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HOW BEST BUY IMPLEMENTS THE FIVE FORCES MODEL TO BUILD MARKET SHARE AND CUSTOMER LOYALTY

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This case study is designed to show the practical application of Porter's Five Forces Model. Dr. Porter's model is used widely at the undergraduate level to illustrate the importance of corporate strategy. Best Buy provides a good case example of the value of applying Porter's Five Forces model in practice. This case is designed for undergraduate marketing educators globally who seek a practical case study for in-class exercises. Discussion questions are provided.

Keywords: Porter's five forces, Strategy, Best buy.

INTRODUCTION

Best Buy is a leading specialty retailer of consumer electronics, computer software, home appliances, and home office products and service. With more than 1,150 stores, the company generated more than $49 billion in annual revenue and $2.235 billion in net profits in fiscal year ending February 27, 2010 (Yahoo Finance, 2010). One of the company's objectives is to educate consumers in the continually changing technological world. The Minneapolis-based company has diversified through an aggressive acquisition strategy; e-commerce; and is experiencing exponential growth in the professional services sector via their Geek Squad business unit.

COMPETITIVE FORCES

Best Buy operates in what would best be described as an oligopoly environment, with their primary competitors being Wal-Mart (Reibstein, 2009). Additionally, Best Buy's online division completes directly with formidable competitors such as Dell and Amazon.com. Using the Porter's five forces model (Porter, 1979) it is evident that Best Buy is positioned well for continued growth, but also faces significant competitive threats.

Intensity of rivalry among competitors

The competition among large electronics retailers is fierce and something that plays an important role in Best Buy's executive level decision making. For example, at Best Buy's corporate headquarters employees entering the building at one point were greeted with a mock triage unit, replete with bandages and litters. This is an unsubtle metaphorical reminder to employees of what will happen to the company if they take their eye off Wal-Mart (Boyle, 2006).

Wal-Mart executives, of course, are also intensely focused on Best Buy. This is evident by the fact that Wal-Mart has been modifying a number of its electronics departments in an effort to create a more customer centric retail environment (Berner, 2005; Gulati, 2010). Best Buy's focus on customer centricity, which is essentially de-centralizing control and empowering store-level managers and employees to tailor offerings and displays that reflect the needs of local customers. This strategy has contributed to a 7% increase in 2010 same store sales (Retailers Daily, 2010), which is outpacing other big-box retailers, including Wal-Mart. Prior to the *Great Recession* of 2007 (Fehr, 2010), the company realized a 22% increase in same store sales (Anderson, 2006) for fiscal 2006.

One of the reasons for Best Buy's success has been its supply chain efficiency (Supply Chain Digest, 2006; Accenture, 2007). However, online competitors, such as Dell Computer Corp pose a significant threat to Best Buy as they are equally logistically efficient and have the advantages associated with being vertically integrated.

Pressure from substitute products

Best Buy executives recognize that high-volume retailers like Wal-Mart, and online retailers, like Dell, potentially have the ability to undercut their costs, which will corresponding reduce their market share. Thus, they have developed a series of partnerships with electronics manufacturers in China (Barney, 2006) to produce their own products, under various brand names, which reduces the risk of losing market-share to lower cost substitute products.

While vertical integration mitigates the risk of substitute products, Best Buy has further mitigated the risk by offering value-added services (Berner, 2005; Best Buy 2010), such as extended warranties and technical services.

Barriers to entry

One of the major advantages of operating as part of an oligopoly is that there are few competitors. With regard to big-box retailers like Best Buy the huge capital costs associated with building a retail infrastructure. According to Boyle (2006) the costs of modifying existing stores to represent a more customer centric focus is approximately $600,000 per location. The costs of capital costs associated with retail, along with ancillary human resource and marketing expenses result in a significant barrier to entry for up-start competitors.

The barriers to entry, however, for online competitors are relatively low (Mendelsohn, 2006). Therefore, manufacturers of consumer electronics seeking to emulate Dell's direct model could bypass Best Buy and sell direct. However, a more likely scenario would that that manufactures will develop their own online storefronts while maintaining their relationships with the big-box retailers. These retailers provide a critical mass of volume that could not, in all likelihood, be generated solely through an online channel. A prime example of this type of

hybrid retail/online strategy would be the recent strategic alliance Best Buy forged with Apple Computer to promote and sell numerous Apple brands (Kazit, 2006).

Bargaining power of buyers (customers)

Best Buy management appears to be acutely aware of the number of options consumers have. Although the retail options are limited to a few players, online outlets provide consumers with a wealth of purchasing options. While consumers do not have the ability to haggle with in an effort to achieve a lower-price, they can achieve the same effect by conducting a modicum of research. In an effort to mitigate the power of buyers Best Buy has been aggressive in promoting extended warranties (Berner, 2005), which serve the purpose of maintaining a relationship with buyers and increasing their switching costs. While Best Buy's aggressive approach to selling warranties has drawn the ire of consumer groups (Huffman, 2005), it continues to be a significant source of revenue.

Bargaining power of suppliers

One of the keys to Best Buy's growth has been the effective management of its supply chain and communication with its vendors. The company has established a comprehensive vendor extranet where terms of vendor expectations are clearly articulated.

Relationships between large retailers and their supply chain partners have changed considerably over the past decade, largely due to the success achieved by Wal-Mart (Corshen, 2004). This balance of power, from manufacturer to retailer, mitigates the supplier risks Best Buy faces considerably. Also, this risk is further reduced by the firm's vertical integration strategy.

Of course, manufacturers with products that are in high demand will have more powerful than those who do not, but the relationship between Best Buy and its vendor base appears to be relatively symbiotic. As the largest consumer electronics retailer in the world, Best Buy appears to have more leverage than their vendors but do not appear to be wielding it unethically.

GROWTH STRATEGY

The growth strategy of Best Buy is threefold. The three facets are increased same-store sales; acquire high potential companies; focus on services. Each strategy has been delivering results to the company's bottom line and enhancing its market value.

Increasing same-store sales

In fiscal 2006 Best Buy increased same-store sales by an impressive 22% (Anderson, 2006), of course, this rate of growth wasn't a realistic target during the post-2007 recessionary period. Yet, the company maintained its customer oriented view during the recovery and it appears to be paying dividends, as same-store sales are at 7%: larger than those of Wal-mart. The strategy is based on an organizational value known as *customer centricity*. Essentially, this principle empowers store level managers and employees to take a much more active role in delivering products to their customers. According to Millwood (2004):

> Best Buy has identified key customers in five areas of its customer-centricity program: affluent professionals seeking the best technology experience; younger males wanting cutting-edge technology and entertainment; fathers looking for technology to improve their lifestyle; mothers who seek technology to enrich their children's lives; and small-business people using technology to improve their bottom lines.

Although the company is continuing to build new stores internationally, two hundred stores have opened since 2007, company leaders have recognized that it is easier to retain an existing customer than attract a new one. Moreover, the positive human resource benefits from this empowerment strategy have been remarkable as employee retention is at an all-time for the company (Toncheva, 2010).

Acquiring high potential companies

Best Buy executives recognize that it is often more cost effective to buy market-share rather than building it from scratch, especially with regard to international expansion. Thus, the company's executives have purchased several going concerns in recent years including Geek Squad; Jiangsu Five Star Appliance Co. (China), and Future Shop (Canada).

Geek Squad is the company's high profile entry into personal and professional computer services, which Best Buy calculates is $230 Billion market opportunity (Anderson, 2006). Jiangsu Five Star Appliance Co., China's fourth largest retail chain, represents the firm's first retail foray into a region where it has strong manufacturing and political relationships. Future Shop is Canada's largest retail chain, and helps Best Buy to retain its position as the largest North American electronics retailer.

Of the companies acquired, Geek Squad may generate the best long-term strategic competitive results for the company, as any firm that is competing with Wal-Mart will inevitably lose market-share to their low-cost strategy. By focusing on services the firm can maintain relationships with customers that monolithic centralized conglomerates, like Wal-Mart, can't compete with. Additionally, the higher margins and lower overhead associated with providing professional services allows for revenue growth without huge capital outlay.

Focus on services

In addition to Geek Squad, with its 1,200 locations nationally, Best Buy has identified digital music downloads as a viable revenue source and recently partnered with Real Networks to make music downloads available online (Boston Globe, 2006), and acquired Napster (Skillings, 2008). In addition to receiving a fee for each download, company executives are confident that this service will stimulate sales of music players in their stores and online.

Company executives clearly have an excellent understanding of the supply chain, and view vertical integration a logical approach. Delving into services is simply the next evolutionary step, and the results have been (and should continue to be) positive.

DISCUSSION QUESTIONS

- How is the concept of 'customer centricity' related to Porter's Five Forces Model? Discuss.
- Do you agree with the strategy of expanding into services rather focusing solely on than the company's historical role as a retailer of products? What are the potential risks and rewards?
- What lessons should Best Buy's competitors learn from this case?

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