The Footwear Paradox – How It's Reshaping the Industry

Introduction

In the first part of this article we identified two macro trends in the footwear industry: first, big brands are getting bigger, squeezing out smaller ones. Second, the biggest brands are increasingly global. These forces have seen a small group of brands amass a record share of the industry: Nike, Adidas, Skechers, Puma, Vans, Timberland, Under Armour and Gucci combined reported $15bn of additional footwear revenue in the last five years[i], approximately the entire growth of the global industry.

And if the clout of big global brands seems like an obvious outcome of globalization, the wider consumer goods (FMCG) industry shows that's not the case. Big brands across FMCG have lagged the market in recent years and *lost out* to smaller, nimbler rivals.

Reasons include:

- Millennials deserting corporations in favor of small, healthy and environmentally-friendly brands
- The emergence of innovative direct-to-consumer (DTC) brands
- The disruption of traditional retail by online specialists and discount grocers

These forces have reined in the power of big consumer brands globally. Except in footwear.

This article will explore this paradox. In particular:

1. The causes behind footwear concentration; and why it is unique
2. The long-term consequences for consumers and brands

Spoiler alert: there is no grand unifying theory, but enough evidence to draw some illuminating insight.

1. Causes of concentration in footwear

If globalization doesn't explain big and global brands outgrowing small and local ones, what does? Four forces shed light.

Instagram: @jaadiee

Athleisure

That sports clothes and shoes are being increasingly worn for non-sports uses requires no data validation. Athleisure has become ubiquitous, cutting across categories, geographies and demographics. Consumers increasingly value comfort. The de-formalization of workplace cultures contributed too.

Whereas traditional footwear – think brown shoes and heels – is full of domestic brands and private label, the same is not true in sports. It could be technology, R&D intensiveness, or simply the fact sports is a much younger industry (decades versus centuries), either way, there are fewer sports brands than non-sports brands in footwear. It is logical, then, that the athleisure trend disproportionately benefited a few (even if all sorts of brands subsequently piled into the category).

Actual sports participation probably had less of an impact. Running as a category, for instance, has trailed the market for years. New Balance and Asics running sales struggled, while their lifestyle divisions flourished. Similarly, Nike Sportswear has consistently outgrown Nike Running in recent years.

Athleisure was an exceptionally benevolent trend for big footwear brands. Elsewhere in FMCG, big incumbents were not so lucky. Healthy eating and craft beer, for example, were not kind to big packaged food companies and global brewers, at least not in the short-term.

The Kardashian Effect

It's not just brands that globalized. Social media redefined how businesses interact with consumers.

Brands have gained unprecedented access to their target audiences, cutting out intermediaries and reaching far-flung corners of the world. There are a billion Instagram users globally. Nike has 102m followers; Gucci 40m; Adidas Originals 36m.

Social media knows no borders. Content is available virtually everywhere. Users see the same Selena Gomez post regardless of their geography, gender or demographic (although sponsored ads are geo-targeted). Making a teenager in Jakarta see the same content as a teenager in Cologne has never been so easy.

Social media is altering not just research and discovery, but also how we buy. In a recent study, 72% of Instagram users admitted using it in their consumer decision journey[ii]. Social influencing has become a billion-dollar industry, with some influencers charging hundreds of thousands per post.

Trends now spread further and faster. Global brands thrive on it. Developing a global product and marketing strategy is easier if consumers can be made to want the same thing everywhere. Nike worked hard to turn Air Max Day into a global event.

Source: Retail Dive (infographic by XCart)

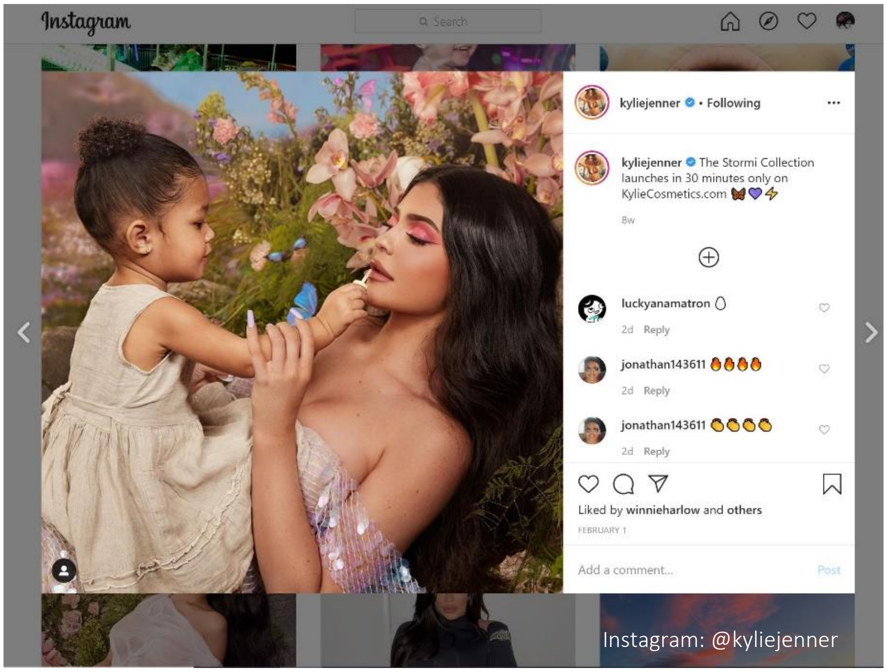
Tastes still vary – basketball-inspired footwear never caught on outside the US; Italian teenagers wear Napapijri in striking numbers – but consumers increasingly see the same thing. Micro-trends are harder to maintain. The smoke and mirrors that brands once used to exaggerate strengths and hide inconsistencies are harder to maintain.

Social media shrank the world. So why have FMCG sectors been impacted differently?

The short answer is that social media is just a conveyor or amplifier for the most-compelling product and marketing proposition. By reducing the power of traditional gatekeepers – magazines, newspapers, ad agencies – it can also benefit small brands. Success depends on which narrative resonates most with consumers.

In food and beverage, the rise of healthy living caught incumbents off-guard. New rivals capitalized before they could respond. The cost-efficient response was to buy them out. Coca-Cola acquired Innocent Smoothies, rather than try to rebrand Coke as a healthy drink.

In skincare too, multinationals were caught napping. Allying consumer-centrism with social media nous, startups have stormed the industry. Independent makeup brands have consistently outgrown the market in recent years[iii]. Model-influencer Kylie Jenner built Kylie Skin into a $1.2bn brand in just five years (Coty acquired half for $600m in November). Glossier, founded by blogger Amy Weiss, shrewdly leveraged the blogosphere and social media to build itself to a similar $1.2bn valuation (coincidence). Social media made their meteoric rise possible, but it was not the primary factor.



Instagram: @kyliejenner

In footwear, big brands managed to control the narrative to their advantage ie athleisure. They leveraged athletes, influencer relationships and social media effectively. Kylie Jenner's boyfriend Travis Scott has a long-term deal with Nike (she regularly flaunts the product); her brother-in-law Kanye West is with Adidas. Smaller brands were crowded out.

Product, marketing and trend-relevance still matter. Social media is an amplifier. Depending on the circumstances, it can be either a boon or a threat to established brands.

Embracing Direct-to-Consumer (DTC)

Third, big brands in footwear were quicker to recognize direct-to-consumer – selling through owned stores, both physical and online – as a strategic imperative.

DTC gives brands not just more control over their image, or a channel to clear unsold merchandise, it also reduces their dependence on multi-brand retailers at a time when many are fledgling. Of the footwear brands surveyed[iv], all had between 22% and 41% of revenues coming from owned retail (luxury is even higher). In a traditionally wholesale-driven industry, that is an edge.

Exhibit 2: DTC as a percentage of global sales

Brand Owner	Brand	Revenue from DTC (%)
Nike Inc	Nike	32%
Skechers USA Inc	Skechers	29%
Deckers Corp	UGG, Hoka, Sanuk, Teva	29%
Under Armour Inc	Under Armour	35%
Asics Corp	Asics	22%
VF Corp	Vans, Timberland, North Face	33%
Puma SE	Puma	25%
Capri Holdings	Michael Kors	60%
Columbia Sportswear Co	Columbia	41%

Kering SA	Gucci	86%
Ecco Sko A/S	Ecco	27%

Data: publicly available information

Size offers benefits in DTC. The large capex requirements for brick-and-mortar stores are more manageable. Competing for (scarce) ecommerce and digital talent is easier. Finally, global brand name-recognition helps generate traffic to stores. A consumer shopping for a pair of shoes may realistically visit 4-5 different brand stores (virtual or physical), but probably not 20 or 25.

Nike flagship store, New York City

Success provides margin and cash-flow benefits. Gross margins in footwear have been squeezed between rising manufacturing costs in Asia and price-conscious consumers. Vertical integration protects the end-to-end margin. Provided costs are managed prudently, DTC generates more cash to reinvest in product, people, marketing and technology. That boosts sales, creating a virtuous cycle. As retail becomes increasingly complex and technology-intensive, expect big companies to retain a competitive advantage.

The counterargument is that the digital revolution also made it easier for small brands to sell direct. Shopify, Square and clouds full of software and services now exist to help small businesses transact with consumers.

So which is it – has DTC helped big brands or small ones?

In footwear, the data is unambiguous. DTC accounted for a huge share of the growth generated by the biggest brands. Elsewhere in consumer goods, it is not so clear.

In food and beverages, the biggest FMCG, DTC has never been part of the business model. Coca-Cola, Mars and Kraft-Heinz have never bothered with stores (outside the odd M&M's flagship in Times Square). Their business model is built on partnerships with supermarkets and grocers – joint product innovation, in-store execution and supply chain harmonization. In alcohol, regulation has stifled DTC, especially in the US. Partly as a result, ecommerce in food and beverages lags. Less than 2% of industry sales are online. DTC was simply a non-factor.

Elsewhere in consumer goods, DTC has often been harnessed by small upstarts more effectively than large multinationals, including in skincare.

Footwear has been the exception. Even there, however, things are starting to change.

The Consolidation Curve

The final (and perhaps least satisfactory) explanation is that footwear is concentrating among big brands because that is what industries do as they mature. Simply put, concentration occurs over time because size offers benefits. Big firms use size to their advantage, creating a virtuous cycle that sees the big get bigger.

The phenomenon was summarized in a Harvard Business Review article called the Consolidation Curve (Deans, Kroeger, Zeisel, 2002)[v] . Its authors identify 4 stages of an industry lifecycle:

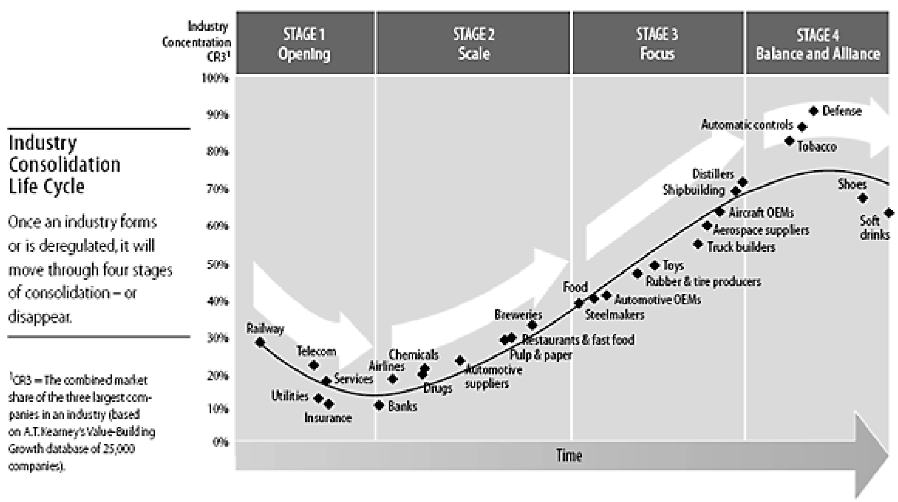
1. The Opening stage – or fragmentation – marks an industry's early days. Many small players vie for customers' attention and the 3 biggest rarely command more than 10-30% of the market

2. The Scaling stage – or acquisition – sees stronger competitors pull ahead, acquiring/eliminating weaker ones (in FMCG, big portfolio companies accumulate multiple brands). The share of the top 3 firms typically rises to 15-45%

3. The Focus stage – or expansion – sees emerging leaders focus on their core business, scale and build brand recognition. 5 to 12 major players usually remain and the top three control between 35% and 70%

4. In the Balance and Alliance stage the industry stabilize around a few large firms. They entrench their position, acquiring rivals and lobbying for favorable regulatory environment. Growth slows and requires product extensions or overseas expansion. The top three companies can control up to 70-90% of the market. A common example of a consolidated industry is soft drinks with Coca-Cola and Pepsi.

Writing in 2002, Deans et al. believed footwear to be in stage 4. More likely it is still in stage 3. Markets are still consolidating and the number of brands will narrow further, before moving the industry into stage 4.



Deans, Kroeger, Zeisel (2002)

Deans et al. understood the internet would reshape industries. Their prediction was that the lifecycle would merely accelerate, with industries moving through the four stages in less time.

It's possible the digital age actually created a fifth stage, where small brands begin to reemerge on the back of smarter, nimbler, more local, more digital strategies. Data in the FMCG industry suggests this may be happening – I would not rule it out.

The alternative explanation is that the industry lifecycle applies to *companies*, not *brands*. Even as consumers opt for smaller, niche brands, those brands are being acquired by multinationals. Innocent, Kylie Skin, Goose Island are just a few among hundreds of examples. It likely is possible for an industry to experience brand-fragmentation while still concentrating at the company level.

In footwear, portfolio companies do exist, such as VF Corporation, Deckers and Nike Inc., but with big brands outperforming smaller ones, the need to acquire has been limited.

Footwear remains unique with concentration occurring at both brand and company level. The implications are profound.

2. Consequences for the footwear industry

The footwear industry remains healthily competitive. Consumer choice abounds. The biggest player, Nike, controls about 10% of the market. The top five less than a third. Samsung controls 20% of the global smartphone market and the top five brands about 65%[vi] (link).

Still, the footwear industry is changing for both brands and consumers.

Consumers

For consumers, industry-concentration will lead to a narrowing of choice. As the five biggest brands close in on 40% of the market, expect merchandise mixes across distribution channels to start looking increasingly alike. The total number of product options may not decline - ecommerce accommodates higher SKU counts than traditional retail – but they will come from fewer brands. In the era of hyper-individuality, irony will see more people wear the same logo on their feet.

The second likely consequence will be on prices. In real terms (adjusted for inflation), footwear prices have not budged in decades. As fewer brands control more of the market – and increasingly sell direct to consumers – expect change. The biggest will use their brand and market-power to nudge prices upward, offsetting rising input costs. Anyone following the basketball footwear market in the US, where Nike Inc. controls 95%, will be familiar with the phenomenon.

Brands

The impact on brands will be even more profound.

Global brands are not winning uniformly. After years of success, Under Armor – whose growth in footwear made it a standout performer – is under pressure (-90% share price since 2015). Foot Locker calls with analysts often feature the line: "suppliers not named Nike continue to underperform". Asics and Reebok struggle to find their place in North America. Adidas outgrew Nike globally in 2016-17, but that trend swiftly reversed in 2018. The market is largely functioning as a competitive market should.

Still, numbers don't lie. As the market concentrates in fewer hands, the share available to everyone else is shrinking by billions each year.

The first casualty will be an old-guard of brands that failed to evolve. For years, niches of average product and brand execution survived in footwear. Margins were healthy. A cozy ecosystem of brand and retailer relationships existed. Digital and data were nowhere in industry lexicon.

Times have changed. Globalization, digital, DTC, the disruption of traditional retail – all are brutally exposing laggards. They are hemorrhaging. Nine West filed for bankruptcy in 2017. Rockport in 2018. Many more will go.

At the same time, the forces that helped small brands emerge elsewhere in consumer goods will do the same in footwear. Many already have, with impressive results. Hoka and On in running, Veja and All Birds in ethical footwear, and Nobull in fitness are examples.

All five are young – only Veja existed 10 years ago. All made rapid strides. Originally from France, Hoka developed an oversized cushioned-sole for running. It was acquired by Deckers Corp in 2013 and has since made inroads globally. On was founded in Switzerland in 2010, also on comfort running technology. It has distribution in over 50 markets worldwide (plus an endorsement from Roger Federer). Veja – also from France –

sources its footwear from sustainable Brazilian rubber. It recently opened a store in Paris, followed by one in New York. Nobull was spun out of Reebok Crossfit in Boston. It operates through DTC only – the majority online – and has a cult-following among fitness enthusiasts. All Birds was founded in 2014 as an environmentally-friendly, comfortable wool-based sneaker. It has stores in the US, New Zealand, Germany, the UK, China, Japan and is valued at more than $1.4bn.

These brands came with fresh ideas and innovative product. They used digital and DTC to their advantage. They grasped the strategic imperative of going global. They are disrupting. May many others follow their lead.

Instagram: @nobullproject

Final words

The footwear industry is going through a much-needed bout of creative destruction. The weakest brands are imploding under pressure from big global players on one end, and creative upstarts on the other. In an increasingly harsh and unforgiving environment, only the best ideas can thrive. The small brand is not dead, but many small brands are.

Will global footwear brands eventually be challenged by newcomers, as they were in FMCG? Only time will tell. In the meantime, they best not get too complacent.

Joseph Knoertzer – Principal, J Quaix Consulting

www.jquaix.com

[i] Publicly available financial reports

[ii] Retail Dive, 2019

[iii] https://www.wsj.com/articles/small-cosmetics-brands-make-over-the-beauty-market-by-targeting-millennials-11556296365

[iv] Death of the Small Brand (Part 1): https://medium.com/@jknoertzer/death-of-the-small-brand-855aaa6b6677

[v] Consolidation and concentration used interchangeably here – as fewer firms remain in an industry (consolidation), those remaining have more share (concentration); vice versa, when concentration increases smaller players are left with less and many ultimately disappear (consolidation)

[vi] https://www.counterpointresearch.com/global-smartphone-market-apple-gained-the-top-spot-in-2019-q4-while-huawei-surpassed-apple-to-become-the-second-largest-brand-in-cy-2019/