CHAPTER

5

Customer Acquisition Strategies and Tactics

Managing customer acquisition consists of a variety of interrelated tasks and activities. Among the more important are pricing programs, advertising, alternative and direct marketing systems, sales promotions, and personal selling methods. Based on the solid foundation of developing a customer-oriented company, customer acquisition creates the lifeline of sales and return visits vital to a company's long-term success.

The product life cycle model remains an important tool for understanding how to acquire customers. The introduction, growth, maturity, and decline stages of the cycle necessitate careful responses and strategies from the marketing team.

Customer acquisition provides a key response to the challenges of competition, especially in the maturity stage of the product life cycle. At every point, companies face the demands of keeping current customers balanced with using tactics to find new customers. In general, three basic forms of customer acquisition are

1. developing existing or new markets,
2. developing existing or new products, and
3. branding programs.

Identifying Markets

Customers are acquired through the analysis of existing markets and new markets. New customers can be located in existing markets. Some may be found through the efforts to increase brand switching. Others can be identified when new needs arise as situations change, such as when television programming shifted from analog to digital signals. Further, a product may be featured as being different and better, which is the product differentiation approach to attracting new customers in existing markets.

Finding new markets, the second approach to identifying markets, consists of geographic expansion into domestic markets and international markets. When a company does not operate nationally, domestic markets are assessed to see which will be the most viable for entry. International markets require careful study prior to setting up any kind of exporting arrangement.

Developing Products

Acquisition of new customers often results from the implementation of a product strategy. Products attract new customers by offering new features, eliminating old problems, and solving different needs. Products will be matched with viable market segments.

Product development is a marketing strategy in which new goods and services are developed and then added to current lines. These are marketed to existing customers. Product diversification occurs when new goods and services are created for new market segments not currently served by the company. Unmet needs, cultural trends, and other developments lead to development and diversification strategies. Recent cultural trends associated with diet have led to new food products, while the desire for connectivity has been associated with the creation of new electronic devices. One key to developing products is following through with a well-designed plan of implementation that brings the whole company into the process.

Product improvements solve specific problems. Many products have been made smaller, faster, more efficient, and more user-friendly over the years. Product improvements may help a firm capture new customers and acquire competitors' customers when it appears the company is selling a "better mousetrap."

Product line extensions allow the marketing team to meet more specific consumer needs. A customer with blood pressure problems is likely to try a no- or low-sodium food product. Someone with diabetes will watch for unsweetened or artificially sweetened products.

Branding

A strong brand can contribute to customer acquisition. Major brands enjoy the benefit of being the first considered for new shoppers or those in new situations. Gillette may be the first brand a new shaver will try. Holiday Inn benefits from a well-known brand name that might attract international travelers in foreign countries.

Types of Brands

A brand is the name given to an item or, in some cases, an organization. Brands are assigned to individual products, lines of products, companies offering products, individual services, and companies that offer services. The term used to identify an entire company is the corporate name, which may or may not also be a brand. When the corporate name is attached to all products, it is a house mark. The primary forms of brands include family brands, flanker brands, brand extensions, private brands or private labels, cobrands, and global brands.

A family brand is the name used when a company offers a series or group of products under one brand. The primary advantage of a family brand is that consumers usually transfer the image associated with the brand name to any new products added to current lines. The transfer associations hold as long as the products are in the same product category.

A flanker brand is the development of a new brand by a company in a good or service category in which the company has a brand offering. Proctor and Gamble has launched a variety of flanker brands for products such as laundry detergent. Flanker brands may offer lower or higher priced options in the same brand category.

A brand extension is the use of the firm's current brand name on new products and new versions of current products. Successful brands continuously evolve to meet the changing needs of a diverse marketplace. When a company offers multiple brands or creates brand extensions, one concern will be that one version of the product can cannibalize the others from the same company. Also, when the extension does not fit with the company's image, problems are likely to emerge.

Private brands or private labels appear in stores that sell consumer goods, such as generic soups and vegetables in grocery stores. They are also found in retailers that launch company private-label brands, such as No Boundaries, Simply Basic, and Kid Connection in Walmart. Private labels have become increasingly popular as low-cost but relatively equal-quality options. These labels fit well with retail stores with strong brand or company names.

Cobranding occurs when two firms work together to market a good or service, such as a credit card attached to an airline or retail chain. Ingredient branding takes place when a product is featured as a key ingredient or component of another product, such as Dolby Sound or NutraSweet. These programs build on the strength of two brands rather than one and encourage cooperative advertising, data sharing, and cross-selling of additional products.

A global brand is one used by a multinational corporation. Strong global brands often possess the advantage of brand equity.

Developing Powerful Brands

The three steps of developing powerful brands include brand awareness, brand equity, and brand loyalty. Brand awareness is the beginning. The two levels of brand awareness include the knowledge that a brand exists followed by knowing what unique things a brand provides. Brand equity is the perception that a brand is different and better. The foundation of brand equity consists of five parts:

1. Differentiation
2. Relevance
3. Esteem
4. Knowledge
5. Emotion

Brand loyalty exists when a consumer makes a concerted effort to find and purchase a specific brand. Brand loyalty can take place between consumers and retail operations. It also links customers with specific brands or products. Brand-loyal customers are more likely to become advocates who encourage others to try a brand.

Brand parity means consumers believe there are few, if any, tangible distinctions between competing brands. It is more likely to be present in mature markets, and consumers become primarily price sensitive. Price does not always serve as a signal of quality. Brand parity may be combated through promotional and advertising programs seeking to find and promote differences, or the marketing team may simply recognize it exists and that such perceptions cannot be changed.

Customer Service and Customer Acquisition

Perceptions of excellence will be not only based on tangible product features but also emerge from intangibles. To acquire customers, manufacturing operations must go beyond providing superior products and make sure the items are delivered on time, in accurate amounts, with correct billing procedures, and with quality service after the sale.

Retail stores become more likely to acquire customers when best-value merchandise is offered by caring and attentive salespeople, delivery teams, repair departments, and all others who make contact with consumers.

The importance of a brand reaches a premium for companies that vend services. Services are intangible, which makes the name the primary means by which a company and its services are identified. The responsibility for strong brands spreads from the top marketing manager through the entire organization, including first-line employees both within and outside the marketing department.

A connection also exists between pricing and company service. Customers paying higher prices expect the best service. In general, any time a customer considers a new company, product, or service, several factors influence the final choice. The one common denominator for markets, products, brands, and prices is the connection to customer service. The company that delivers the most memorable quality service automatically has an advantage.

The Cases

Ruth's Chris: The High Stakes of International Expansion

The Ruth's Chris Steakhouse company began with a single unit in New Orleans and had, over the years, expanded to more than 80 locations in 5 countries. Some of the locations were franchisees. The management team, led by Dan Savannah, successfully launched a public offering of stock. The marketing managers needed to sustain the organization's growth by expanding into more countries with franchise restaurants. Other potential options included opening different types of restaurants in the same locations, adding different types of restaurants in new locations, or placing more of the same types of restaurants in the same markets.

The Ultimate Fighting Championships (UFC): The Evolution of a Sport

Mixed martial arts may be viewed as both a sport and as an entertainment venue. The Ultimate Fighting Championship (UFC) brand enjoyed the advantage of a strong domestic fan base in a growing market. International expansion opportunities also were available. Bryan Johnston, the chief marketing officer for UFC, faced the challenges of participant injuries that made some events less attractive, increasing competition, and finding ways to retain two types of fans—those who saw the sport as an athletic fighting event and those who enjoyed the entertainment aspects. After many state governments banned the original format, rules were created to protect participants and eliminate some of the more unseemly aspects of the fights. Combatants were expected to demand higher pay as the level of competition grew. In these circumstances, the goal became to defend the current fan base while reaching new market segments domestically along with international markets.

Best Buy Inc.—Dual Branding in China

In 2002, the successful retail chain Best Buy acquired Future Shop, the largest consumer electronics firm in Canada. Bests Buy's marketing managers faced the choice of operating with two brands or consolidating. In Canada, the choice to keep two brands worked well, with little cannibalization. Based on this experience, the marketing team encountered a similar decision. Best Buy acquired Five Star, the third-largest retailer of appliances and consumer electronics in China. The primary choice was between assuming only the Best Buy brand and operating with two. Five Star was well known and established, whereas Best Buy had only recently entered the Chinese market.

Ruth's Chris: The High Stakes of International Expansion

By Allen H. Kupetz and Professor Ilan Alon

> Well, I was so lucky that I fell into something that I really, really love. And I think that if you ever go into business, you better find something you really love, because you spend so many hours with it . . . it almost becomes your life.
>
> Ruth Fertel, 1927–2002
> Founder of Ruth's Chris Steak House

In 2006, Ruth's Chris Steak House (Ruth's Chris) was fresh off a sizzling initial public offering (IPO). Dan Hannah, vice-president for business development since June 2004, was responsible for the development of a new business strategy focused on continued growth of franchise and company-operated restaurants. He also oversaw franchisee relations. Now a public company, Ruth's Chris had to meet Wall Street's expectations for revenue growth. Current stores were seeing consistent incremental revenue growth, but new restaurants were critical and Hannah knew that the international opportunities offered a tremendous upside.

With restaurants in just five countries including the United States, the challenge for Hannah was to decide where to go to next. Ruth's Chris regularly received inquiries from would-be franchisees all over the world, but strict criteria—liquid net worth of at least US$1 million, verifiable experience within the hospitality industry, and an ability and desire to develop multiple locations—eliminated many of the prospects. And the cost of a franchise—a US$100,000 per restaurant franchise fee, a five percent of gross sales royalty fee, and a two percent of gross sales fee as a contribution to the national advertising campaign—eliminated some qualified prospects. All this was coupled with a debate within Ruth's Chris senior management team about the need and desire to grow its international business. So where was Hannah to look for new international franchisees and what countries would be best suited for the fine dining that made Ruth's Chris famous?

The House That Ruth Built

Ruth Fertel, the founder of Ruth's Chris, was born in New Orleans in 1927. She skipped several grades in grammar school, and later entered Louisiana State University in Baton Rouge at the age of 15 to

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pursue degrees in chemistry and physics. After graduation, Fertel landed a job teaching at McNeese State University. The majority of her students were football players who not only towered over her, but were actually older than she was. Fertel taught for two semesters. In 1948, the former Ruth Ann Adstad married Rodney Fertel who lived in Baton Rouge and shared her love of horses. They had two sons, Jerry and Randy. They opened a racing stable in Baton Rouge. Ruth Fertel earned a thoroughbred trainer's license, making her the first female horse trainer in Louisiana. Ruth and Rodney Fertel divorced in 1958.

In 1965, Ruth Fertel spotted an ad in the *New Orleans Times-Picayune* selling a steak house. She mortgaged her home for US$22,000 to purchase Chris Steak House, a 60-seat restaurant on the corner of Broad and Ursuline in New Orleans, near the fairgrounds racetrack. In September of 1965, the city of New Orleans was ravaged by Hurricane Betsy just a few months after Fertel purchased Chris Steak House. The restaurant was left without power, so she cooked everything she had and brought it to her brother in devastated Plaquemines Parish to aid in the relief effort.

In 1976, the thriving restaurant was destroyed in a kitchen fire. Fertel bought a new property a few blocks away on Broad Street and soon opened under a new name, "Ruth's Chris Steak House," since her original contract with former owner, Chris Matulich, precluded her from using the name Chris Steak House in a different location. After years of failed attempts, Tom Moran, a regular customer and business owner from Baton Rouge, convinced a hesitant Fertel to let him open the first Ruth's Chris franchise in 1976. It opened on Airline Highway in Baton Rouge. Fertel reluctantly began awarding more and more franchises. In the 1980s, the little corner steak house grew into a global phenomenon with restaurants opening every year in cities around the nation and the world. Fertel became something of an icon herself and was dubbed by her peers "The First Lady of American Restaurants."

Ruth's Chris grew to become the largest fine dining steak house in the United States (see Exhibit 1) with its focus on an unwavering commitment to customer satisfaction and its broad selection of USDA Prime grade steaks (USDA Prime is a meat grade label that refers to evenly distributed marbling that enhances the flavor of the steak). The menu also included premium quality lamb chops, veal chops, fish, chicken, and lobster. Steak and seafood combinations and a vegetable platter were also available at selected restaurants. Dinner entrees were generally priced between US$18 to US$38. Three company-owned restaurants were open for lunch and offered entrees generally ranging in price from US$11 to US$24. The Ruth's Chris core menu was similar at all of its restaurants. The company occasionally introduced new items as specials that allowed the restaurant to offer its guests additional choices, such as items inspired by Ruth's Chris New Orleans heritage.[1]

In 2005, Ruth's Chris enjoyed a significant milestone, completing a successful IPO that raised more than US$154 million in new equity capital. In their 2005 Annual Report, the company said it had plans "to embark on an accelerated development plan and expand our footprint through both company-owned and franchised locations." 2005 restaurant sales grew to a record US$415.8 million from 82 locations in the United States and 10 international locations

Exhibit 1 Fine Dining Steak Houses by Brand in the United States (2005)

Company Name	Number of Restaurants
Ruth's Chris	92
Morton's	66
Fleming's	32
Palm	28
Capital Grille	22
Shula's	16
Sullivan's	15
Smith & Wollensky	11
Del Frisco	6

Source: Ruth's Chris Steak House files.

including Canada (1995, 2003), Hong Kong (1997, 2001), Mexico (1993, 1996, 2001), and Taiwan (1993, 1996, 2001). As of December 2005, 41 of the 92 Ruth's Chris restaurants were company-owned and 51 were franchisee-owned, including all 10 of the international restaurants (see Exhibit 2).

Figure 1 Ruth's Chris Restaurant Growth by Decade

Decade	New Restaurants (total)	New Restaurants (company-owned)	New Restaurants (franchises)
1965–1969	1	1	0
1970–1979	4	2	2
1980–1989	19	8	11
1990–1999	44	19	25
2000–2005	25	12	13
	93[2]	42	51

Source: Ruth's Chris Steak House files.

Ruth's Chris's 51 franchisee-owned restaurants were owned by just 17 franchisees, with five new franchisees having the rights to develop a new restaurant, and the three largest franchisees owning eight, six and five restaurants respectively. Prior to 2004, each franchisee entered into a 10-year franchise agreement with three 10-year renewal options for each restaurant. Each agreement granted the franchisee territorial protection, with the option to develop a certain number of restaurants in their territory. Ruth's Chris's franchisee agreements generally included termination clauses in the event of nonperformance by the franchisee.[3]

A World of Opportunities

As part of the international market selection process, Hannah considered four standard models (see Figure 2):

Product development—new kinds of restaurants in existing markets

Diversification—new kinds of restaurants in new markets

Exhibit 2 Ruth's Chris's Locations in the United States (2005)

Source: Ruth's Chris Steak House files.

Figure 2 Restaurant Growth Paths[4]

		Restaurant Brands: Existing	Restaurant Brands: New
Market	Existing	**Penetration** (more restaurants) *Same market, same product*	**Product development** (new brands) *Same market, new product*
	New	**Market development** (new markets) *New market, same product*	**Diversification** (new brands for new market) *New product, new market*

Penetration—more of the same restaurants in the same market

Market development—more of the same restaurants in new markets

The product development model (new kinds of restaurants in existing markets) was never seriously considered by Ruth's Chris. It had built a brand based on fine dining steak houses and, with only 92 stores, the company saw little need and no value in diversifying with new kinds of restaurants.

The diversification model (new kinds of restaurants in new markets) was also never considered by Ruth's Chris. In only four international markets, Hannah knew that the current fine dining steak house model would work in new markets without the risk of brand dilution or brand confusion.

The penetration model (more of the same restaurants in the same market) was already underway in a small way with new restaurants opening up in Canada. The limiting factor was simply that fine dining establishments would never be as ubiquitous as quick service restaurants (i.e., fast food) like McDonald's. Even the largest cities in the world would be unlikely to host more than five to six Ruth's Chris steak houses.

The market development model (more of the same restaurants in new markets) appeared the most obvious path to increased revenue. Franchisees in the four international markets—Canada, Hong Kong, Mexico and Taiwan—were profitable and could offer testimony to would-be franchisees of the value of a Ruth's Chris franchise.

With the management team agreed on a model, the challenge shifted to market selection criteria. The key success factors were well defined:

- Beef-eaters: Ruth's Chris was a steak house (though there were several fish items on the menu) and, thus, its primary customers were people who enjoy beef. According to the World Resources Institute, in 2002 there were 17 countries above the mean per capita of annual beef consumption for high-income countries (93.5 kilograms—see Exhibit 3).[5]
- Legal to import U.S. beef: The current Ruth's Chris model used only USDA Prime beef, thus it had to be exportable to the target country. In some cases, Australian beef was able to meet the same high U.S. standard.
- Population/high urbanization rates: With the target customer being a well-to-do beef-eater, restaurants needed to be in densely populated areas to have a large enough pool. Most large centers probably met this requirement.
- High disposable income: Ruth's Chris is a fine dining experience and the average cost of a meal for a customer ordering an entrée was over US$70 at a Ruth's Chris in the United States. While this might seem to eliminate many countries quickly, there are countries (e.g., China) that have such large populations that even a very small percentage of high disposable income people could create an appropriate pool of potential customers.
- Do people go out to eat? This was a critical factor. If well-to-do beef-eaters did not go out to eat, these countries had to be removed from the target list.

Exhibit 3 Meat Consumption per Capita[5] (in kilograms)

Region/Classification	2002	2001	2000	1999	1998	Growth Rate 1998–2002
World	39.7	38.8	38.6	38.0	37.7	5.31%
Asia (excluding Middle East)	27.8	26.9	26.6	25.7	25.4	9.45%
Central America/Caribbean	46.9	45.7	44.8	42.9	41.3	13.56%
Europe	74.3	72.5	70.5	70.6	73.1	1.64%
Middle East/North Africa	25.7	25.7	26.0	25.1	24.7	4.05%
North America	123.2	119.1	120.5	122.2	118.3	4.14%
South America	69.7	68.4	69.1	67.6	64.2	8.57%
Sub-Saharan Africa	13.0	12.9	13.1	12.8	12.6	3.17%
Developed Countries	80.0	78.0	77.2	77.3	77.6	3.09%
Developing Countries	28.9	28.1	28.0	27.1	26.6	8.65%
High-Income Countries	93.5	91.9	92.0	92.2	90.9	2.86%
Low-Income Countries	8.8	8.6	8.4	8.3	8.2	7.32%
Middle-Income Countries	46.1	44.6	43.9	42.7	42.3	8.98%

- Affinity for U.S. brands: The name "Ruth's Chris" was uniquely American as was the Ruth Fertel story. Countries that were overtly anti-United States would be eliminated from—or at least pushed down—the target list. One measure of affinity could be the presence of existing U.S. restaurants and successful franchises.

What Should Ruth's Chris Do Next?

Hannah had many years of experience in the restaurant franchising business, and thus had both personal preferences and good instincts about where Ruth's Chris should be looking for new markets. "Which markets should we enter first?" he thought to himself. Market entry was critical, but there were other issues too. Should franchising continue to be Ruth's Chris exclusive international mode of entry? Were there opportunities for joint ventures or company-owned stores in certain markets? How could he identify and evaluate new potential franchisees? Was there an opportunity to find a global partner/brand with which to partner?

Hannah gathered information from several reliable U.S. government and related websites and created the table in Exhibit 4. He noted that many of his top prospects currently did not allow the importation of U.S. beef, but he felt that this was a political (rather than a cultural) variable and thus could change quickly under the right circumstances and with what he felt was the trend toward ever more free trade. He could not find any data on how often people went out to eat or a measure of their affinity toward U.S. brands. Maybe the success of U.S. casual dining restaurants in a country might be a good indicator of how its citizens felt toward U.S. restaurants. With his spreadsheet open, he went to work on the numbers and began contemplating the future global expansion of the company.

> "If you've ever had a filet this good, welcome back."
>
> Ruth Fertel, 1927–2002
> Founder of Ruth's Chris Steak House

Exhibit 4 Data Table

Country	Per Capita Beef Consumption (kg)	Population (1,000s)	Urbanization Rate (%)	Per Capita GDP (PPP in US$)
Argentina	97.6	39,921	90%	$13,100
Bahamas	123.6	303	89%	$20,200
Belgium	86.1	10,379	97%	$31,400
Brazil	82.4	188,078	83%	$8,400
Chile	66.4	16,134	87%	$11,300
China	52.4	1,313,973	39%	$6,800
Costa Rica	40.4	4,075	61%	$11,100
Czech Rep	77.3	10,235	74%	$19,500
France	101.1	60,876	76%	$29,900
Germany	82.1	82,422	88%	$30,400
Greece	78.7	10,688	61%	$22,200
Hungary	100.7	9,981	65%	$16,300
Ireland	106.3	4,062	60%	$41,000
Israel	97.1	6,352	92%	$24,600
Italy	90.4	58,133	67%	$29,200
Japan	43.9	127,463	65%	$31,500
Kuwait	60.2	2,418	96%	$19,200
Malaysia	50.9	24,385	64%	$12,100

Country	Per Capita Beef Consumption (kg)	Population (1,000s)	Urbanization Rate (%)	Per Capita GDP (PPP in US$)
Netherlands	89.3	16,491	66%	$30,500
Panama	54.5	3,191	57%	$7,200
Poland	78.1	38,536	62%	$13,300
Portugal	91.1	10,605	55%	$19,300
Russia	51	142,893	73%	$11,100
Singapore	71.1	4,492	100%	$28,100
South Africa	39	44,187	57%	$12,000
South Korea	74.4	48,846	80%	$20,400
Spain	118.6	40,397	77%	$25,500
Switzerland	72.9	7,523	68%	$32,300
Turkey	19.3	70,413	66%	$8,200
UAE/Dubai	74.4	2,602	85%	$43,400
U.K.	79.6	60,609	89%	$30,300
United States	124.8	298,444	80%	$41,800
Vietnam	28.6	84,402	26%	$2,800

Source: World Resources Institute, "Meat Consumption: Per Capita (1984–2002)," retrieved on June 7, 2006 from http://earthtrends.wri.org/text/agriculture-food/variable-193.html and World Bank Key Development Data & Statistics, http://web.worldbank.org/WBSITE/EXTERNAL/DATASTATISTICS/0,,contentMDK:20535285~menuPK:232599~pagePK:64133150~piPK:64133175~theSitePK:239419,00.html, retrieved on June 7, 2006.

CASE QUESTIONS

1. What decision criteria were being used in the selection of potential nations for expansion? Are there other criteria the company should have included?
2. Of the four potential options, which assumes the most risk? Which is the most risk-averse? Defend your answers.
3. Of the four potential options, which offers the best chance to attract more customers in the same areas? Which offers the best opportunity to expand the total number of company customers? Why?
4. What modifications to the company's brand might be necessary, either when operating a steakhouse in other countries or some new form of restaurant?
5. Which marketing tactics will the company have to examine and possibly change when operating in other countries?

The Ultimate Fighting Championships (UFC): The Evolution of a Sport

By Jesse Baker, under the supervision of Matthew Thomson

> The UFC is the most exciting combat sport in the world because there are so many ways to win and so many ways to lose. . . . Boxing is your father's sport.
>
> –Dana White

> What makes UFC so great is that every single man on the planet gets it immediately. It's just two guys beating each other up.
>
> –Lorenzo Fertitta

> We're not for everyone, and we don't try to be. If you don't like fighting sports, great, this is America, that's your right. All we ask is that people understand what we are.
>
> –Dana White

In early February of 2010, Bryan Johnston, the chief marketing officer for the Ultimate Fighting Championship (UFC), returned to his office at Zuffa LLC, the parent company for the UFC, in Las Vegas, Nevada. He was frustrated by the numerous athlete injuries that continued to plague scheduled events, most recently UFC 108 on January 2, 2010. This situation gave him cause to reflect on some much bigger issues he had been dealing with since leaving his role as vice president of partner marketing at Burton Snowboards to join the UFC and take full control of the organization's marketing activities in June 2009. Johnston was the first senior member of the firm who did not come from a background in boxing or television.[1] He felt a great deal of pressure to ensure that the UFC continued to meet the high expectations that had been set by its phenomenal early success.

The name UFC had become synonymous with mixed martial arts across North America. Over the past decade, the company had experienced unparalleled growth in the sporting industry and was now valued at more than $1 billion.[2] However, the competitive landscape was changing quickly, and Johnston understood that he was running out of time to make important decisions on how to continue to grow the league while maintaining the UFC's competitive advantage that stemmed from its dominant position as the market leader.

The UFC had already begun to make strides in new international markets. According to the results of an Ipsos-Reid Canadian Sports Monitor Study, 22 percent of Canadian adults were interested in the UFC, which was fast approaching the Canadian National Basketball Association (NBA) fan base of 26 percent of Canadian adults.[3] Furthermore, 39 percent of those interested in the UFC said their interest had increased over the past few years, more than any of the 30 other sports surveyed in Canada, including hockey and the Olympics (see Exhibit 1).[4] Still, Johnston wondered about the long-term sustainability of the UFC's current strategy. In January 2010, a 10 percent stake in the company had been sold to Flash Entertainment, a Middle Eastern entertainment company and a wholly

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Exhibit 1 Ispos-Reid Canadian Sports Monitor Study Results

S3_11. (U.F.C. (Ultimate Fighting Championship)) Thinking about your interest in these sports and events in the past few years, would you say that you have less interest, the same interest or more interest than before? If you have never had an interest in the sport or event you can indicate that as well

Proportions/Means: Columns Tested (5% risk level) - A/B/C/D/E/F - G/H - I/J/K/L/M/N/O/P/Q/R/S - T/U*
small base

	Total (Age)	18 to 34	18 to 49	25 to 54	35 to 54	45 to 54	55+
Base: Casual or avid fan	409	166	318	295	185	74	58
Weighted	431	208	354	315	176	64*	47*
Less Interest	60 14%	27 13%	44 13%	39 12%	24 14%	11 17%	8 18%
The Same	203 47%	91 44%	165 47%	148 47%	91 52%	34 54%	21 44%
More	169 39%	90 43%	145 41%	129 41%	61 35%	18 29%	18 38%

Source: Ipsos-Reid Canadian Sports Monitor Study, Table 25.

owned subsidiary of the Abu Dhabi government.[5] Johnston hoped that this move would allow the UFC to develop strategic partnerships in the Middle East and throughout Asia. However, if the UFC could not even deliver on the advertised fights within the United States, how would the company be able to deliver quality fights overseas? New international markets would dramatically increase the demand for talented main-event fighters.

Johnston also wondered whether local talent would need to be identified and recruited to attract fans and fill seats in these new markets. The popularity of English-born fighter Michael Bisping was paramount to the success of UFC events in the United Kingdom. Would his popularity also hold true in other regions? Johnston was also wary of an expansion strategy that would compromise the company's core fan base, many of whom remained skeptical of the UFC's international initiatives. He remembered an interview he had seen recently, in which Marshall Zelaznik, the UFC's managing director of International Development, had reiterated the disappointment of many UFC fans, who feared that too many international events would dilute the quality of the events held within the United States.[6] Johnston did not want to alienate the UFC's primary market by stretching the resources too thin.

Early Development

The concept of the UFC was originally developed in 1993, as a single-elimination, eight-man tournament called War of the Worlds by Art Davie, an enthusiast with an advertising background, and Rorion Gracie, a master in the martial art of Brazilian jiu-jitsu.[7] The concept developed as a tournament that would feature martial artists from different disciplines facing each other to determine the best martial art. Davie and Gracie formed WOW Promotions and founded Semaphore Entertainment Group (SEG) as a television partner.[8] The trademarked octagon design was developed for the enclosure in which the bouts were staged, and Davie and Gracie named the show "The Ultimate Fighting Championship."[9] The first event, later to be known as UFC 1, was held in Denver, Colorado, and proved to be a success from its inception, drawing 86,592 pay-per-view (PPV) television subscribers.[10] Following UFC 5, in April 1995, Davie and Gracie sold their interests in the organization to SEG.

Despite the UFC's early success, controversy surrounding the absence of any standard set of rules to govern the sport led to the sport being banned in 36 states.[11] One of many public figures who spoke out against the sport was U.S. Senator John McCain, who declared it to be "human cock-fighting."[12] As a result, the UFC was dropped from major cable PPV distributor, Viewer's Choice, and other individual cable carriers, such as TCI Cable.[13] The controversy also was a major barrier against obtaining official athletic sanctioning from state athletic commissions.

In the early 1990s, in fact, the UFC's tagline had been "There Are No Rules!" In reality, though, a limited set of rules did exist: no eye gouging and no biting. Other techniques such as hair pulling, head butting, groin strikes, and fish hooking were frowned upon, but still permitted. These rules, or their lack thereof, were a major source of the controversy. Although the sport was appealing to some, until the sport was able to establish a clear set of rules to better protect fighters, opportunities were clearly limited for the sport's growth.

In an attempt to gain more widespread acceptance and popularity, the UFC changed some rules and decided to increase its cooperation with state athletic commissions. On September 30, 2000, the UFC held its first U.S.-sanctioned mixed martial arts event in New Jersey. UFC 28 was sanctioned under the New Jersey State Athletic Control Board's "Unified Rules."[14]

Zuffa LLC Purchase

Attempts to have the sport sanctioned across the United States eventually drove SEG to the brink of bankruptcy. In 2001, Frank and Lorenzo Fertitta, executives with Station Casinos, and Dana White, a boxing promoter, bought the UFC for $2 million and created Zuffa LLC (Zuffa),[15] a parent entity controlling the UFC.[16]

Lorenzo Fertitta, a former member of the Nevada State Athletic Commission, used his relationships to secure sanctioning in the state of Nevada in 2001. The UFC made its return to pay-per-view with UFC 33: Victory in Vegas. The UFC slowly began to regain popularity, and advertising and corporate sponsorships followed.[17] The UFC started generating higher live gates (i.e., ticket revenue) from hosting events at casino venues such as Trump Taj Mahal and the MGM Grand Garden Arena. The organization started to see PPV revenues as high as revenues before the political controversies in 1997.

The UFC secured its first television deal with Fox Sports Net (FSN). *The Best Damn Sports Show* aired the first mixed martial arts match in June 2002 at UFC 37.5, featuring as its main event Chuck Lidell vs. Vitor Belfort.[18] Later, FSN would also air one-hour highlights of the UFC's greatest fights.

The first major milestone came at UFC 40, when pay-per-view buys hit 150,000. The fight featured a grudge match between Tito Ortiz and UFC legend Ken Shamrock.[19] Despite this success, the UFC continued to experience financial deficits. By 2004, Zuffa had reported $34 million of losses since purchasing the UFC. [20]

The Ultimate Fighter and Spike TV

To avoid bankruptcy once again, Zuffa decided to take the UFC beyond pay-per-view and into cable television by creating *The Ultimate Fighter (TUF),* a reality-TV series that featured up-and-coming mixed martial arts (MMA) fighters competing for a contract in the UFC. Several different networks rejected the concept, and not until Zuffa offered to pay the $10 million production costs was a partner found—in Spike TV.[21]

The show aired for the first time in January 2005, following *WWE Raw,* and it became an instant success. The finale for the first show featured fan favorite Forrest Griffin matched up against Stephan Bonnar with the winner receiving a six-figure contract with the UFC. Dana White had since credited this event with having saved the UFC.[22] A second season was aired in August of the same year, and two more seasons were aired in 2006. The success of the show led Spike TV to pick up more UFC content in the form of *UFC Unleashed,* an hour-long show that aired select fights from previous events, and *UFC Fight Night,* a series of fight events that debuted in August 2005. Spike would also feature *Countdown* specials to promote upcoming UFC pay-per-view cards.

In 2009, the 10th season of *TUF* featured a selection of heavyweight fighters, including the YouTube-famous, Kevin "Kimbo Slice" Ferguson.[23] This episode was an enormous success, drawing the highest ratings in the show's history with a household rating of between 3.7 million and 5.3 million total viewers.[24] The difficulty for Johnston lay in whether this success could be duplicated in foreign markets. The company's expansion strategy involved airing non-live UFC content, such as *TUF* and *UFC Unleashed* and *Fight Night;* however, given what he knew about the highly fragmented nature of his target audience, Johnston wondered whether these shows, which did incredibly well in North America, would experience similar success in other countries.

UFC's strategic partnership with Spike TV proved to be the ideal opportunity for the UFC to maximize exposure. These programs became the main outlets through which the UFC promoted its pay-per-view events, which allowed UFC to spend very little on advertising while targeting its core audience effectively. UFC was also able to generate significant sponsorship revenues through its television programming. The result was a dramatic increase in pay-per-view buys and an overall explosion in growth for the sport of MMA as a whole.

Explosion of Pay-per-View Buy Rates

UFC 52 was the first event to air after the first season of *TUF.* The event featured two future hall-of-famers, Chuck "The Iceman" Liddell and Randy "The Natural" Couture. The event doubled the last benchmark with pay-per-view audience of 300,000.[25] The second season of *TUF* was used to promote a rubber match between Liddell and Couture at UFC 57.[26] This event drew an estimated 410,000 pay-per-view buys.[27] The next big milestone came in the same year when Chuck Liddell faced Tito Ortiz in UFC 66. The event drew more than one million pay-per-view buys, and the UFC's popularity continued to skyrocket.[28] In 2006, the UFC broke the pay-per-view industry's record for the most revenues in a single year with more than $222,766,000, exceeding PPV revenues from boxing and the WWE.[29] In July 2007, BodogLife.com, a gambling website, stated that, for the first time, the betting revenues from the UFC would surpass those from boxing.[30]

Playing a huge role in UFC's success was the organization's ability to promote its pay-per-view events through its cable television outlets, along with its ability to capitalize on the hype created by these shows, with much-anticipated fighter matchups following directly after. In the meantime, UFC had developed a self-sustaining positive feedback loop of publicly available material that served to promote the next pay-per-view event without having to draw on outside sources, resulting in favorable cost-efficiencies for the organization.

World Extreme Cagefighting and PRIDE Acquisitions

The UFC continued to expand its reach into new markets with the acquisitions of World Extreme Cagefighting (WEC) in December 2006 and PRIDE Fighting Championships (PRIDE) on March 27, 2007.[31]

WEC was a promotional company based in California that showcased fighters in lower weight classes than those featured by the UFC. This arrangement allowed the UFC to control a broader range of mixed martial arts entertainment within the United States (see Exhibit 2).

The acquisition of PRIDE, a struggling Japanese-based league cost less than $70 million and was intended initially to be run as a separate

Exhibit 2 List of Weight Classes for Ultimate Fighting Championship and World Extreme Cagefighting

Ultimate Fighting Championship			
Division	**Upper Weight Limit**	**Champion**	**Title Defenses**
Heavyweight	265 lb (120 kg)	Brock Lesnar *UFC 91*	1
Light Heavyweight	205 lb (93 kg)	Lyoto Machida *UFC 98*	1
Middleweight	185 lb (84 kg)	Anderson Silva *UFC 64*	5
Welterweight	170 lb (77 kg)	Georges St-Pierre *UFC 83*	3
Lightweight	155 lb (70 kg)	BJ Penn *UFC 80*	3
World Extreme Cagefighting			
Division	**Upper Weight Limit**	**Champion**	**Title Defenses**
Lightweight	155 lb (70 kg)	Ben Henderson *WEC 46*	0
Featherweight	145 lb (66 kg)	Jose Aldo *WEC 44*	0
Bantamweight	135 lb (61 kg)	Brian Bowles *WEC 42*	0
Flyweight	125 lb (57 kg)	Vacant	–

Source: Case writer.

organization.[32] PRIDE had been the UCF's largest international rival and had featured many of the world's greatest fighters. Shortly after the acquisition, on October 4, 2007, the UFC closed the Japanese operations of PRIDE and began to rebrand many of the top PRIDE fighters under the UFC name.[33] When interviewed on ESPNEWS, Dana White remained vague about the reasons for closing the league, simply claiming that the model was not sustainable and that "PRIDE is a mess."[34] Many people in the MMA community understood this rebranding as another step in the company's attempts to align the UFC's brand as closely as possible with the sport of MMA as a whole. It also revealed the UFC's intentions to buy out competitors and close their doors as a strategy to ensure its market position. The league followed this decision with a series of UFC events that served to unify the leagues under one name by pitting UFC and PRIDE champions against each other.[35]

Johnston was becoming increasingly concerned with the longer-term implications of the UFC's current business strategy. The league was undoubtedly the strongest it had ever been. However, limiting the number of avenues that young fighters could take to pursue careers in the sport of MMA seemed counter-intuitive, especially while simultaneously attempting to grow the organization. This strategy would undoubtedly require access to an increasingly large pool of talented fighters. Although ultimately the UFC's strategy had worked well in terms of ensuring its dominance in market share, Johnston was beginning to wonder whether these decisions would hinder the UFC's ability to jump into international markets. Despite the huge potential market that existed in Asia, he wondered how the UFC would be perceived given its previous decisions to close the doors of PRIDE and force its fighters to compete overseas in the UFC. PRIDE fighters were generally given very little time to adapt to the UFC's different fighting styles and rules. Many PRIDE fighters refused to accept the terms of the merger and felt they were not receiving a fair opportunity to establish themselves in the UFC. As a result, many fighters left the UFC for other smaller competing organizations.

New Competition Emerges

Mixed martial arts had reached superstar status in the world of sport, and the UFC was capturing approximately 90 percent of the industry's total revenues.[36] However, many challenging organizations were emerging, each with a unique business model in attempts to become established in the market and to steal revenues from the MMA giant. The UFC had a simple strategy for limiting the growth of its competitors; it scheduled free counter-programming at the same time as their competitors with the intention of stealing revenues.[37] And although this approach was not profitable in itself, it worked by preventing new competitors from both achieving profitable operations and recouping their investments in high-profile fighters.

Although some competing organizations were airing live fights for free on cable television, an offering that the UFC was yet to make available on a regular basis, others were investing huge amounts to attract some of the world's best fighters. A key example was the world's number-one ranked mixed martial arts fighter, Fedor Emelianenko, who held the PRIDE Heavyweight Championship before the league was closed by the UFC, and who, despite being considered by most to be the world's best fighter, had never fought in the UFC. This situation was the result of Emelianenko's long-standing dispute with Dana White over the terms of a contract. Emelianenko was quoted as saying, "The bottom line was that the UFC was a one-sided offer, and you know, that's something that can never be acceptable."[38] Johnston recalled White's less than politically correct response to Emelianenko's accusations. "Let me put it this way. I've done fight contract with all the best fighters in the world . . . who the——is Fedor? Are you serious?"[39] Although Johnston understood that this attitude had played a crucial role in building the UFC brand with free publicity through Dana White's constant appearances in the media, he was also concerned with how this attitude could negatively affect other important relationships as the league continued to grow. Facing increased competition, Johnston wondered whether the organization might need to start rethinking the way it negotiated contracts with the league's fighters. He knew that the UFC would not be able to continue dominating the terms of contract agreements as it had in the past.

In 2008, Affliction Entertainment emerged as a promotions company, created by Affliction Clothing. The clothing company was looking to challenge the UFC in the United States after having experienced disputes with the UFC over royalties. Affliction Clothing, which had been one of the UFC's largest clothing sponsors, had been able to secure, with the financial support of Donald Trump, Fedor Emelianenko, considered by many to be the world's number-one ranked fighter.[40] The UFC reacted by banning fighters from wearing Affliction Clothing logos. The UFC also aired a last minute, free, live event on Spike TV, featuring one of the UFC's top fighters, Anderson Silva, to compete with Affliction Entertainment's pay-per-view event, *Affliction: Banned,* on July 19, 2008.[41] One year later, on July 24, 2009, Affliction Entertainment announced that it would be closing the promotions business and Affliction Clothing would return to sponsoring the UFC.[42]

When Affliction Entertainment closed its doors, Strikeforce, a fighting league based out of California, signed Emelianenko and offered its first MMA fight on November 7, 2009, on live CBS. Strikeforce established sponsorship deals with Rockstar Energy Drink and found other partners to begin hosting fights in Japan. In June of 2009, Strikeforce also aired the first female championship on cable television.[43]

Other emerging competition included the International Fight League (IFL), which had a huge presence in overseas markets but was not well established within the United States. IFL was also not airing televised live fights. As well, EliteXC was challenging for market share, but the company had invested too much money in few main fighters and its business model did not appear to be sustainable. Mark Cuban, a well-known entrepreneur who also owned the National Basketball Association's Dallas Mavericks, was also pushing his way into the MMA market by partnering with organizations, such as Affliction Entertainment, and airing fights on his cable network, HDNet.[44]

DREAM was one of the UFC's strongest international competitors that emerged after the UFC's purchase and dissolution of PRIDE. The league contained numerous well-respected and talented fighters who would be competitive in U.S. markets but who had very limited exposure in North America. The style of the DREAM fighters and the marketing of their events differed greatly from the UFC. The league had established partnerships with HDNet, EliteXC, Strikeforce and M-1 Global, owned in part by Fedor Emelianenko.[45,46,47] Johnston expected this large network of increasingly integrated organizations would pose a serious threat to the UFC's ability to compete in new international markets.

Fighters' Salaries

With new competition in the United States and globally, Johnston wondered whether the company was doing enough to both retain the league's top talent and attract new fighters. He reflected on what he knew about original fighter payouts that often left first-time fighters losing money from their fights. To be cleared for a fight, the average medical bills for a fighter totaled approximately \$2,500,[48] which included magnetic resonance imaging (MRI) scan, computerized axial tomography (CAT) scan, blood work, an eye exam, and a full physical examination. For first-time fighters, the actual payout was set at approximately \$2,000, with an additional \$2,000 being awarded to the winner.[49] As a result, because of the medical bills alone, a first-time fighter who lost his fight would lose money overall. In reality, many other costs, such as training expenses, travel, and fight preparation, would further compound the situation. If a fighter won his first fight, he might break even. If he continued to win, his earnings would increase incrementally (usually by \$2,000 a fight).[50] The majority of fighters in the league, however, did not have large endorsements or high-profile contract agreements with the UFC; instead, they were barely scraping by. Johnston wondered whether this model provided enough real incentive for young athletes to join the sport. How was this model going to affect the long-term growth prospects for the sport? Did it make sense for an organization that had experienced such immense growth and success to take advantage of its talent?

Fighter compensation had been increasing along with company revenues, but Johnston realized that the UFC continued to lack significantly, compared with other major sports leagues.[51] Johnston examined an analysis of disclosed payouts and compared it with the UFC revenues over the past four years (see Exhibit 3). He wondered whether the current payout structure was enough, or did the UFC need to drastically change the way it compensated fighters?

The UFC also lacked any form of union to protect the interests of its athletes, although such unions existed in every other major sports league: the National Football League (NFL), the National Basketball Association (NBA), Major League Baseball (MLB), the National Hockey League (NHL) and the Association of Tennis Professionals (ATP). In the past, attempts to protect the athletes' interests had been actively resisted by the company's president, Dana White. The league had been criticized for refusing to negotiate contracts; as a result, in several instances, the UFC's most popular fighters had refused to fight, preferring instead to leave the UFC for smaller, competing leagues. For example, Tito Ortiz, a former light heavyweight champion and fan favorite, left the UFC over a dispute with Dana White.[52] He later returned to the league and ended up fighting for less money than he had originally been offered.[53]

Johnston was uncomfortable with the way the UFC had, in the past, exploited what was essentially a monopoly in the North American market in order to bully fighters into what many believed to

Exhibit 3 Ultimate Fighting Championship: Number of Fights/Event, Average GATE Revenue/Fight, and Total Bonuses Paid Out to Fighters, 2006–2009

Year	2006	2007	2008	2009	Δ 2006 – 2009
Average Number of Fights, per Event	8.9	9.1	9.9	10.5	18.3%
Average Gate Revenue, UFC Events	$376,406	$614,077	$735,000	$898,375	138.7%
Average Gate Revenue, UFN/TUF Events	$170,250	$245,300	$321,833	$434,665	155.3%
Size of Average Bonus Pool Paid Out by UFC Event to Fighters	–	$162,500	$196,667	$216,333	33.1%

Note: UFC = Ultimate Fighting Championships; TUF = The Ultimate Fighter; UFN = Ultimate Fight Night.

be unfair contracts. As new leagues emerged and gained momentum, he realized that achieving such favorable payment contracts with fighters might become increasingly difficult. The UFC had already seen many of its fighters leave, but had taken little action to rebuild these relationships. He wondered whether it was time to start paying more attention to this issue, but was unsure of how to go about making changes and how to gain buy-in from the rest of the leadership team, including White, who had seriously resisted the issue in the past.

Beyond the league's contract policies, the UFC also had final say on all sponsorship deals, including all forms of individual fighter sponsorships. Until recently, the UFC had not been able to control any sponsored images that appeared on the fighter's body.[54] However, in 2009, a new rule was established that required every sponsor to pay a licensing fee as high as $100,000 to the UFC for the right to sponsor a fighter. This fee made it substantially harder for up-and-coming fighters because sponsors were not willing to fund newer fighters who were more likely to fight on the undercard, therefore providing the sponsor with only limited exposure.[55] The licensing requirement also essentially locked out smaller or new companies from sponsoring the UFC because they could not afford to pay the required fees. Johnston believed that limited sponsorship competition might be harmful to the UFC and might adversely affect its long-term opportunities for sponsorship revenue.

The league had also just finished establishing a new set of corporate sponsors, including Harley-Davidson and Bud Light. Referring to the UFC's sponsors, Dana White was quoted in an interview as having said, "We don't need anybody."[56] Johnston understood the value of establishing strategic partnerships, and he was unclear about what exactly White had meant by this. Although White had also spoken about how the UFC was seeking strategic partners rather than blue-chip sponsors, Johnston was not sure whether the UFC's current sponsorship relationships reflected this preference.[57] Should the league be pursuing more cross-promotional advertising initiatives to push the UFC into new markets? Harley-Davidson was an expensive motorcycle brand that primarily targeted an older demographic. Was this choice of a corporate sponsor in line with the UFC's target audience of males aged 18 to 36?

International Expansion Opportunities

The UFC was looking to follow up its recent partnership with Flash Entertainment by building a new arena at the Emirate Hotel in Abu Dhabi, a city that was emerging as the cultural and entertainment mecca of the United Arab Emirates (UAE). The new building would be an outdoor arena with 10,000-plus seats and coliseum-style seating that preserved the trademark UFC atmosphere.[58] Johnston was still unsure about where to promote the event, but expected to see interest from across the UAE and planned to promote the event through the UFC's European, British and Asian partners.[59] When a UFC event had been held in Australia, fans had traveled from across the country to attend. Johnston wondered whether a similar response could be expected in the UAE, or whether the demand would be large enough within the city.[60]

Johnston also knew that the UFC had been working for years to tap into the huge boxing market in Mexico by developing young Mexican talent, such as Cain Velasquez and Roger Huerta. The UFC had also recently signed a television deal with Grupo Televisa S.A.B., the world's largest Spanish-speaking media company, and had debuted with a free, live broadcast of UFC 100, on July 11, 2009.[61] Other programming included live *UFC Fight Night* events, *UFC Countdown* shows and one-hour feature programs.[62] Johnston was eager to hold the UFC's first pay-per-view event in Mexico, but wanted to ensure that it would be a success.

The UFC had already experienced success through ESPN in the United Kingdom and Ireland, and on June 1, 2009, the UFC expanded into Portugal by showing UFC 98: MACHIDA vs. EVANS, on pay-per-view.[63] This event was followed by a Chinese TV Deal on June 29, 2009, which provided the UFC with one to four hours of UFC programming each week on Saturdays and Sundays, broadcast in languages specific to each province.[64] Inner Mongolia Television (NMTV) would air the events, which could reach a potential 240 million viewers in China.[65] Johnston was excited by the potential of this market, but he wondered what the next step would be. Was India the next frontier for the UFC? If successful, the UFC would see huge upside potential, but Johnston was not sure that the UFC had a product that was adequate to meet the needs of this market. He was not even sure he understood exactly what those needs were. The company was already busy trying to establish the UFC brand in Western Europe and America. Was the company perhaps moving too quickly?

Johnston also wondered how the UFC would market the events in new countries. He wondered whether he fully understood how the UFC was perceived in these new markets. Would it be enough to continue promoting the league in the same way as in the past? Would this approach be effective in foreign markets where the league did not receive free publicity through a huge range of media outlets? In Asia, for example, the league would be compared to Japanese fighting organizations such as PRIDE. These leagues featured different fighting styles and much more cultured traditions. Although Japanese events would still feature an elaborate show, many fans did not like the way the UFC had "Americanized" a sport that was seen in other countries to be worthy of much more elegance and respect.

The UFC's core fan base in North America resulted from converting fans from World Wrestling Entertainment (WWE) and boxing. Originally, the UFC's target audience had been perceived to be males aged 18 to 36. These assumptions were driving the organization's decisions on the sponsors to target and the event promotions to pursue. However, Johnston believed he was beginning to better understand the polarized and dynamic nature of the UFC's fan base.

In fact, not only men were drawn to the sport; Johnston also suspected that much interest was also generated in females aged 18 to 36. This female audience, he realized, would open up an entirely new sponsorship base. He wondered how he should go about examining the true nature of the UFC's audience and how he could best convey this audience sector to new potential sponsors.

The UFC also needed to consider an entirely new potential audience of fans who were neither MMA enthusiasts nor fans of boxing or professional wrestling. These potential fans were general sports fans who had been introduced to the UFC through various media. Johnston wondered where these general sports fans fit into the existing categories of fans or whether they valued something altogether different. WWE fans tended to be more interested in the "show" and less concerned with the more technical aspects of the sport as compared with the boxing segment, which valued the fighters' athleticism and talent. WWE-rooted fans enjoyed watching rivalries develop in the media between the fighters and valued high-profile fighters with well-developed media personalities. Ultimately, these rivalries had been initiated to drive buys for PPV events. Johnston had recognized that the situation was unique in that the UFC was able to appeal to different customer segments that watched for different reasons. He also understood that a delicate balance was required when trying to meet the needs of these core fan bases. Regardless of the direction the company chose to pursue, it needed to ensure it continued to meet the needs of the existing fans.

The UFC had become a master in the art of generating free publicity through almost all media outlets, including television, radio, newsprint, and social media networks. Much of the early success of the UFC could be attributed to the company's president, Dana White, who took a non-traditional role and became the organization's most crucial publicity machine. At various times, White had been scrutinized for his derogatory language and controversial comments. His loud personality and unorthodox role as an outspoken celebrity chief executive officer (CEO) was proving to be a unique and successful marketing strategy. Many fans related to his rough and aggressive attitude, which had been a strong driving force behind the growth and success of the league. In fact, many of his disputes with writers, athletes, and public interest groups such as GLAAD[66] had been well documented by White himself through his Twitter account.

Frank and Lorenzo Fertitta owned the remaining 90 percent of Zuffa LLC. They had got their start in business as casino executives, and both shared a passion for mixed martial arts. They had allowed White to function as the organization's front man. When the company was founded, they wrote a legally binding clause into their contract that stated, in the event of a dispute between the two majority owners, a three, five-minute round, mixed martial arts fight would be used to determine the winner.[67] Recently, Lorenzo Fertitta had resigned as Station Casinos' president to work full-time as chair and CEO of the UFC to help the organization focus on its global expansion, which included "landing more big-name sponsors, particularly in countries other than the U.S."[68]

Another important personality of the league was Joe Rogan, a former martial artist and the former host of the popular TV reality show *Fear Factor.* Rogan had become one of the organization's most popular characters as the color commentator for all major UFC events. His seemingly infinite knowledge and incredibly accurate insights made him a fan favorite and one of the league's most valuable assets. In addition, Joe Silva served as the league's matchmaker and talent recruiter. He negotiated all contracts and played a key role in establishing the favorable deals the UFC was able to secure with many top fighters. Johnston wondered whether he should speak to Silva directly about his concerns.

Financial Overview

Standard and Poor's had released its latest credit report on Zuffa LLC, which documented the corporation's most recent financing activities. Zuffa's credit rating was reaffirmed at BB– (stable but not "investment grade").[69]

The company's 75 percent event-driven business model posed some concern to Johnston from a business standpoint. The company had recently made attempts to diversify its revenue streams by releasing a new video game, *UFC Unleashed,* and improved operating margins had been experienced on the company's U.K. operations.[70] Despite tremendous growth over the past year, Johnston understood that the company had really only been profitable for the last four years. Johnston wondered whether the owners would ever be interested in taking the company public, and, if so, when would be the right time to do so. He believed that if this option was to be pursued, the company's financial structure would first need to be re-evaluated.

Because more and more American states were moving toward legalizing mixed martial arts, Johnston knew that a huge potential for growth remained within North America. Currently, the 2010 fight schedule featured more international events than ever before. He wondered whether the company was moving in the right direction. Too much focus on overseas markets could leave the UFC vulnerable to the increasing competition within the United States, and a failure abroad could be devastating.

Johnston sat down at his desk and began to prepare his recommendations for the company's executive meeting later that week. He had not been with the organization for long and needed to carefully consider how to approach many of these issues. He knew that the executive could not alienate the organization's core fan base or dilute the quality of the UFC experience for its viewers. The massive potential of the European, Middle Eastern, and Asian markets was an opportunity that could not be overlooked; however, moving into those international markets would not be as simple as duplicating the experience offered in the United States. Despite the company's strong financial position, the UFC could not afford to make significant investments in unprofitable new markets. To further complicate his job, Johnston realized that White and the Fertitta brothers did not operate their company in a typical manner; they had become enormously successful by trusting their instincts and gambling on their emotions. Johnston was concerned about the potential for this mentality to lead the company down the wrong path. White and the Fertittas had done a remarkable job at building the UFC brand, but Johnston's experience told him how quickly their success could change if they did not take the right steps to protect it. His decisions would play a crucial role in shaping the future of the organization.

CASE QUESTIONS

1. What are the primary challenges the UFC faces in defending its domestic market or reaching new customers in those markets? Do you believe young women, ages 18 to 36, represent a viable new target market? Why or why not?
2. When seeking to build the fan base by expanding into other countries, what aspects of each nation should be most carefully considered first?
3. How could the UFC product, the actual fights, be improved to attract a greater number of fans?
4. When a general sports fan considers the UFC brand, what aspects of the past may hurt the brand? How can the company refine the brand in order to retain current fans and reach the more general sports fan?
5. What additional branding opportunities are possible for the UFC?

Best Buy Inc.—Dual Branding in China

By R. Chandrasekhar, under the supervision of Professor Niraj Dawar

In June 2006, John Noble, senior vice president at Best Buy International, a division of Best Buy Inc. (Best Buy), the largest retailer of consumer electronics (CE) in the United States, faced a major strategic branding decision. Earlier that month, the company had acquired a majority stake in Jiangsu Five Star Appliances (Five Star), the third-largest retailer of appliances and consumer electronics in China. Noble had been assigned to the international division just a month earlier from the company's Canadian operations, where he had held a similar position since 2002. In his new role,

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Noble was tasked to decide and plan how Best Buy should implement a dual-brand strategy in China. The dual-brand strategy adopted in Canada four years earlier seemed to have worked well. "Will the dual-brand strategy work in China?" he wondered. "How should I make it work?"

While negotiating for a majority stake in Five Star, which had 135 stores in China, Best Buy announced plans to open its first Best Buy store in China in December 2006, to be followed by two more stores in the next 12 to 18 months. Five Star also announced its own agenda of opening 25 additional stores in China, under the Five Star banner, during approximately the same period.

Context

When Best Buy decided to go beyond the domestic market in the United States in December 2000, the company had found neighboring Canada to be a logical first step. The Canadian CE market was fragmented, with only one dominant player, Future Shop. Best Buy's original objective was to set up its own stores in various Canadian cities to compete directly with Future Shop stores. It had planned to open the first of several stores in the Toronto area in 2003, and then embark on a three-year expansion program that would see the launch of 15 stores in major Canadian cities. Best Buy had a target of setting up 60 to 65 stores across Canada, competing with the 95 stores of Future Shop, which itself was planning to increase its stores to 120 over four years. As part of a defense strategy, Future Shop was also finalizing plans to relocate or renovate at least half of its existing stores by 2005.

In August 2001, the founders of the two companies met and decided, over the course of three weeks, that "together we could accomplish infinitely more than if we were to go our own ways and compete with each other."[1] By January 2002, Best Buy had acquired 100 percent ownership in Future Shop. Then, when the time came to finalize integration, the management of Best Buy took a surprising decision: to retain the Future Shop brand and let it compete with Best Buy as an independent brand, a strategy that had no precedent within the company. The dual-brand strategy—wherein two brands, both part of a common corporate entity, vied for market share—was an initiative being tested for the first time at Best Buy (see Exhibit 1).

In reference to whether the dual brand strategy could be implemented, Richard Schulze, the founder of Best Buy, was famously quoted for saying, at the time of the acquisition, "I'm not saying it can't be done, I'm saying it's never been done before. . . ."

Exhibit 1 Best Buy and Future Shop in 2002

	Best Buy	Future Shop
Typical store size	35,000 square feet	26,000 square feet
Store associates	Blue Shirts	Product Experts
Staff mandate	Technology is fun. We make it easy for the customer	Providing Trusted Personalized Service
Customers	Tech enthusiasts who enjoy the interactive shopping experience and grab-and-go convenience	Tech savvy; a notch higher than the Best Buy customer; at the cutting edge of developments in technology
Aisles	Wide aisles to provide for grab-and-go shopping	Highlights key technologies first

(Continued)

Exhibit 1 (Continued)

	Best Buy	Future Shop
Service	Upon request	Attentive
Sales	Customer led No high-pressure salesmanship	Sales-person led Commission-based sales
Target group	Higher success rate with female customers	Male-oriented
Customer profile	15 to 39 years	25 to 44 years
Brand identity	"Turn on the fun"	"The place to get it first"
In-store experience	Relaxed	Guided
Product mix	Although by category the two store brands were very similar, each was able to offer a unique selection of products and brands. Product brands and depth of selection differed within product categories. On average, 45 percent overlap of the product assortment (excluding entertainment software) between the two store brands.	
Areas of distinction	Higher propensity towards self-service; non-commissioned sales staff; greater assortment of ready-made electronics packages; wider aisles and more interactive displays; higher ratio of female customers, seeking to integrate products into their lifestyles; customers with higher incomes and higher levels of education	Commissioned sales staff guiding the customer by providing customized, trusted and personalized approach; tech savvy, early adopters looking for the best deal; customer base more diverse

Source: Company files

Best Buy

Headquartered in Minneapolis in the United States, Best Buy was driven by a vision of "meeting consumers at the intersection of technology and life."[2] The company saw its core strategy as "bringing technology and consumers together in a retail environment that focuses on educating consumers on the features and benefits of technology and entertainment while maximizing overall profitability."[3] Best Buy was positioned to deliver new technologies at the retail level in the three segments of devices, connections, and content, enabling the company to capitalize on the progressive digitization of analog products and the accelerating digital product cycles to mobilize consumer demand. The company was selling its products at moderate to upper moderate price points.

Growing at a rate of between 15 percent and 20 percent every year, Best Buy had attained sales revenues of US$30.9 billion for the year ending March 2006 (see Exhibit 2). The company had more than 20 percent share of the retail American consumer electronics market, which was valued at US$152 billion in 2006.[4] Globally, the CE market was averaging a growth rate of 10 percent and was expected, according to CEA/GfK Worldwide Consumer Electronics Sales & Forecast, to reach revenues of US$700 billion by 2009.[5] In planning to maintain double-digit growth rate year after year, Best Buy saw, in its international expansion, a window of opportunity.

Exhibit 2 Best Buy Inc.—Income Statement

Year ending March (in US$million)	2006	2005	2004	2003	2002	2001	2000	1999
Revenue								
Domestic	27,380	24,616	22,225	20,946	17,711	15,326	12,494	10,064
International	3,468	2,817	2,323	–	–	–	–	–
Total	30,848	27,433	24,548	20,946	17,711	15,326	12,494	10,064
Less: Cost of goods sold	23,122	20,938	18,677	15,710	13,941	12,267	10,100	8,250
Gross profit	7,726	6,495	5,871	5,236	3,770	3,059	2,394	1,814
Less: S&G expenses	6,082	5,053	4,567	4,226	2,862	2,455	1,854	1,463
Operating income	1,644	1,442	1,304	1,010	908	604	539	351
Net interest income	77	1	(8)	4	18	37	23	1
Earnings before tax	1,721	1,443	1,296	1,014	926	641	562	352
Income tax	581	509	496	392	356	245	215	136
Other (Loss)/Gain	–	50	(95)	(523)	–	–	–	–
Net earnings	1,140	984	705	99	570	396	347	216
Category wise revenue Domestic								
– Home Office	8,762	8,380	7,556	–	–			
– Video & Audio	11,773	9,609	8,445	–	–			
– Ent. Software	5,202	5,169	4,889	–	–			
– Appliances	1,643	1,476	1,335	–	–			
International								
– Home Office	1,526	1,127	929	–	–			
– Video & Audio	1,318	1,155	930	–	–			
– Ent. Software	487	422	348	–	–			
– Appliances	139	113	116	–	–			
Number of employees (in 000s)	128							
Cash and equivalents (in US$million)	681	354	245					

Source: Best Buy annual report.

History

Best Buy was founded in 1966, by Richard Schulze, an American entrepreneur from the mid-west. The chain, which was known at the time as Sound of Music, was retailing audio components sourced from vendors. The company struggled through the recession years of the 1970s, and with the arrival of the video cassette recorder in the early 1980s, the music chain expanded into retailing video components. In 1983, Sound of Music moved into mass merchandising by switching to a superstore format (characterized by a wide range of products and boxes of merchandise in a warehouse atmosphere) under the new, distinctive yellow Best Buy banner. Six years later, Best Buy refined its retailing techniques in three ways: the introduction of self-service, the placement of its salespersons (referred to as "Blue Shirts") on fixed pay instead of on commission, and reconfiguration of stores' formats to a discount style. The changes were made in recognition of both a trend in customers of being knowledgeable enough to choose products on their own and their preference of shopping in a consumer-friendly environment.

Innovations

The company's decision to stop paying commissions to salespersons and put them on salary did not go well initially with vendors such as Toshiba and Hitachi. These manufacturers had long felt that a high-pressure, incentives-oriented, and results-driven approach at the store was necessary to move products. But Best Buy soon realized that its customers were comfortable in the new, informal ambience at its stores.

After entering new domestic markets, such as Chicago, Philadelphia, and Boston, Best Buy became the biggest seller of home personal computers (PCs) in 1995, in time for the Internet boom. In 1996, Best Buy surpassed Circuit City to become the top CE retailer in the United States, a position that Best Buy had since held.

Best Buy had spotted another trend. Digital devices and home networks were growing in complexity, opening up a prospect for marketing the necessary technical services to homes and small businesses. This opportunity was pegged at being worth more than US$20 billion a year in the United States. Best Buy had acquired, in October 2002, a Minneapolis-based start-up specializing in repairing and installing PCs, called Geek Squad. Within a year, Best Buy had Geek Squad precincts, staffed by newly recruited techies, in more than 20 stores. By 2005, the geeks had set up shop in all Best Buy stores. The move was an advantage over competitors, such as Walmart, which did not provide service back-up for their CE sales.

Centricity

Best Buy had identified the technology enthusiast as its core customer. This target group was characterized by the following attributes: aged 15 to 39, male, highly educated, above-average income and eager for products and services that would render personal time both productive and enjoyable, and resonate with being fun, honest, young and techno-savvy. Best Buy was building its brand promise on those very lines: "being fun, honest, young, and techno-savvy."

In the late 1990s, Best Buy established a standard operating platform (SOP) for replication across the chain, which included procedures for inventory management, transaction processing, customer relations, store administration, products sales and merchandising. SOP had a harmonizing effect on the company, helping ensure consistency and enforcing discipline across the network of stores. Best Buy was now a process-driven organization with systems and procedures firmly in place. By early 2000, however, Best Buy was evolving from being an organization thriving on standardization to one offering, within a standard format, different value propositions appealing to different groups of customers. Thus, the company began in 2001 to test and implement a concept it called centricity.

The concept was based on four elements:

1. Identifying customers generating the most revenue

2. Segmenting these customers
3. Realigning the stores to meet the needs of these customers
4. Empowering the store sales staff, known as Blue Shirts, to steer these customers toward products and services that would encourage them to visit more often and spend more on each visit

The company's market researchers combed through reams of sales and demographic data to determine whether a particular location should be tailored to, say, empty nesters or small business owners. A store located in a geographical area characterized by a higher density of homemakers would, for example, include features such as personal shopping assistants (PSAs) who were chosen from among Blue Shirts to help a shopper with such tasks as selecting the right digital camera for her family. Blue Shirts were schooled in financial metrics, such as return on capital, so that they could ascertain for themselves the effectiveness of merchandising.

Centricity was a big investment in terms of enhancing end user experience. The company examined, in detail, everything from store fixtures and layout to the product–employee mix and staff training. Recasting a store toward affluent tech-enthusiasts would cost approximately US$600,000 alone for lighting and fixtures. The concept of centricity, which was built essentially on customer insights, was also meant to encourage employee innovations in support of a better customer experience, not just at a single moment in time but on a continuous basis. The goal was to drive customer engagement and foster repeat visits.

Store Operations

At headquarters in Minneapolis, Best Buy store operations were organized into three divisions. Each division was divided into regions under the supervision of a senior vice president overseeing store performance through regional managers who were with responsibility for a number of districts within the region. The district managers monitored store operations closely. Each district also had a loss prevention manager, and product security personnel employed at each store controlled inventory shrinkage. Best Buy controlled advertising, pricing, and inventory policies from corporate headquarters.

Competitors

The CE retail market in the United States was competitive at four levels. The major competitors were mass merchandisers (e.g., Walmart and Costco). These competitors were regularly increasing their portfolio of CE products, particularly of those products less complex to sell, install, and operate. Contemporary channels of distribution (such as Internet shopping, facilitated by e-commerce platforms set up by some manufacturers themselves) were the second source of competition. Also competing in the CE market and gaining market share were factory-direct shopping services (e.g., Dell Computers). Finally, home improvement retailers (e.g., Home Depot and Lowe's) were also entering into the consumer electronic product market. Lines were blurring as retailers of all kinds were widening their product assortments in pursuit of revenues and margins.

Dual Branding in Canada

Best Buy paid Cdn$560.71 million (US$363.95 million) to acquire Future Shop, based on the offering price of Cdn$17 per share, a 47.8 percent premium over the market price of Cdn$11.50 per share. However, a little over a year after deciding to expand internationally, Best Buy experimented with a concept that was novel in the CE market worldwide. Said Noble:

> There were four reasons why Best Buy veered towards a dual-branding strategy in Canada. First, the Canadian CE market was fragmented with the leader, Future Shop, having only about 15 percent share. We felt there was room for a second brand. Given that most

> retail sectors in the US had at least two major players—for example, Home Depot/Lowe's and Staples/Office Depot—we felt that a second major retailer in CE in Canada would be in order. Second, Best Buy had already signed, before perceiving Future Shop as a potential target for acquisition, about eight real estate leases as part of its original greenfield approach. Some of these leased spaces (as in the Heartland location at Mississauga, a suburb of Toronto) were situated right next to Future Shop stores for planned head-to-head competition. We were committed to those locations. Third, there were operational factors. Conversion of Future Shop stores into Best Buy stores would take a while, particularly in terms of store redesigns and staff transition. Not all the elements of Best Buy's SOP could simply be set up "as is" in Canada. There would be a period of time when the two brands had to be managed independently. As it turned out, it gave us a window through which to look at issues differently. But, the most important reason was the recognition that Future Shop was a well established brand, with over 95 percent unaided brand awareness among Canadians. Replacing such a hugely successful brand with Best Buy, which was unknown in Canada, seemed counter-intuitive.

Best Buy also had other reasons for pursuing a dual-brand strategy. If the senior staff at Future Shop were focused on setting up the Best Buy operation, their activities risked affecting negatively on the existing sales of Future Shop stores. Putting together a separate team at Best Buy, fully dedicated to opening the greenfield stores of Best Buy, as originally planned, would speed up the process of the company's market entry.

But the dual-brand strategy also had some downsides. Said Noble:

> We had four concerns about the dual-branding strategy. Cannibalization was, of course, a major issue. It was likely that each Best Buy store would eat into the earnings of a Future Shop store and vice versa, particularly when the two were in close proximity. Since the company would have to manage two different brands, the marketing dollars in Canada would be split in half, minimizing the impact of ad-spend. Also imminent was the possibility of a blurring of brand identity in the eyes of the consumer. Finally, there would be duplication of roles at the corporate headquarters at Minneapolis, with the two brands requiring separate staff inputs.

The two brands were each headed by a vice president based in Vancouver, the location of Best Buy Canada Ltd. (BBYC), the newly formed subsidiary that maintained the two brands. BBYC took several steps to reinforce the operations of both brands at ground level: opening an automated 450,000-square-foot distribution center in Ontario and, eventually, another 500,000-square-foot distribution center in British Columbia, to support store growth for both brands; outsourcing a call center to provide 24-hour service, seven days a week; and retaining a premier insurance company to underwrite product warranties. Stores of both brands were open 60 to 75 hours per week, seven days a week. All stores used the parent company's SOP.

An average Future Shop store was staffed by a general manager, an operations manager, one to four department managers and 48 to 95 sales associates, as well as part-time sales associates. An average Canada Best Buy store was staffed by a general manager; assistant managers for operations, merchandising, inventory and sales; and 80 to 110 sales associates, including full-time and part-time sales associates.

Although Best Buy and Future Shop effectively competed for market share, the positioning for each company was different. Best Buy, with its yellow-price-tag logo continued to offer the "grab and go" option by providing an open floor plan that allowed customers to shop on their own or with the help of a no-pressure (i.e., non-commissioned) Blue Shirt product specialist if desired. Future Shop focused on offering the trusted, personalized customer service for which it was already well known in Canadian cities.

By the end of the first year of operations, there were indications that the dual-branding strategy was working in Canada. For example, the Future Shop store at Mississauga had sales revenues of $40 million in 2001/02. In 2002/03, post-acquisition, revenues were $38 million. Cannibalization was minimal because the Best Buy store, located across the street, had delivered an additional $30 million in sales for the same period. Overall, Best Buy had achieved a combined market share in Canada of 34 percent. In some places, the proximity of the two banners had created a shopping destination. The company's research also pointed out that the customer bases of Best Buy and Future Shop were different. Canadian customers viewed the two brands as distinct, not interchangeable. One indication was that only 18 percent of customers applying for a Best Buy credit card in fiscal 2004 already held a Future Shop credit card (see Exhibit 3).

The board of Best Buy was now willing to support the dual-brand strategy in Canada as long as Best Buy entered new markets in Canada and delivered on sales targets, while Future Shop continued to deliver on its own sales targets. In negotiating with Five Star in China, the board was willing to support a similar strategy on similar expectations (see Exhibit 4).

Entering China

A country of 1.3 billion consumers, China had been attracting the attention of overseas investors since it began liberalizing the economy in 1985. Over the next two decades, its manufacturing side boomed, with the growth in gross domestic product (GDP) averaging 10 percent per annum. The consumption side, however, was growing at a pace slower than output and not catching up. Consumption as a percentage of GDP had in fact dropped from 47 percent in 1995 to 37 percent in 2005.[6] A process of adjustment was under way, and because the Chinese economy was moving from the historical investment-led growth model to a consumption-led growth model, many multinational marketers were beginning to see an opportunity. McKinsey Global Institute had predicted that

Exhibit 3 Best Buy and Future Shop—Performance Metrics 2000 and 2006

Metric	2000		2006	
	Best Buy (in US)	Future Shop	Best Buy (in Canada)	Future Shop
Sales growth	21.4%	17.0%	34.3%	14.2%
Gross margin	20.2%	22.7%	24.2%	24.8%
SG&A expense ratio	16.2%	20.1%	17.8%	16.7%
Operating margin	4.0%	2.6%	6.4%	8.1%
Sales per square foot	$870	$746	$1,010	$1,069
Inventory turn	7.5	7.4	6.4	6.4
Operating ROA	18.7%	12.77%	n/a	n/a

Source: Deutsche Banc Alex. Brown estimates for 2000 data, Company records for 2006 data.

Note: SG&A = selling, general and administrative; ROA = return on assets; n/a = not applicable.

Exhibit 4 Best Buy—Number of International Stores 2006

Province/State	Canada		China	
	Best Buy Stores	Future Shop Stores	Best Buy Stores	Five Star Stores
Alberta	7	15		
British Columbia	7	21		
Manitoba	2	5		
New Brunswick	–	3		
Newfoundland	–	1		
Nova Scotia	1	3		
Ontario	25	55		
Prince Edward	–	1		
Quebec	8	24		
Saskatchewan	1	3		
Anhui			–	12
Henan			–	9
Jiangsu			–	99
Shandong			–	9
Shanghai			1	–
Sichuan			–	6
Yunnan			–	4
Zhejiang			–	21
Total	51	131	1	160

Source: Best Buy 2008 annual report.

China would become the third-largest consumer market in the world by 2025 (see Exhibit 5).

Best Buy's original interest in China had been flagged by China's manufacturing base. Since the 1990s, the China had become a major hub in the Asian region for the manufacture of CE components. In a little more than a decade, China was playing host to a number of manufacturers from the United States and Europe. Attracted by the country's low labor costs, these manufacturers had started relocating their domestic manufacturing operations to China. A fast-growing home market was also spurring China's CE manufacturing industry. According to Instat, an American high-tech market research firm with an office in China, the manufacturing end of the CE industry in China, which was estimated at $71.5 billion in 2006, was expected to more than double by 2010.[7]

In September 2003, Best Buy opened a 25-person sourcing office in Shanghai, China. This move complemented the company's plans to expand its existing 450 stores in the United States and 127 stores in Canada to at least 1,200 stores in North America over the long haul. The Shanghai office was seen as a means of both lowering the cost of goods sold and driving gross profit rates on individual

Exhibit 5 China's Economy, 2003–2005

	Unit	2005	2004	2003
Gross National Income	100 million Yuan	183,956.1	159,586.7	135,174.0
Gross Domestic Product	100 million Yuan	183,084.8	159,878.3	135,822.8
Per capita Gross Domestic Product	Yuan per person	14,040.0	12,336.0	10,542.0
Population	Million	1,307.56	1,299.88	1,292.27
– Male		673.75	669.76	665.56
– Female		633.81	630.12	626.71
– Urban		562.12	542.83	523.76
– Rural		745.54	757.05	768.51
Economically active persons	Million	778.77	768.23	767.05
Number of employed persons	Million	758.25	752.00	744.32
Annual Per Capita Income	Yuan			
– Urban households		10,493	9,422	5,160
– Rural households		3,255	2,936	2,090
Annual Per Capita Consumption Expenditure—Urban households	Yuan	7,943	7,182	4,186
– Rural households		2,955	2,185	1,617

Source: National Bureau of Statistics of China, Chinese Statistical Yearbook, 2006, http://www.stats.gov.cn/tjsj/ndsj/2006/indexeh.htm, accessed December 10, 2008.

products. This office was also meant to fill the gaps in the company's product assortment with private labels from the Asian region. Said Noble:

> China was chosen as the second international expansion market primarily due to the overall market opportunity, consumer fundamentals and macro-economic factors. We did look at other markets such as Europe, especially France and Germany, but, they were mature, competitive and offered less quality retail real estate at a high cost.[8]

The Chinese CE retail market was fragmented. The top five players together held less than 20 percent of the market share. However, the Chinese market was expected to account for 25 percent of the global CE market by 2010. Taking a slice of the new growth opportunity ranked high on the agendas of multinational corporations. Best Buy was the first, and so far the only, multinational to have entered the retail end of Chinese CE market.

China's CE retail market was, however, a complex terrain to navigate for a new entrant. Price wars were rampant. In categories such as TVs and white goods, excess capacity had squeezed profit margins to less than three percent, the lowest in the world. Although consolidation among electronics retailers had been ongoing, a new wave of mergers and acquisitions (M&As) was evident within a space of a few months in early 2006. Gome Electrical Appliances Holdings Ltd. (Gome), China's leading electronics specialty chain, had already mounted a bid on China Paradise Electronics Retail Ltd. (China Paradise), which itself had struck—and then put on hold—an alliance with the privately owned Dazhong

Electrical Appliance Co. Ltd., the fifth-largest CE retailer in China The formalities pertaining to acquisition of China Paradise by Gome were to reach closure in late July 2006. Best Buy had already acquired Jiangsu Five Star in April 2006.

The Chinese CE market had some unique characteristics. For example, approximately two-thirds of the sales staff in a retail store were on the payroll of suppliers. Also, the rate of growth of "other income" was often higher than the rate of growth in sales. The gross margin of Chinese retailers was understated without taking into account "other income," which included rebates and listing fees, often the equivalent of a retailer's gross profit. Instead of a mark-up on the cost of goods sold, the retailers received rebates.[9]

Buyer Behavior

In 2004, approximately 36 million urban Chinese households had a disposable income of at least RMB25,000 (approximately US$3,000) a year, which was considered, by local standards, a reasonable threshold for entering the consumer class. By 2009, the number was expected to almost triple, to 105 million urban households. A massive influx of new consumers was now reaching the retail cash registers. Every year, approximately 20 million Chinese (the population of Australia) turned 18 years of age. Prosperity was lifting the incomes of tens of millions more.[10]

Chinese consumers were not prone to opening their wallets freely. The savings rate in China in 2006 was 28 percent of monthly household income, compared with three percent in the United Kingdom and two percent in Canada. Chinese consumers were also not accustomed to the concept of credit. The credit card penetration rate in urban households was less than four percent, compared with 75 percent in the United States, 78 percent in Japan and 91 percent in Germany. Less than six percent of credit card holders in China carried forward their ongoing balances.[11]

Observers had found that Chinese consumers responded better to messages focusing on functional features than those focusing on brand imagery. At one level, Chinese consumers were attracted to brand names but, on another level, they were wary of premium prices. Brand preferences of customers did not always translate into revenues in the form of increased market share for companies. Salespersons held sway over the buying decisions of consumers who were also influenced by point-of-sale promotions to make last-minute switches. Because Chinese consumers had a sense of national pride, a multinational corporation, by seeming foreign, could lose potential customer segments.[12]

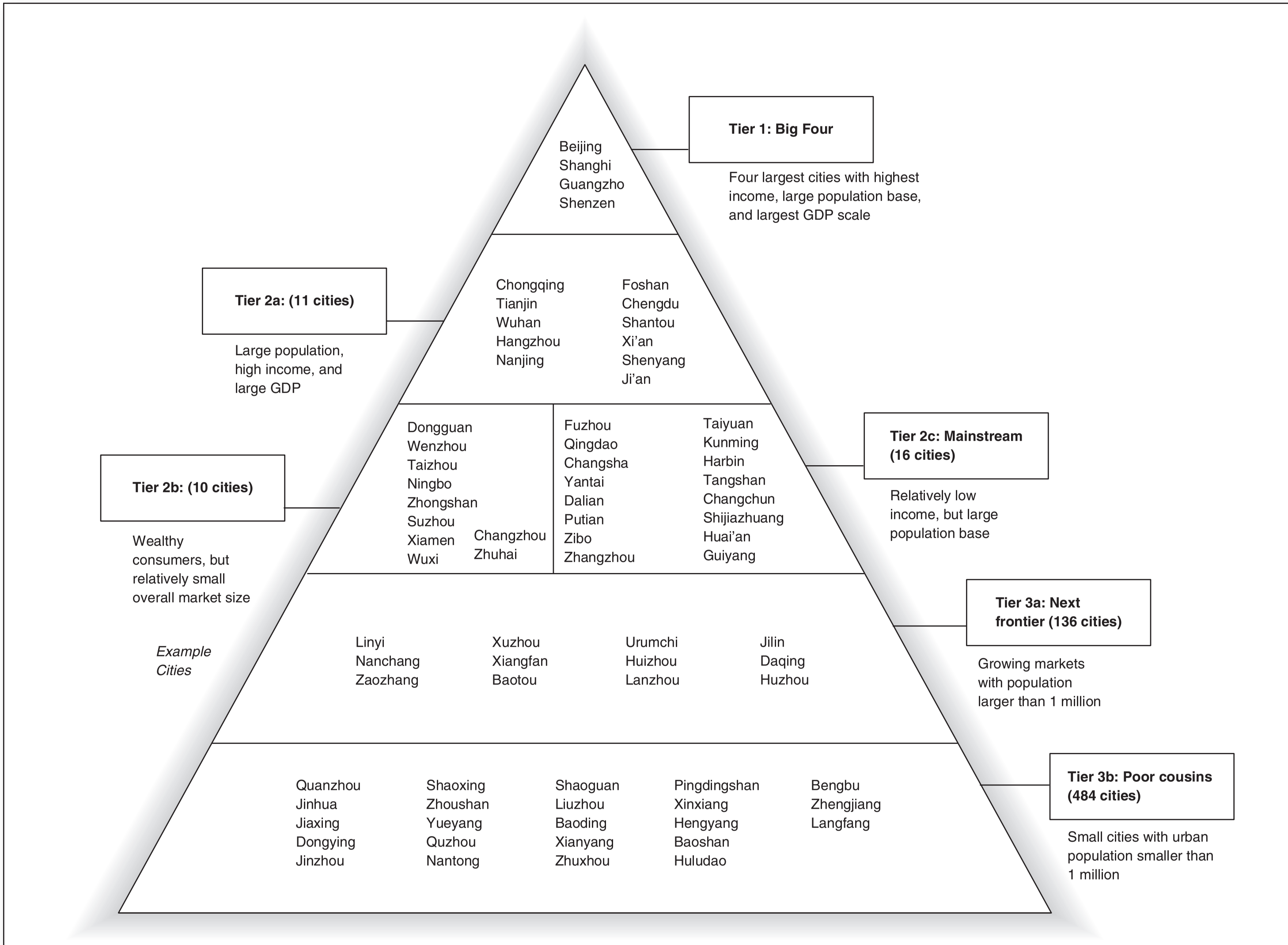
Growth Centers

In markets such as the United States and Canada, consumers exhibited few differences between regions, which required companies to make choices only between products and segments. In China, the trade-offs had an additional dimension, requiring product-segment-region choices. Marketers had to factor in regional differences because as one moved across tiers of cities in China, a steep drop-off was experienced in infrastructure, channels and disposable income. When a mass merchandiser entered China, it evaluated the country's cities, giving each locale a tier designation on the basis of size, sophistication, purchasing habits, attitudes, and disposable income of its population and its own product offerings.[13] A typical classification is shown in Exhibit 6.

A massive increase in retail space was evidence of increasing competition in China's tier-one cities in particular. Major players were eyeing growth opportunities in tier-two and tier-three cities. The attendant risk was the longer breakeven point because, given the much lower income levels in those cities, sales would be slower. However, the costs of retail space would be lower, and given less competition, margins were likely to be higher.

China also had other limitations. Land acquisition in cities was often difficult; procedural delays meant that a new entrant would take at least six months to open a store; relationships between vendors and retailers were so close and guarded by local customs and preferences, that an outsider did not have an easy time getting a foot in the door. Manufacturers of CE were not likely to cut a new entrant such as Best Buy much slack on pricing, particularly because personal relationships (referred

Exhibit 6 China's Tiered Cities



Source: Diana Farrell et al., From *"Made in China" to "Sold in China": The Rise of the Chinese Urban Consumer,* McKinsey Global Institute, November 2006.

to as "guanxi" in local terminology) influenced the conduct of business among Chinese who were more comfortable dealing with people they knew. China was also experiencing a crunch of quality human resources because retailing, as an industry, had not yet developed in the country.

Major Competitors

Before being acquired by Best Buy, Five Star had two major competitors, Gome Electrical Appliances Holdings Ltd. (Gome) and Suning, both publicly held (see Exhibit 7). Together, the two

Exhibit 7 Major Competitors in China

Financials (in RMB million)	Gome		Suning	
	2004	2005	2004	2005
Revenue	12,647	17,959	9,107	15,936
Net profit	486	496		
Revenue by geography (%)				
– Northeast China		5		3
– North China		33		15
– East China		9		59
– West China		23		5
– South China		26		15
– Central China		4		3
Sales per square meter	25,940		32,141	23,929
Number of stores	442		94	224
Revenue by category (%)				
– Air conditioners		16		
– Audiovisual		28		
– Refrigerators/Washing machines		18		
– Telecom		16		
– Small electrical appliances		10		
– Digital/IT products		12		
– Service		–		
Mission	"Competitive pricing from high volume"		"Service is the sole product of Suning"	
Store formats, positioning	a. Traditional (3,500 square meters): price-conscious mass market b. Digital (260 square meters): high-end customer in downtown c. Eagle (15,000 square meters): service-conscious, mid to high-end customers		Flagship: in large cities Central: the most common	

Sources: Gome Electrical Appliances Holdings Limited website, http://www.gome.com.hk/eng, accessed December 5, 2008; Suning website, www.cnsuning.com/include/english, accessed December 5, 2008; Jean Zhou, Deutsche Bank equity research Report, dated April 7, 2006; Sandy Chen, Citigroup equity research report on Gome, dated October 12, 2005.

companies had saturated many of the country's largest cities over the past few years. Although the total market shares in 2005 of the top five in 2005 (comprising Gome, Suning, Five Star and two others) accounted for less than 20 percent of market share, Gome and Suning held a combined market share of 70 percent in some appliance product categories, such as air conditioners.

Gome Group

The Gome Group had two companies: Gome Electrical Appliances Holdings Ltd. and Beijing Gome (an unlisted company). In 1993, Gome opened its first store in Beijing, and soon expanded into other major cities in China, gaining widespread consumer acceptance. By mid-2005, the group had 437 stores (of which 263 belonged to the listed company) in 132 cities in China, with the most extensive distribution network of all the home appliance retailers in China. It was leading in all regional markets (Northeast China, North China, Northwest China, South West China, and South China) with the exception of East China, the home market of Suning, where Gome was ranked number three.[14] Gome was the largest CE retailer in China with six percent market share, prior to its acquisition of China Paradise. The company was mounting a bid on China Paradise, likely to come through in a few weeks, for a record sum of $677 million.[15]

At the beginning of 2005, Gome had announced its four-year growth initiative aimed at enlarging its geographical coverage and raising its national market share to 10 to 15 percent by the end of 2008. Although Gome had set itself apart, to start with, on a super-store format offering the lowest prices, the differentiation had been subsequently commoditized in by its competitors. Gome had then cracked the traditional business model (of selling through intermediaries to various retail formats) by dealing directly with mega brands. In introducing category killers, the company had set a new trend in CE retailing in China. The company had also begun to focus on pre-sales service, as opposed to the industry practice of after-sales service, by advising customers on which brands to choose. Because this service was not easy to implement at the store level, where brands had their own commission-based sales staff, Gome was examining a new store format it called Eagle (Gome had been known earlier as China Eagle). Gome opened its first Eagle store in December 2005, in Shenyang. This mega-store, which occupied 15,000 square meters differed in two ways: all sales staff at Eagle were on the payroll of Gome; and the display format was based on categories not brands. The company was planning to open six to nine Eagle stores in the next three years, depending upon how the performance of the first two.

The group was planning to expand rapidly into tier-two cities in particular, not only because of improvements in economies of scale and customer acquisition but also because, as a first mover, it could secure preferential tax treatments from local governments welcoming jobs creation opportunities. It was unlikely that the second or third movers would be entitled to the benefits offered to the first mover.[16]

Suning

Suning had grown from a regional air-conditioning retailer to a leading CE retail chain in China in less than a decade. It was in the process of converting its stores into a customer-oriented format it called 3C (computers, communications and consumer electronics). The company was on an expansion spree, increasing its stores five fold in the last three years to 224, with more than half of them opening in 2005 alone, covering 61 cities. It was now planning to double the number of stores in two years. By the end of 2006, only 25 percent of Suning's retail space would have been opened for two years or more. In common with Gome, which also had a high proportion of new retail space, rapid store expansion and entry into less affluent tier-two cities had led to lower productivity of retail space at Suning.[17]

Suning operated three types of stores that shared the same format: flagship, central, and community. The stores differed in size and product assortment. Flagship stores were found in large cities or regional headquarters. These stores were the largest in size and sold a wide variety of products. The central stores were most common. All the stores were CE retail stores targeting the mass market.

Suning sought differentiation in two ways. It was aligning its product assortment to address the needs of what it called "3C"customer groups (computers, communications and consumer electronics). It was also using service as its key competitive advantage. The company had set up 15 regional distribution centers, 30 customer service centers, and 500 service stations of its own to reinforce the message that service was its main product.

Five Star

Five Star was China's third-largest electronics and appliances chain. It had 135 stores located mostly in the fast-growing, second-tier cities, in eight of China's 34 provinces. Founded in 1998 and headquartered in Nanjing in Jiangsu province, it had revenues of US$700 million in 2005, a 50 percent increase over 2004. The company's founder Wang Jianguo wanted to expand internationally but was constrained by delays in official permissions for listing his company abroad. "Our scale was becoming a bottleneck to development," he said.[18] When Best Buy sounded the idea of making an investment in the company, he decided to cash out and offload 75 percent stake in the company to Best Buy for $180 million. Five Star employed more than 12,000 of its own employees (see Exhibit 8).

Exhibit 8 Best Buy and Five Star—July 2006

Metric	Best Buy[1]	Five Star
Store size	86,000 square feet	35,000 square feet
Customers	Middle-to upper-income young singles and couples	Middle-income families Somewhat price sensitive
Service	Mixed-brand packaged solutions displayed by lifestyle requirements	Personal shopping assistants guiding customers through vendor booths; Attentive
Sales	Led by non-commissioned staff on Best Buy's payroll	Led by staff on the payroll of manufacturer
Customer profile	18–42 years old	20–50 years old
Brand identity	Premium full service	Good price with good services
In-store experience	Grab and go	Guided
Product mix (%)		White goods: 16% Air conditioning: 23% Home entertainment: 25% Digital products: 7% Cell phones: 13% Kitchen utensils: 9% Small appliances: 5%
Store associates	100% employed by Best Buy and non-commissioned	30% employed by Five Star on non-commission; 70% employed by vendors on commission

Metric	Best Buy[1]	Five Star
Sales growth		44%
Gross margin		13.5%
SG&A expense ratio		11.5%
Operating margin		2.0%
Sales per square foot		$230
Inventory turn		7
Operating ROA		5%

Source: Company files

Note: SG&A = selling, general and administrative; ROA = return on assets.

1. Best Buy was yet to open its store in China as of June 2006.

Issues in June 2006

In examining the prospects of dual-branding strategy in China, Noble had to make a call on whether it would serve as well in China as it did in Canada. He had to define the road map for implementing the strategy in China. In a broader context, he also had to explore the possibility of developing dual branding into Best Buy's main competence over time. Best Buy was now at a stage at which the learning it had gained from international expansion, initiated in 2002, could be used to accelerate the company's transformation in the U.S. domestic market, which it considered its core market. In his new role at Best Buy International, Noble was regularly tracking and evaluating global opportunities, looking for growing economies with buoyant consumer demand. Turkey and Mexico were potential targets for international expansion.

Customer centricity was a home-grown competence that Best Buy had deployed in Canada, and that seemed to have a universal appeal, applicable to any new market. SOP, which the company owned, was another. Geek Squad, a company innovation, seemed to be equally pervasive. Noble wondered whether a dual-branding strategy, which had been executed in Canada, could be as readily implemented in the international markets of the future. Was there a template of dual-branding that could be deployed, with a minor tweaking where necessary, to any new market, he wondered. What would that template be?

CASE QUESTIONS

1. What are the primary advantages of using a dual-brand strategy in China? Are they the same as what occurred in Canada?
2. What are the primary disadvantages of using a dual-brand strategy in China? Are they the same as what occurred in Canada?
3. What are the advantages of moving to a single brand name in China?
4. What are the disadvantages of moving to a single brand name in China?
5. Are there any cultural differences in Canada, as compared with China, that would affect the choice of brand strategy?
6. In terms of employees, would allowing Five Star to retain its management team and local employees create problems or opportunities for Best Buy? What happened in Canada? Does that outcome affect your answer?