Works and Structure, out of those that showed promise.

Of course, it takes insight to know what concepts should be tested and judgment to decide if a successful local test will travel over different geographies and through time. Further, scaling a good retail idea, expanding its footprint, can take a long time. During that time, competitors can observe the business model and operations that are driving the potential new category or subcategory. There is little to prevent them from being first movers in another city or country. To find a winning concept and scale it across markets while holding back competition is thus very difficult. Yet there are a host of retailers that have done just that. Their stories are instructive. How did they come up with the concepts? How were they scaled? How did they avoid having others copy the concepts?

Among the role-model retailers that have pulled it off are Victoria's Secret and Zara in women's wear; Eddie Bauer and L.L.Bean in outdoor clothing and accessories; The Body Shop and Bath & Body Works in toiletries; Amazon and Japan's Rakuten, an online mall, in e-commerce; IKEA and La-Z-Boy in furniture; Apple and Best Buy in computers; Walmart and Target in discounting; McDonald's and Subway in fast food; and more. Each has been able to scale, often based on a story and distinct offering and supporting culture. We will take a closer look at Muji (clothing and home furnishings), IKEA, Zara, H&M (women's

clothing), Best Buy, Whole Foods Market, Subway, and Zappos (an online shoe site), each of which has established and dominated a new subcategory and has a set of characteristics that represent sustainable differentiation.

Muji

One of the strongest retail brands in Japan is Muji. BrandJapan has measured brand strength for 1,100 brands in Japan for nine years. Muji is always in the top 30 and usually in the top 20, a spot shared by only 3 other retail brands. It started as a sales corner of the Seiyu department store, with a lineup of nine household products and thirty-one food products. After opening its first stand-alone store in 1983 it became an independent company in 1990, and now have over 330 stores, nearly one-third of which are outside Japan. Few brands deliver more emotional and self-expressive benefits than does the Muji brand. Yet the Muji brand vision is to not be a brand!! It is the no-brand brand.

Muji, short for Mujirushi Ryohin, is represented by four characters that mean literally “no-brand quality goods.” Their values are all about simplicity, nature, moderation, humility, and self-restraint. The Muji philosophy is to deliver functional products that strive to be not the best but “enough.” “Enough” does not mean compromise and resignation but rather a feeling of satisfaction from knowing that the product will deliver what is needed but no more. Superfluous features and attributes that are unrelated to function are omitted. The aspiration at Muji is to achieve the extraordinary by modesty and plainness in the pursuit of the pure and ordinary. Not a contradiction at Muji.

A visit to a Muji store is an eye-opener. One of the first things you notice is that the clothes are all bland, mostly white or beige and never bright. Beige works. And there is no logo on the front of the shirts, in fact there is no label at all—not even on the inside of the garments. Why would you want a label? The furniture, cookware, and office equipment are plain

but functional. The designs are simple, not for some minimalist statement but in order to provide just what is needed to deliver functionality. Periodically there is a Muji design competition that regularly gets two thousand entrants and results in products for the store that support the Muji beliefs and lifestyle. The prices are low, not by using cheap materials or inferior designs but by cutting out frills and using designs with the right objectives.

The store setting supports the products and the philosophy. The music in the background is soothing. The ambiance is relaxing and delivers emotional benefits that are very Japanese but also travel well. Actually, in Japan, unlike in the United States, a personality dimension that appears relatively frequently is calmness. Muji has it.

Not surprisingly, Muji is sensitive to the environment. They aspire to live in compatibility and sensitivity with the earth. Toward that end they developed a set of three large campgrounds that allow people to enjoy nature that is undisturbed. The campsites host Muji summer camp jamborees, which are events that bond Muji and the participants to undisturbed nature.

Muji can be described as a reaction to the glitz of the Ginza and other shopping centers that are filled with brands each trying to be more upscale than the next. Muji is anti-glitz. It explicitly desires to eliminate the self-expressive benefits to which people usually aspire. The badge of Louis Vuitton is the polar opposite of Muji's. Ironically, this desire to eliminate self-expressive benefits actually provides self-expressive benefits. Shopping at Muji and using Muji products make a forceful statement about who you are. You are above looking for badge brands. You are, rather, a rational person who is interested in the right values, connecting with a firm that is about function, antiprestige brands, calmness, moderation, and nature.

The fact that Muji has seen little real competition shows the strength of the barriers that Muji has created. These barriers are based not only on the products, but also on all that emanates

from its core values and culture including its people, ambiance, programs, and philosophy. It would be impossible for Macy's to carve out a section with a subbrand and deliver the Muji spirit, lifestyle, and products. It just could not happen.

The brand Muji has a most unusual brand story—a nonbrand that delivers emotional and self-expressive benefits. Today's trends make the story even more interesting. Consumers have seen the downside of the excesses of debt-driven materialistic purchasing. There is almost a craving for simplicity, a move away from prideful and self-absorbed brand benefits toward more satisfying values. Desires for fewer additives in food, for entertainment systems that are easy to operate, for less product confusion, for sustainable consumption, and on and on are becoming visible. It may be that the simple and unassuming may become more of a mainstream formula rather than a niche strategy. If so, the Muji brand may become a role model toward which others look.

IKEA

The founder of IKEA started selling pens, wallets, and other products at low prices as a seventeen-year-old boy in a village in Sweden in 1943. By 1953 he had added inexpensive, locally made furniture and opened a store to demonstrate the quality of his goods in the context of a price war. Three years later an employee removed the legs of a table in order to get it into a car. That event led to the concept of packing furniture in easy-to-transport containers and outsourcing assembly to customers.

Today IKEA, with over three hundred stores, is the largest furniture retailer in the world. Like Muji, IKEA features affordable products with materials selected with cost in mind and with designs that are simple but of high quality. There are also sharp differences between the two. IKEA delivers fewer emotional and self-expressive benefits than Muji, and buying at IKEA is not a

statement against ego-enhancing brands. IKEA signature stores have efficient warehouses at which customers pick up unassembled items they selected from displays that mimic home settings. Each store has a huge footprint, oversized and visible signage, unique layout, and restaurants that provide instant energy, visibly, and often buzz for the IKEA brand. Further, the bulk of the marketing budget, some 70 percent, goes into a 350-page catalogue that provides in-home visibility plus a link between the customer and the store. The idea is to make good furniture available to the widest possible customer group.

IKEA leverages its Swedish background. The designs, many of which are branded, fit into a Swedish design tradition that makes simple and functional seem clever and more appealing. Swedish food, such as meatballs and loganberry jam, are served inside the store and provide both charm and a link to Sweden.

IKEA thus means affordable furniture because of scale, design, and being unassembled plus wide selection, easy shopping, informative displays, and a Swedish look and feel.

Zara

Zara, which opened its first store in Spain in 1973 and now has over 1,500 stores around the world, along with the Swedish firm H&M, pioneered and refined the concept of value-priced, fast fashion and are its exemplars. “Fast fashion” means that just after the fashion show is over or a trendy fashion emerges, a fast-fashion retailer offers the latest styles at an extremely low price. Customers, particularly young women who are fashion conscious, view this proposition as compelling.

Fast-fashion retailing requires an integrated design and supply chain. Clothing stores, even today, generally plan ahead six to nine months, in part to make the supply chain, usually based in China and other low-cost countries, work. Zara operates differently. They are vertically integrated, with design and manufacturing done in Spain or Northern Portugal (where wages are

low) for the fashion-forward merchandise. Their knowledge of dyeing, cutting, and materials along with their design flare provide a significant edge. As a result they can create designs and supply stores with merchandise in two to five weeks, garnering process economies along the way because the communication and logistics challenges are reduced.

In addition to providing access to the latest fashions, the fast-fashion model has another important benefit to customers: there is always something new in the store. The merchandise profile at Zara changes continuously. Most designs last only a month, and those that don't perform are gone within a week. Shoppers are attracted to visiting Zara frequently in order to see what is new. One study found that the average Zara shopper in Spain visits Zara seventeen times a year versus three times for some competitors because of the continuous refreshing of the line.¹ The resulting buzz plus the sheer retail presence have driven the brand. As a result, Zara does not need an advertising budget.

One of the enablers of the Zara method, in addition to their integrated design-and-supply system, is their ability to detect fashion trends and respond rapidly. Competitor stores rely on the instincts of an insightful merchant to forecast six months in advance or more. However good he or she is, that task is nearly impossible. Zara has a much less demanding forecast horizon and several useful inputs. One is the experience of its stores, especially the fashion-forward ones at which customers tend to be fashion sensitive. When a design does well in those settings, it is a signal to be aggressive about extending the design placement to other stores. Another is the sales consultants in the stores, who are in daily contact with customers and can cumulatively provide ideas. A third is the Zara offices around the globe, which have fashion-sensitive people observing—particularly in countries and segments that typically lead fashions.

Success and scale, however, provide both advantages and challenges. It is helpful to have a sales level with enough size to be efficient and a barrier to competitors. However, when a

business grows beyond that point and is no longer a regional operation, it becomes harder to maintain the integrity of the business model. Zara has indeed struggled to scale the model as the capacity of the Spanish core to serve the global reach has become stretched.

H&M

H&M, a Swedish retailer that has enjoyed 20 percent growth for decades and now has close to two thousand stores, also features trendy fast fashion, but generally operates at even lower price points than Zara. About 25 percent of the H&M stock is made up of fast-fashion items that turn over quickly. The aim is to have something new in the store every day. These items are designed in Sweden and sourced in lower-wage European countries by suppliers directly connected to and tightly integrated with H&M.

To create interest, H&M was a pioneer in the use of designer brands. The Italian designer Roberto Cavalli and the Parisian designer Sonia Rekeil both have clothing lines at H&M. Further, celebrities, such as Madonna and singer Kylie Minogue (H&M loves Kylie was an H&M brand), have endorsed limited, one-time collections that often sell out in days. The rest of the product selection—basic, everyday items that can have longer lead time—are sourced in Asia. H&M also put fashion magazine *Elle*-endorsed items at the front of its U.S. stores in order to provide interest and credibility.

Zara and H&M both have experienced a stunning growth rate in the last twenty-five years. Their value proposition surrounding fast fashion—namely the latest fashion at a low price and a continuously new product profile in stores—had traction among the clothes-buying segments. Their supply chain that delivers speed and low cost and their fashion sensitively represent formidable barriers to other clothing retailers.

Best Buy

Best Buy has a heritage as a small, regional retail chain called Sound of Music that began in 1966 in Minnesota. However, it was in 1983 that Best Buy opened its first superstore and began its rise to becoming a national player. By 2010 the firm, still headquartered in Minnesota, had well over one thousand stores, was estimated to have around 20 percent of the U.S. market for consumer electronics retailing, and had a firm toehold in China and Europe. Along the way a major competitor, Circuit City, fell by the wayside.

Best Buy had always offered the value that comes from the scale of being a big-box retailer with warehouse distribution. However, it also always had a feel for customers as well and strove to reduce customers' stress and frustration in dealing with relatively complex decisions and products. A policy adopted in 1989 to eliminate sales commissions supported a very different customer relationship than was the norm in similar stores. The salesperson became an adviser, and the customer felt a reduced pressure to buy and to remain attached to someone who may not have been a good match—a gutsy move because suppliers could have rebelled. They were used to having the commission structure as a lever to target merchandise that they wanted to move, whether because of a high profit margin or obsolete design. The commission structure was an important part of their marketing. Best Buy did end up retaining suppliers and fundamentally changed the buying experience. Years later, in 2005, Best Buy eliminated mail-in rebates, another change that ultimately made the customer's life easier but again disrupted the promotions of suppliers.

After 2000 the aftermath of the high-tech-bubble meltdown, together with the 9/11 incident, made the market environment difficult. Further, Walmart and Amazon as well as Costco and Dell had emerged as huge threats because they all were entering the consumer electronics space with substantial

advantages. So how was Best Buy going to compete with these firms that had virtually destroyed competitors in books, music, videos, and toys?

The answer that emerged after Best Buy had examined customers, trends, and competitors was to create a new subcategory, selling service instead of or in addition to products. Customers were extremely frustrated by products that were hard to evaluate and impossible to set up. There were too many extra features that contributed to hypercomplexity and total frustration when it came to installing and operating the products in the home or office, especially when they were expected to work with other products. Best Buy aimed to provide a service surrounding the buying and installation of the equipment that would reduce the time, bad decisions, and stress involved. The cornerstone of these strategies was the Geek Squad and such customer-centric programs as the Twelforce.

The Geek Squad was an eight-year-old, fifty-person Minneapolis startup that installed and repaired computers when Best Buy bought it in 2002. It was founded by Robert Stephens, like Microsoft's Bill Gates a college dropout, with \$200 and a bicycle.² The firm was tiny and local but had established some credibility with its fixed-price offering by serving some big customers, and Stephens was a talent. It was expected to provide the foundation for a service that would address the unmet need of painless selection, installation, and repair of computer products. The Geek Squad provided a start-up core of people but also a brand, personality, and logo (see Figure 3.1) that fit into the Best Buy effort to imbue its brand with fun and irreverence. Because much of the Best Buy product line was about entertainment,

Figure 3.1 The Geek Squad Logo



it seemed like a good idea to move the brand away from the serious preoccupation with functions and price that dominates stores in their genre.

The Geek Squad developed a whole family of tongue-in-cheek characters. There were the special agents who would go on home cases, counter agents who would help in stores, double agents who would go to both, and covert agents who would assist over the phone. They drove in Geekmobiles, VW bugs with colorful Geek Squad graphics. Stephens once described the Geek Squad as a “living comic book.”³ They dressed in uniforms that were impossibly geeky, with clip-on ties, black pants, and white socks included. Over time they expanded their portfolio to include home theaters; car installation services; iPod and MP3 services. There is now a Web site; a way to check the progress of your order on the Internet; a route to priority service (911 repair); a blog; and a partnership with the TV show, *HouseSmarts*.

The Geek Squad, an IT staff for the individual and a trusted advisor, became a determinant of store choice. Circuit City tried to copy with its Firedog in 2005, but it was too weak, too little, and too late in terms of both substance and brand. Walmart announced a plan to offer similar services via outsourcing, but that route has significant limitations. The Geek Squad in 2010 had over twenty thousand people, around 13 percent of all Best Buy employees, and drove a very profitable, fast-growing business.

Another element to support service orientation, called “customer centricity,” was stimulated by the insight that the best customers should be identified and the buying experience should be tailored for them rather than for some average customer.⁴ The archetypes of the primary customer sets might be the affluent tech enthusiast; the busy suburban mom; the young, gadget-oriented gamer; the price-conscious family man; and the small-business owner. A store would specialize in one or a small number of these segments depending on its clientele, and that

would affect the layout, store features, and the type and training of people. In particular, stores that went after the busy suburban mom had personal shopping assistants who would guide, recommend, help with the transaction, and load equipment into vehicles. Stores after the young gamer have a good selection of games and an area where the games can be tried out.

Still another initiative that fits with the new thrust was the Twelpforce, whereby hundreds of employees interact with customers via Twitter. They can answer questions in real time about service or application issues. The tweets are aggregated and available for the customer interested in a particular issue on the Best Buy Web site. The Twelpforce reinforces the fact that Best Buy has knowledgeable employees who will help you have a better purchasing and user experience and provides a useful information platform that for some will be a go-to source.

In 2009 Best Buy embarked on a program that potentially could create a new subcategory: stores that have taken the leadership on recycling electronics and have a concern for the environment.⁵ Its management recognized that sustainability is a rising social value and thus a business opportunity. Best Buy had experimented with small recycling efforts since 2001, but in March 2009 they launched a program, ultimately branded as Greener Together, to take almost anything electronic at no cost. TV sets, computers, and monitors required a \$10 recycling fee that was balanced by a \$10 discount coupon. Unlike the Geek Squad, this effort will not make money, but it provides a service to customers and validates a claim to having a cradle-to-grave relationship with customers. It also gets customers to make a store visit, which is an important part of store marketing. More important, it helps the brand. It makes Best Buy stand out as a green leader in environmental sensitivity and sustainability and thus for many provides another basis for a relationship. People like to do business with firms they respect and admire.

There is a possibility that the recycling effort may lead to eventually to such offerings as solar panels and windmills.

Credibility in the energy space could also lead to products by which energy use could be monitored and controlled by a home computer system. Best Buy is already selling electric motorcycles, perhaps the ultimate energy-conserving mode of transportation.

The Best Buy breakthrough move to a service offering involved several drivers. First, there was an obvious unmet need. It did not take a lot of insight to know that customers were incredibly frustrated installing and using consumer electronics and became even more so when the components had to work together. Customer research, while not providing the driving insight, did quantify the unmet need and make it more visible internally. Second, the recycling program was driven by a major trend toward being green and was influenced by the desire to deepen the brand-customer relationship by being a part of the process from selecting a product to disposing of it after its life was over. Third, there was the specter of large, formidable competitors moving into the Best Buy space with the ability to price aggressively. A new point of differentiation that would make competitors less relevant was needed. The consulting relationship with customers, the Geek Squad, and the recycling programs did just that. Finally, Best Buy was internally motivated to take its customer relationship to a new level, and they committed to invest in stores, people, and processes to make it happen.

Whole Foods Market

In 1978 John Mackey and a partner opened a natural food store in Austin, Texas, under the Safeway brand, which was a spin on the Safeway brand. Two years later a merger with another small, local brand prompted the first Whole Foods Market store. From this beginning, Whole Foods Market, under the leadership of Mackey, became a major grocer that is a source of natural food (food with no additives, preservatives, or sweeteners) and organic food (food that has not been exposed to chemicals

and related contaminants during production). Its success has been in part based on an ability to acquire or merge with other like-minded regional supermarkets and imbue them with the Whole Foods Market culture, operations, and features. In 2009 Whole Foods Market had around two hundred seventy-five stores, some in Europe, and was approaching \$10 billion in sales. In the process, it became very different from other grocery chains in at least three ways.

First, it is a visibly socially responsible firm with a stated purpose to care about communities, people, and the environment. The tagline is “Whole Foods, whole people, whole planet.” Although all firms aspire to be socially responsible, few deliver, and even fewer get market credit for what they do. Whole Foods Market has tangible programs that make a difference. Further, these programs are cumulatively visible and reinforce its reputation as not only going further than others but really caring. The result is a connection with the prime target segments that is based on shared values and respect for effective programs.

The Whole Foods Market social programs and related customer information and protection initiatives are impressive. It has enforced farmed seafood standards and was the first U.S. retailer to offer seafood certified by the Marine Stewardship Council, an independent organization that fosters sustainable fishing practices and has created and enforced extensive aquaculture environmental standards for farmed seafood. It changed its buying to reflect more humane treatment of animals. In 2006, Whole Foods Market became the only Fortune 500 company to offset 100 percent of its energy with wind power credits. In 2007, it created the Whole Trade Guarantee programs, which affirms that the identified products involve good worker wages and working conditions and sound environmental practices plus 1 percent of the retail price goes to the Whole Planet Foundation for poverty relief. More visibly, the firm eliminated the use of disposable plastic grocery bags, in part by selling large, colorful bags made out of recycled bottles, a designer version

by Sheryl Crow is shown in Figure 3.2. These programs and others were so on-brand and cumulatively visible that Whole Foods Market garnered a host of associated awards.

Second, Whole Foods Market has and conveys a passion for food and health. They aspire to satisfy and delight, to make the shopping process fun and interesting. The product assortment contains items like fresh soup, bakery goods, and food to

Figure 3.2 Sheryl Crow Signature Reusable Shopping Bag



go that involve the customer with aromas, tasting opportunities, and a wide selection. Shopping becomes a stimulating adventure. A host of items that are first seen at Whole Foods Market and others are unique to its store. The availability of healthy items makes it clear where its interests and priorities lie. The “team members” reinforce the core values around natural, organic, and healthy eating because they are informed, involved and clearly care.

Third, Whole Foods Market has developed the capability of providing organic and natural food with consistent quality and extensive selection. It has a program to actively manage the handling and labeling of organic and natural products. Its experience with sourcing and presenting such food products is not easy to duplicate. For the growing segment that looks for organic and natural products, Whole Foods Market becomes the go-to place.

Other stores are trying to respond by increasing their organic and natural selections, but it is a struggle because Whole Foods Market not only has the competence to deliver but also has an authenticity that comes from its legacy and values. Others can copy what they do but not who they are. The reality is that many of Whole Foods Market’s competitors are more interested in logistics, warehousing, checkout efficiency, and making money than in food, and it shows.

Whole Foods Market represents a commitment strategy. It has a passion about its business that shows up in its culture and operations and is hard to duplicate. The horizontal merger and acquisition strategy has enabled the firm over the years to build what was a local business into a national and potentially global business, thereby creating scale advantages. Whole Foods Market kept its eye on the ball and did not get diverted by other business ventures not related directly to its business and its passion.

Whole Foods Market had the timing right and developed advantages hard for competitors to overcome. The demand for

natural and organic food enjoyed years of 20 percent growth, spawned in part by a revolution in sensitivity and attitudes toward eating, and became hard to ignore. Healthy eating and environmental issues were in the news and in the bookstores and affected attitudes toward brands. Despite these increasingly visible trends, the natural and organic movement was below the radar screens of most major food retailers for many years. It was considered in large part a quasi-hippy niche that was happily delegated to small fringe retailers. The niche grew, however, and some of those fringe retailers ended up joining Whole Foods Market.

It was not until around 2005, when the sales of natural and organic products reached about \$14 billion, that the major supermarket chains took notice and began to ramp up their offerings. The established chains recognized that a looming relevance problem faced them. There was a growing segment that wanted credible natural and organic food. In addition, the presence or absence of such food was a signal that the store was or was not interested in healthy food. Because the trends had reached a tipping point, the food chains had to act by adding natural and organic food to their selections. The problem then was branding, because they did not have adequate brand platforms to support credible organic and natural offerings.

One supermarket branding route was to use subbrands. In 2006 Safeway launched the O Organic brand, which was so successful that it was sold outside the Safeway chain. That same year Kellogg's developed an organic version of its major cereal products, such as Organic Raisin Bran. The chains, however, had several problems. Their brands, even with a strong subbrand like O Organic or a supplier brand like Kellogg's, were at a disadvantage compared with Whole Foods Market, who not only had credibility of delivering but also of believing. The food chains were at best going to deliver functional benefits. And delivering was not that easy, because the supply was limited and the operations involved in maintaining organic purity were daunting.

The Subway Story

Subway has now over thirty-two thousand restaurants in over ninety countries, doing over \$90 billion in sales. It is consistently ranked number one in *Entrepreneur* magazine's list of top franchises.⁶ Started in 1965, it grew to sixteen outlets in 1974 when it decided to convert to a franchise model. During the 1980s and 1990s Subway was a submarine sandwich shop offering good value with fresh ingredients, baked bread, an ability to have the sandwich made “your” way, and an obvious emphasis on cleanliness and food safety. As the leader in the subcategory, Subway had a value proposition that was all about the heartiness and freshness of sub sandwiches. The signature sandwich was the BMT, which meant “biggest, meatiest, tastiest,” and included salami, pepperoni, and ham.

In 1999 everything changed. First, there was the trend during the 1990s toward healthy eating, and the role of fat, particularly saturated fat and trans fat, had become visible. Second, a 1999 article appeared in *Men's Health* about a college student, named Jared Fogle, who lost 245 pounds by walking and by eating a Subway diet consisting of two Subway sandwiches each day, a 6-inch turkey at lunch and a foot-long veggie at dinner.⁷ Third, Subway had a latent ability to deliver healthy meals as compared to the pizza, hamburger, fried chicken, and taco alternatives. Something clicked at Subway—these three facts came together. The result was the creation of a new subcategory, healthy fast-food meals. The new subcategory was a portion of the submarine sandwich market and a small part of all fast-food offerings, but it had substance and momentum.

The relatively easy first step was to exploit the existing Subway menu. In 1997 Subway developed a logo around its “7 under 6” menu—7 of its sandwiches had fewer than 6 grams of fat. This became the centerpiece of its healthier fast-food brand. Of course, most of its customers order more indulgent sandwiches, but the healthier choices were very visible.

Subway surrounded the “healthier” claim with nutritional information that is on signage out front as opposed to hidden behind the counter.

Over time Subway buttressed the substance and appearance of its healthier menus. In 2003 they added a Kids Pak with a juice box, a fruit roll-up, and an active toy. The next year Subway introduced a line of carb-controlled wraps with under 5 grams of net carbs and created a school curriculum with the tagline, “One Body? One Life? Eat Fresh! Get Fit!” aimed at elementary students supported by a subwaykids.com Web site. In 2007 Subway launched its FreshFit and FreshFit for Kids meals, which feature healthier-for-you side options, such as apple slices, plump raisins, low-fat milk, bottled water, and Dannon yogurt. Subway developed the meals to fit into the American Heart Association’s approach to a healthy lifestyle. To support FreshFit, 150 Subway brand ambassadors awarded bicycles and thousands of Subway Cash Cards to consumers and spectators for their “random acts of fitness”—such as climbing stairs or power walking. That same year Subway removed all trans fat and added higher-fiber wheat and honey oat breads.

The key to the creation of the healthy fast-food subcategory was Jared Fogle, his Subway story, and the symbol of his huge pants. He became a centerpiece of the advertising and a spokesman, spending two hundred days a year representing Subway. He has done a lot more than tell the story. He has gotten involved with programs to turn his story into progress on helping kids turn to healthier choices that provide nutrition and energy. Among the kids’ programs were Jared’s Steps to Healthier Kids information cards and a Jared and Friends School Tour, which stressed the importance of healthy eating and exercise. In addition, the FreshFit launch teamed Jared Fogle and musician LL Cool J on a double-decker bus for a TV and print media event in Times Square in New York City.

The totality of the program worked. Subway became the healthy fast-food alternative. In 2009 Zagat Fast-Food Survey rated the Subway brand as the number-one provider of “healthy options.”⁸ The three drivers were the substance behind the menu; the brand behind the “7 under 6”; the symbol of Jared’s story backed up by a real person; and the vision that generated an ongoing stream of programs that supported the healthy eating position. The menu plus advertising would not have led to success.

A side story about how Subway needed to be concerned with staying relevant in the face of an emerging subcategory. Subway became conscious of the appeal of the fast-growing rival Quiznos, who had created its own subcategory—toasted submarine sandwiches—and had become the number-two brand. Started in 1981, by 2000 they had one thousand stores, and by 2003 that number had doubled. In response, Subway installed ovens in all its units in 2005 and offered its customers the choice of toasted versions of its sandwiches. Subway did not promote this additional feature; the intent was not to join the toasted subcategory but to remove a reason not to choose Subway, to maintain its relevance to those attracted to toasted sandwiches.

Zappos

A brand about happiness? Disney? Actually, it is Zappos.

In 1999 Nick Swinmurn spent a frustrating day trying to find shoes. Stores were out of his size or color or model. Reasoning that an online e-commerce retailer could stock a wide range of shoes and remove this source of frustration, he started a firm called Shoesite.com. In part because 1999 was at the height of the Internet boom, Swinmurn sold the idea to the venture firm Venture Frogs, who funded it with a \$500,000 investment under the proviso that he hire someone who knew shoes.

Venture Frogs was cofounded by Tony Hsieh (pronounced Shay), who was also the cofounder of LinkExchange, which was sold to Microsoft for \$275 million even though the firm only had \$10 million in sales and Hsieh was only twenty-four years old. Hsieh, a computer science major at Harvard, was at the right place at the right time. Those were the days. With his share of the money, Hsieh decided to start Venture Frogs as a fund that would incubate Internet startups.

Swinmurn found that, even with a shoe person from Nordstrom on board, the operational task was too much. Shoe firms were reluctant to participate, associating the Internet with low prices and wanting to protect their existing retail relationships. Also, the use of local retailers to fill orders via dropshipping, the only feasible operating model, was expensive and did not provide good service because too often the ordered models were out of stock. After six months and with only three manufacturers on board, the company was failing. It was the story of most start-ups with great ideas capable of creating new categories or subcategories: underfunding, real barriers to execution, and inadequate staffing and leadership. In this case, however, Hsieh, tired of financing troubled firms and desiring to create a place where work would be fun, gave the concept a chance by stepping in to underwrite the firm, and, as important, becoming the co-CEO.

The name was changed to Zappos, stimulated by the Italian word for “shoes,” *zapatos*, and by the realization that in the long run the firm should not be locked into shoes. In fact they eventually went into eyewear, handbags, apparel, watches, and electronics and even had backburner ideas to go into service-intensive industries like banking, hotels, or airlines. The name was not the only change. Because of the difficulty of obtaining a broad array of shoe manufacturers, a decision was made to change the firm’s brand essence to over-the-top service rather than broad selection. A tagline of “Powered by service” was ultimately created. The manufacturer scope did, however, grow.

There were fifty manufacturers on board after a year and a half, and one hundred a year later. However, it would take seven years before Nike became a participant.

The mission was to have the best service in the industry. The signature policies were free shipping (customers expecting five or six days were surprised to get shoes by air); a 365-day return policy with free shipping; and a call center that was open 24/7 and staffed in the United States with involved, informed, customer-oriented representatives. Zappos, unlike other e-commerce firms, actually encourages customers to call in, with a visible 800 number believing that the resulting personal contact with its sales reps will foster the relationship with the brand. Zappos also departed from most e-commerce firms by not competing on price. It was about service and selection. In order to deliver the service expected, in 2003 Zappos opened a warehouse in Kentucky and basically stopped all drop-shipping, allowing them to control the logistics and reduce the out-of-stock incidences.

This level of service was expensive. It was financed in part by foregoing profits and having a reduced marketing budget. The firm did not turn profitable until 2006 when sales reached \$600 million. Hsieh reasoned that the marketing budget was better spent on free shipping and a 24/7 call center, which would generate word-of-mouth advertising. Further, search-engine marketing was extremely effective and inexpensive—Zappos simply bought the brand names of shoe manufacturers so that when a customer searched for a shoe brand on Google, a Zappos ad would appear.

The real secret to the service level is not so much the policies and the programs as the culture and values of the company. The first value is to deliver WOW customer service. The up-front goal is to exceed expectations and to generate customer loyalty. One story, among many, is that when Zappos was informed that shoes were ordered for a husband who died in a car accident, the call center rep not only refunded the purchase price but sent flowers to the funeral. On her own.

Other values encourage employees to drive change, be creative and open minded, pursue growth, build open and honest relationships, build a family spirit, be passionate, and be humble. But the value that defines the atmosphere more than the others is to create fun and a little weirdness. The ability to be offbeat and quirky, thereby making life in the office fun and unpredictable and encouraging innovation, is not only tolerated but communicated externally as well as internally and rewarded.

The hiring and training process and the reward system help make it possible to maintain a strong culture even though wages and perks (except for generous health care) were below average. The hiring process includes a culture-matching section. For example, applicants are asked to describe how weird they are on a 1-to-10 scale—the number is not as important as the reaction to the question. A humbleness test involves asking whether the last title the applicant had was appropriate. Applicants, particularly senior ones, are evaluated in informal social settings. There is a two-week culture-training session, followed by two weeks in the call center and one week in the warehouse. After that time, employees are given \$2,000, no questions asked, to leave the firm if they do not feel comfortable with the culture. Unlike at most call centers, the representatives are not measured by the length of call or by sales. Rather, there are spot checks of their conversations, and representatives are measured to the extent to which they make the customer feel happy and connected. The goal is personal emotional connection (PEC). A failure to fit the culture is grounds for dismissal.

The culture is supported as well with a host of activities that reinforce the values. Hsieh, whose modest desk is tucked into a row of cubicles, twitters regularly to the employees and some 1.6 million followers with thoughtful notes that are designed to inspire, inform, connect, or entertain. Employees contribute each year to a culture book with a one-hundred- to five-hundred-word comment on what the Zappos culture means to them. The book is sent to anyone interested. The office has jungle creepers that

hang from the ceiling, and some have bells or pompoms used to greet visitors. Visitors coming to see great service in action are common. Managers are expected to spend 10 to 20 percent of their time socializing with those working for them.

Zappos, like Disney, is selling its culture programs and tricks to others. They have a two-day, \$4,000 seminar on how to create a strong culture. A Web site, Zappos Insights, offers management videos and tips from staffers at a cost of \$39.95 a month. This effort reinforces the culture internally and provides credibility and buzz around the service mission of Zappos externally.

Back to happiness. Hsieh has taken a professional interest in happiness and concluded that the Zappos vision should be to deliver happiness to customers and employees. He noted that the many happiness studies and theories from psychology and elsewhere suggest that happiness is influenced by four basic needs: perceived control, perceived progress, connectedness, and being part of a larger vision. He has attempted to make sure that Zappos has responsive programs and policies.

Perceived control is achieved in part by allowing Zappos employees to have control over the customer relationships. The call center representatives, for example, are not tied to scripts but are encouraged to be themselves and let their personalities show through. Further, they have as much authority to handle customer problems as Hsieh has. Employees also have some control over their compensation, in that they can earn raises by completing courses in some twenty skill sets.

Professional progress is ongoing at Zappos both in terms of training and advancement. Those with two years of experience or more can choose among a host of professional development programs, from specialized training to personal development, for example in public speaking. Promotions happen more quickly because they are broken down into six-month increments that make progress more continuous, and there are a variety of recognition opportunities.

The last two dimensions of happiness are driven by the culture. Connectiveness is encouraged with a familial social atmosphere, events, and the culture hiring screening. It is measured by how many best friends are within the firm. The values, in particular delivering WOW service, provide the larger vision. Zappos was never about sales goals but, rather, about delivering the best service possible.

Happiness applies to customers as well. In particular, the customer has a great deal of control, is part of an interactive family of customers and employees, and is often aware that the Zappos relationship is about more than transactions. The customer-driven architecture of the Web site allows customers to control the shopping experience. They are encouraged to call if they need advice or assistance. The passionate customers that resonate with the Zappos values and experience can create or view videos with commentaries on Zappos and can put an “I love Zappos” button on their Facebook pages. The act of spreading the word about Zappos broadens and deepens the brand relationship. The culture, values, and happiness concepts enabled Zappos to create a new subcategory of retailing based on employee energy and empowerment to deliver WOW customer relationships. Interestingly, the strategy was pushed without the support of the venture capital investors, who felt it held back short-term profitability. In the long run, it has clearly paid off.

Zappos exceeded \$1 billion in sales in 2008 and was sold to Amazon in 2009 for an estimated \$1.2 billion. Amazon asked Heish to run Zappos independently with a mandate to maintain and enhance the culture and the delivery of high-touch, WOW customer service in the face of Amazon’s focus on low prices. The substantial barriers that Zappos has created in the form of customer relationships are expected to be enhanced as Zappos accesses Amazon’s technology and infrastructure to become more efficient and to deliver even better customer performance in terms of in-stock, fast, efficient order fulfillment. Sounds like a combination that might indeed create the

elusive synergy that is so often assumed in major acquisitions. The fans and members of the Zappos team are looking forward to seeing this vision emerge.

Key Takeaways

- A strong vision and culture that connects to a core customer group, as we saw in Muji, IKEA, Whole Foods Market, Zara, H&M, and Zappos, provides energy during the early years and direction and commitment as the firm experiences growth and scope expansion.
- A vision-driven organizational culture that involves values, programs, and leadership, it is hard to copy.
- Brand equity, a significant barrier to competitors, can be based on brand visibility and on customer relationships involving emotional and self-expressive benefits that can run deep and are not easily disturbed.
- Timing is critical, because the task is hard enough without wind at your back. Whole Foods Market and Muji benefited from growing interests in their visions. Zappos would not have worked in another time when the Internet was at a different stage of maturity.
- Concepts evolve over time, especially during the early days of a firm's growth. Muji, IKEA, Best Buy, and Whole Foods Market all started small in scope and ambition and expanded the vision as they got traction and found things that worked. Zappos changed from assortment to service as the key value proposition.
- An unmet need that is not served well or is hidden from view will often drive the concept. Zappos, for example, was stimulated by a frustrating shopping experience that existing shoe retailers did not think to question.

- Operations, critical to success, are difficult, requiring financing, innovation, people with specialized skills who believe, and an inspiring vision and champion.
- Brands can carry the innovation message. The Geek Squad, for example, told the service story vividly with humor and personality. The “7 under 6” helped Subway communicate.
- Green values and social programs are popular with a growing portion of most markets, and few organizations have credibility in the space. Whole Foods Market and Muji have broken through with visible substance and are seen as sharing the values, interests, and even lifestyles of an important customer segment.

For Discussion

1. Identify some highly differentiated retailers. What makes them different? How do they achieve and maintain that difference?
2. Evaluate Best Buy’s decision to buy the Geek Squad instead of building a capability from within. What are the pros and cons of the decision? What was the key issue that drove the decision?
3. Why didn’t other shoe stores create the Zappos model when Zappos started? Compare Zappos to Nordstrom.com as a shoe site.