CASE STUDY - ZAPPOS

by Steve Brown

If you are looking to learn more about banking, it pays to study shoes. Today, we highlight one of our favorite retailers and the only place that we buy shoes - Zappos. Zappos history is instructive as in its darkest hour it was forced to change its business model and come up with a new plan.

Zappos was founded in 1999, during the backdrop of the dot com boom, as an online shoe retailer. While many said that shoes, like banking, was a commoditized business and the market couldn't support another major retailer, Zappos believed it could delivery better service through technology. Despite the hype surrounding the Internet at the time, many analysts underscored the fact that shoes are one of the personal items you buy that must be tried on. A salesperson is mandatory, as the consumer has so many selections and doesn't understand the finer points of the shoes without them being pointed out.

At the time, large retailers like Macy's occupied one end of the market with their big one size fits all approach. At the other end of the market were specialty retailers, like Foot Locker, who focused on providing expertise in athletic shoes. Both types of companies, held major market share and invested heavily in stores across the country to deliver service close to the customer. Zappos, in its 2nd year, struggled with profitability. Failing to raise capital, it made a last ditch effort to change.

While many companies would have laid off workers and cut expenses, Zappos spent its last bit of capital to execute on a new long-term strategy. The company realized it needed control over its merchandise in order to deliver superior service and get shoes shipped within 24 hours, so it increased its inventory. Next, it updated its website, adding some 3mm pictures of shoes from different angles. While this is like updating a branch, the company realized that this investment could be spread over millions of customers so it felt its capital was better used than Foot Locker (that ultimately had to close stores).

Next, Zappos built out its technology, created more granular profitability information on its vendors and customers and allowed each shoe manufacturer to see the data. In this manner, venders became partners with Zappos, as each could transparently see their real time performance and offer help on how to improve.

Finally, Zappos retrained its employees with a single motto - We are a service company that just happens to sell shoes. That's a powerful statement and one that should be completely understood by all bankers. As we have said before, banking isn't about loans or deposits for that matter, but rather, it is about delivering financial solutions with excellent customer service.

The combination of an efficient delivery channel and game changing customer service, has pushed Zappos to the most profitable shoe company in the world (now acquired by Amazon) with over $10B in sales. Not bad for a commoditized product.

BANK NEWS

Community Bank Capital

The Senate passed the Small Business Jobs and Credit Act (H.R. 5297) that would establish a $30B fund for community banks to tap as capital in order toe expand lending to small businesses. The legislation is now expected to head to the House next week for a final vote.

Small Biz Lending

The National Small Business Association is reporting a record 41% of small business owners say they can't get adequate financing, up from 22% percent 2Ys ago.

Rich People

A survey by Spectrem Group finds 26% of so called "mass affluent" investors are worried about the political climate the most, followed by the economy (24%), market conditions (10%), unemployment (5%), inflation (4%) and health care (3%).

Richer People

A group of extremely high net worth individuals including 10 billionaires that meets every summer reportedly feels: the US is going to see long-term slow growth; the risk of a double dip is still there; the administration is hostile to business; and that businesses will remain reluctant to add employees because they cannot figure out what their healthcare costs will be or where taxes are heading.

Economic Picture

Austan Goolsbee, the new chairman of President Obama's Council of Economic Advisers (replaced Christina Romer), said a high unemployment rate will remain for some time to come and it will be a long struggle to get out.

Housing Pressure Continues

The National Association of Realtors reports there were 4mm homes listed with brokers for sale in July, so it would take a record 12.5 months to sell them at that month's sales pace. In addition, Moody's Analytics projects 2mm houses will be taken over by banks by the end of next year, resulting in even more downward price pressure.

Ever Smaller

Loans at financial institutions have fallen $620B from the end of 2008 (13.84T) to the 2Q of 2010 ($13.22T) or about 5%. Much more alarming however, is that the data shows lending to the source of new jobs in the country, small businesses, has fallen 21% from the summer just prior to the crisis to the 2Q of 2010 ($1.49T vs. $1.175T).