

STRATEGIC ANALYSIS OF A NICHE RETAIL START-UP

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ABSTRACT

This paper is a strategic analysis of a niche retail start-up company focused on selling decorative pillows to the North American market through online and in-store channels. The firm is relying on a differentiation strategy to achieve competitive advantage in a market crowded with multi-category home décor retailers. There are limits to the amount of revenue that can be generated through the company's retail store, and online sales growth is dependent on sustained internet marketing success. The company must be strategically opportunistic in its pursuit of long-term growth. Additional retail stores, wholesale and custom services are all being considered but would require the development of new internal competencies and a potential shift in strategy. In the short-term, the company must be careful not to become distracted and must frequently review its activities to ensure they are aligned with the current strategy. Where necessary, adjustments should be made to enhance strategic fit.

Keywords: multi-channel retail; niche retail; home textiles; ecommerce; internet marketing

To my girls

(Kori, Haley and Kiara)

for their understanding and support,
and for waiting so patiently for so long.

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1 COMPANY OVERVIEW

Founded in September 2005, Creative Cushions is a specialty retailer of decorative throw pillows and cushions. The company is in the early stages of executing a multi-channel distribution strategy focused on the U.S. and Canadian markets. After incorporating the business in September 2005, the founders spent the following four months establishing the infrastructure and supply channels necessary to support online and brick-and-mortar retail activities.

Creative Cushions is managing a online store containing a comprehensive catalogue of over 350 products and is fulfilling online orders from customers throughout North America. The company is operating out of a single Vancouver location that serves as a retail showroom, warehouse, and online order processing facility. Brick-and-mortar retail activities began in May, 2006, with the commencement of print advertising targeting the local Vancouver market. The company's human resources remain limited to the two company founders and two part-time employees, but early growth is quickly increasing the need for additional resources.

1.1 Products

As a niche online and brick-and-mortar retailer of decorative pillows, Creative Cushions is focused on differentiating itself from the large number of multi-category retailers selling home textiles and other home décor products. Creative Cushions offers consumers a single point of purchase for a wide range of decorative pillow covers. The company strives to offer a higher level of customer service and more in-depth product information than can be found at other home décor retailers. For example, comprehensive product descriptions are provided online along with recommendations for coordinated groupings of pillows. In addition, an in-house interior decorator/designer is available to assist customers with product selection and to coordinate

custom orders. Creative Cushions also sells pillow inserts, either separately or together with pillow covers. These are available in a wide range of sizes and include polyfill, feather/down and 100 percent feather inserts.

Creative Cushions is sourcing directly from international low-cost suppliers that can provide value added services including product design and custom manufacturing. At the present time, approximately 70 percent of the company's imports are from India, Thailand and Turkey. The remaining 30 percent are imported from countries such as France, Belgium, Germany, and the United States. Creative Cushions' decorative pillows, more commonly referred to as cushions in markets outside of the United States, are available in a wide range of styles, sizes, patterns and fabrics and are generally bought as soft furnishings or accent items for beds, sofas, chairs and floor seating.

In addition to ready-made decorative pillow covers, the company is considering offering logo embroidery, monogrammed and custom embroidered pillows to both the corporate and consumer markets. Creative Cushions has partnered with a local embroidery company to help test this service. Furthermore, in response to an increasing number of requests from customers for custom made pillows, Creative Cushions has begun to work with local sewing factories for custom manufacturing. This requires that Creative Cushions also take on the additional activity of sourcing textiles. As a niche focused business, Creative Cushions is relying on its ability to be flexible, adaptable and strategically opportunistic as it strives to establish a competitive advantage.

1.2 Target Market

The results of a survey of 50,000 United States households conducted in December 2002 and January 2003 by National Family Opinion on behalf of *Home Accents Today*, showed that baby boomers and homeowners account for the majority of decorative pillow buyers.

Furthermore, the survey found that "...more than four-fifths of pillow-buying households live in a house, 70% are married and 77% have Internet access".¹ The National Family Opinion Poll also revealed that home accent and gift specialists were the preferred buying destinations for decorative pillows rather than larger home furnishing stores.²

A more recent survey conducted by the Television Bureau of Canada and released in the 2004 Home Décor Industry Report, outlines the Canadian home décor consumer profile of those that spent more than \$250 annually on home décor products as follows:

- Female (54 percent);
- Aged between 35 and 54 (51 percent);
- Having some post secondary or college education (38 percent), although likely to be a university graduate;
- Living with children under twelve (31 percent) in the household, but likely to have children under 3;
- Earning between \$60,000 and \$99,999 (35 percent) and likely to be earning \$100,000 or more.³

Creative Cushions' primary target market consists of women between the ages of 35 and 65. However, because Creative Cushions is providing a very wide product selection that also spans a wide price range, the company must segment its market to target women of different age groups and of different income levels.

Table 1 provides useful data for understanding the decorative pillow consumer market in the United States. The baby boomer consumer group accounts for 60 percent of pillows sold in the \$50 and more price range. Not surprisingly 36 percent of pillows sold in the \$50 and more price range were bought by consumers with incomes of \$75,000 or more.

¹ Dana French, "Pretty Pillows Plump Sales," *Home Accents Today*, October 2004, <http://www.highbeam.com/> (accessed May 12, 2006).

² Ibid.

³ Television Bureau of Canada, "Home Décor Industry Report," www.tvb.ca, (accessed on May 08, 2006).

Table 1: The Decorative Pillow Consumer, by Amount Spent⁴

INCOME	\$10-\$19	\$20-\$49	\$50 OR MORE
Under \$40,000	32%	36%	29%
\$40,000 - \$74,999	31%	35%	35%
\$75,000 or more	37%	29%	36%
GENERATION			
Gen Y	5%	3%	2%
Gen X	15%	14%	14%
Younger Baby Boomers	23%	24%	14%
Older Baby Boomers	33%	26%	46%
Empty Nesters	12%	22%	11%
Seniors	12%	11%	13%

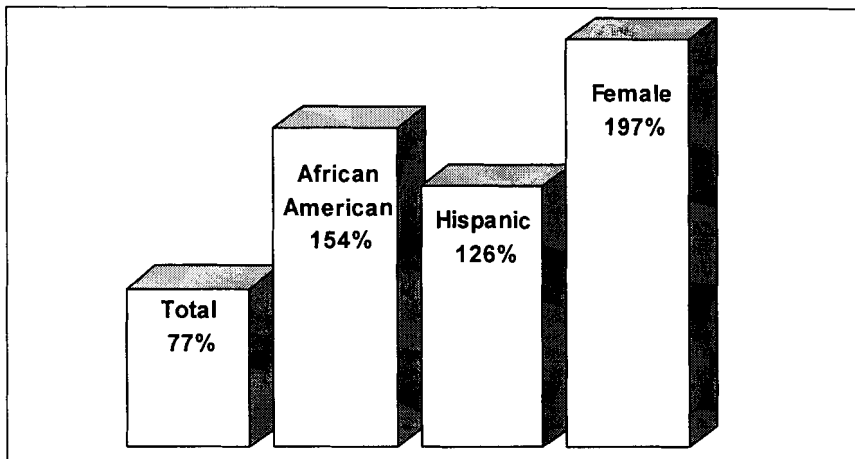
Creative Cushions' primary target market is the middle income and higher income baby boomer market. According to a U.S. Census Bureau report, more than 25 million U.S. households have annual incomes over \$75,000. In addition, as Figure 1 illustrates, from 1991 to 2000 there was a 197 percent increase in the number of women with annual incomes over \$100,000.⁵ Claritas, a San Diego-based market research firm, has forecast that nearly 31 million U.S. households will be headed by 55-74 years olds by 2007. Approximately 6 million of these households are expected to have annual incomes of more that \$100,000.⁶

⁴ Data Source: Dana French, "Pretty Pillows Plump Sales," *Home Accents Today*, October 2004, <http://www.highbeam.com/> (accessed May 12, 2006).

⁵ Kay Anderson, "The Consumer Counts: High Rollers," *Home Accents Today*, January 2003, <http://homeaccentstoday.com/contents/pdfs/CCHighRollers.PDF>, (accessed on May 10, 2006)

⁶ Ibid.

Figure 1: Percent Increase in number of U.S. Households with Annual Income of \$100,000 or more (1991-2000)⁷



A study conducted by PricewaterhouseCoopers in conjunction with the University of St. Gallen, examined the over 55 generation in Germany and the emerging opportunities for retailers as the baby boomer market ages.⁸ The study suggests that there are several key characteristics of the older population that are central to consumer behaviour in western industrialized nations. First, older baby boomers place very high demands on products and services but are willing to pay a premium for them. This creates opportunities for retailers to differentiate themselves from the more price focused competitors by emphasising convenience and customer service. Second, the older generations develop a preference for smaller shops in central locations and are less drawn to the large superstores that are typically located on the outskirts of city centres. In North America, Home Depot has already begun to respond to this trend by opening smaller, more attractively designed retail stores closer to the urban centres. Third, value added services linked to products are becoming increasingly important in the decision-making process. After-market services offer significant growth potential and profit margin.

⁷ Data Source: Kay Anderson, "The Consumer Counts: High Rollers," *Home Accents Today*, January 2003, <http://homeaccentstoday.com/contents/pdfs/CCHighRollers.PDF>, (accessed on May 10, 2006)

⁸ PriceWaterhouseCoopers, "Generation 55+: Opportunities for Retailers and Consumer Goods Manufacturers," April 2006, Special Insert 57, Retail and Consumer Worlds, [http://www.pwc.com/extweb/pwcpublishations.nsf/docid/6BA5A88298D717498525714E00168198/\\$File/en-cart57-1.pdf](http://www.pwc.com/extweb/pwcpublishations.nsf/docid/6BA5A88298D717498525714E00168198/$File/en-cart57-1.pdf) (accessed on June 14, 2006).

1.3 Pricing

Although Creative Cushions is focused on middle to high income consumers, the company carries products in all price ranges. Basic woven fabric pillows with little or no trim fall within the \$14.99 to \$29.99 dollar range. As it is difficult for Creative Cushions to compete with discount stores and department stores that sell basic products in this price range, lower priced solid colour pillows are sold primarily as complements to more expensive embellished products.

The more embellished pillows made from higher-end fabrics are priced within the \$29.99 to \$49.99 range, while higher-end pillows, including one-of-a-kind designer products range as high as \$350. At the higher price ranges, Creative Cushions competes more directly with the high-end home décor retailers, furniture stores and cottage industry manufacturers with direct-to-consumer distribution channels. It is in this market that Creative Cushions can compete on the basis of selection, and by offering customers recommended groupings and collections. The 2002/2003 National Family Opinion poll revealed that 93 percent of households that bought pillows in the \$20 to \$49 dollar range bought more than one, and 90 percent of households that bought pillows priced at \$50 or more, bought more than one. In comparison, the number of households that bought more than one in the \$10-\$19 dollar range was 75 percent.⁹ With an emphasis on customer service, Creative Cushions is therefore focused on selling in the mid to high price range, and on assisting its customers in selecting complementary combinations of higher-end products.

Although discount stores and off-price retailers appeal to the bargain shoppers, the 2002/2003 National Family Opinion poll also revealed that product price ranked among the least important factors when households were shopping for pillows. Topping the list as the most important factors were style and appearance, colour, and overall quality.¹⁰

⁹ Dana French, "Pretty Pillows Plump Sales," *Home Accents Today*, October 2004, <http://www.highbeam.com/> (accessed May 12, 2006).

¹⁰ Ibid.

1.4 The Market Opportunity

Pillows have emerged as one of the most popular fashion accessories for the home. In the United States alone, "... more than 12.5 million households purchased decorative pillows in 2002 and 2003 making them the third most purchased decorative accessory, behind only photo frames and photo albums."¹¹

Like many other home décor products, demand for decorative pillows and cushions is growing rapidly and current U.S. estimates put retail sales of decorative pillows at roughly \$550 million.¹² The demand for decorative pillows is expected to continue to grow as consumers look for affordable ways to beautify their homes. Furthermore, decorative pillows have been found to be a relatively recession proof product category.¹³ Even during economic downturns, decorative pillow sales remain strong as consumers decrease spending on larger more expensive home furnishings and look for less expensive ways to make home improvements.

Manufacturers such as Brentwood Originals, Newport/Layton and Fashion Industries, have seen tremendous growth in their pillow sales in recent years. They have all noted that this growth is directly due to increasing demand for standalone pillows that can be used as accents throughout the home.¹⁴ Decorative pillows are commonly used on couches and chairs and as throw pillows on beds. Large floor pillows are also becoming increasingly popular in North American homes.

Decorative pillows are particularly well suited to seasonal replacement as they are easy to store and typically sell at a price point that makes disposal and replacement an acceptable option. The replacement of decorative pillows is also driven by changes of other home décor items and

¹¹ Dana French, "Pretty Pillows Plump Sales," *Home Accents Today*, October 2004, <http://www.highbeam.com/> (accessed May 12, 2006).

¹² Cecile B. Corral, "Dec pillows provide cushion for suppliers to build on," *Home Textiles Today*. High Point: Oct 27, 2003. Vol.25, Iss. 9; pg. 13

¹³ Jessica Goldbogen, "Pillow Flight: The Decorative Category is taking off with lower price points," HFN The Home Furnishing Network, November 2002, <http://www.highbeam.com> (accessed on July 6, 2006)

¹⁴ Cecile B. Corral, "Dec pillows look to stand alone." *Home Textiles Today*, High Point: Nov 8, 2004. Vol. 26, Iss. 11; pg. 1

home furnishings such as curtains, carpets and rugs, bed throws and bed linens, table cloths, and furniture. The frequency with which decorative pillows are replaced contributes significantly to the ability of retailers to develop repeat business.

The North American online market offers significant opportunity for Creative Cushions. According to the U.S. Census Bureau, U.S. e-commerce retail sales, excluding travel and ticket related purchases, totalled \$55.7 billion in 2003.¹⁵ This figure is projected to reach \$197 billion by 2010.¹⁶ Forester Research Inc. reported that home related products constitute the fifth largest online retail category, and experienced a 33 percent growth in revenue from 2003 to 2004.¹⁷ Furthermore, e-commerce retail sales of furniture and home furnishings are expected to increase from \$5.4 billion in 2005 to \$16.4 billion in 2010.¹⁸

1.5 Company Start-up Overview

Creative Cushions is pursuing a focused differentiation strategy through which it hopes to set itself apart from the large number of home décor retailers that are currently competing for consumer's dollars. From 2006 to 2008, the company plans to focus on two primary channels: online retail and in-store retail. Since inception in September, 2005, the company has concentrated on establishing the basic infrastructure and processes to support its online business. With this accomplished, Creative Cushions is now beginning to develop its in-store retail business. The company is also marketing to interior decorators and designers, offering them as much as 30 percent off local retail pricing. The interior decorator market will demand that Creative Cushions be able to satisfy decorators' desire for fashion forward products. This presents

¹⁵ Kevin Regan and John Yozzo, "2005 Online Retail Report," (July 2005). FTI Consulting Inc. Website: <http://www.fticonsulting.com/>. (accessed on June 05, 2006)

¹⁶ Ibid.

¹⁷ Enid Burns, "Online Retail Growth Robust," (May, 2005). *www.clickz.com*: www.clickz.com/stats/sectors/retailing/print.php/3507541 (accessed on June 28, 2005).

¹⁸ Kevin Regan and John Yozzo, "2005 Online Retail Report," (July 2005). FTI Consulting Inc. Website: <http://www.fticonsulting.com/>. (accessed on June 05, 2006)

new product sourcing challenges and places greater importance on manufacturers' in-house or contract design capabilities.

The decision to commence with an online retail strategy was based primarily on the ease and speed of execution and the relatively low start-up costs. It was also based on the potential to test products and pricing and to gain deeper market intelligence before making the financial commitment to a brick-and-mortar retail operation. The major costs associated with the launch of the online retail business included product sourcing, inventory procurement, website development and office and warehouse lease costs.

1.5.1 Website development

Central to pursuing the North American online retail market was the creation and maintenance of a professional e-commerce website. Creative Cushions has kept website development costs to a minimum through the selection of a fully hosted e-commerce solution provider. A two month evaluation process of numerous solution providers resulted in the final decision to work with California-based Volusion, Inc.

The Volusion system is the backbone for Creative Cushions' operations. In addition to providing a very comprehensive feature set that will easily support the growth of its online business, the Volusion software also meets three key requirements:

- it offers exceptional financial reporting, statistics tracking tools and integration with QuickBooks accounting software. This enables the company to improve on the effectiveness of its website, refine its marketing strategy, and analyze costs and profitability.
- it offers integration with the Moneris™ financial payment gateway which supports in-store and online transactions through a single interface and enables the company to secure lower credit card discount rates and merchant account fees, and;
- it gives Creative Cushions the option of buying a licensed version of the software which enables the company to eventually host the software on its own servers and will give it complete access to the source code for future customization.

Overall, the Volusion solution is an excellent strategic fit. The software not only enables the company to provide superior customer service, but also supports an unlimited number of products and product options and handles inventory updates quickly and easily. Vendor management, knowledge management, shipping management and customer relationship management modules are all tightly integrated within the system. Wholesale, retail and vendor management activities are all supported. Furthermore, technology management issues are minimized as the solution includes data backup and security and technical support. Creative Cushions views its e-commerce solution as a strategic asset as it gives the company the capabilities of a much larger firm and will enable it to quickly scale its online business. All of these features will enable Creative Cushions to remain focused on its business and will support its strategy of differentiation through product selection and customer service.

Creative Cushions believes that the Volusion system will minimize total cost of ownership in the short and the long run. The Volusion software is provided for a monthly fee of US \$197 plus bandwidth usage charges. Creative Cushions' estimates for a custom developed solution ranged from \$25,000 for a site with basic shopping cart functionality, to over \$80,000 for a solution with features comparable to those of Volusion. However, in addition to these development costs, a custom developed solution would have also required monthly hosting fees and technical support fees that would have been in the range of \$60-\$100 a month.

Creative Cushions is currently serving the U.S. and Canadian markets through a single online store. Although this helps to keep costs down while the company is in its formative stages, it is not ideal as it does not enable Creative Cushions to offer different pricing structures for its Canadian and U.S. customers.

1.5.2 Building a Starting Inventory

Initial product sourcing was done through direct travel to industry trade shows in India, Turkey, Thailand, the United States and Germany. Travel costs were kept to a minimum. The company was awarded an all expenses paid trip to India by the Indian government, part of India's aggressive approach toward developing its textiles export industry. Sourcing trips to trade shows in Thailand, Turkey and the United States were arranged to coincide with the founders' other private business trips and vacations. This enabled Creative Cushions to establish supplier relationships with over 20 reputable manufacturers, each of which were prepared to meet the company's requirement for small initial order quantities with a low depth and high breadth of unique products. Suppliers were selected according to the following criteria:

- Highly competitive pricing;
- Unique, high-quality products;
- Willingness to supply in small order quantities;
- Responsiveness;
- Consistent product quality, supply and delivery capabilities;
- Ability to add value through custom design and product recommendation; and,
- Reputation

1.5.3 Physical Infrastructure

The online business required only office, warehouse and order processing space. However, because of the company's plans for local retail, Creative Cushions made the decision to locate within the general area in which it intends to open its first retail store. The company leased a 1700 square foot showroom within Vancouver's False Creek District, an area which is being developed in preparation for the 2010 Winter Olympics. Once a heavy industrial area, the location is now gentrifying and becoming home to upscale apartment buildings and a large number of interior design and home decorating related businesses. As part of this emerging cluster of home décor businesses, Creative Cushions is well located to capitalize on the increasing destination shopping traffic. This location was strategically selected so as to be within an acceptable travel distance for the largest possible number of middle to upper income Vancouver

households. Bounded by high traffic retail corridors, this location was available at approximately one-third of the cost of an equivalent size retail space and gives Creative Cushions a sufficient window of time to develop its business before lease rates are increased.

Prior to establishing a retail store in a more expensive and high-traffic retail location, Creative Cushions is testing its ability to draw local traffic to its current location. Through the use of various local print advertising vehicles, the company is also testing its marketing message and response rates from different market segments. At this stage, to minimize infrastructure costs and maximize operational efficiency, Creative Cushions is striving to keep its online pick-pack-ship operations and retail operations within the same facility. However, as the company expands, it is anticipating the need for separate facilities for office, warehousing and online order processing. When the company reaches this point, it will have important retail technology decisions to make, and although its current e-commerce system supports point-of-Sale (POS) and barcode scanning devices, tight integration of online and offline order processing, inventory management and customer relationship management will become increasingly important.

As Creative Cushions grows its online and brick-and-mortar business, it must stay tuned to the forces that are shaping its competitive environment. As a niche player, Creative Cushions must remain highly focused yet flexible and must constantly strive to satisfy its customers with differentiated products and services.

2 RETAILING IN NORTH AMERICA

Retail is the second largest industry in the U.S. in terms of the total number of businesses and employees engaged.¹⁹ However, overall industry growth is low and is tied closely to a low U.S. population growth rate of 2 percent.²⁰ Year over year sales growth in the industry tends to fluctuate considerably based on a wide range of economic and socio-political variables. U.S. retail sales for 2005 increased 6.1 percent over the previous year and are forecast to increase 4.7 percent in 2006. These relatively strong growth rates are largely the result of low interest rates contributing to a strong housing market, easy availability of consumer credit, moderate inflation and low unemployment rates. However, other factors such as global terrorism, rising energy costs, and high debt levels make for an uncertain future for the retail industry.

Treating retail as a single industry presents analysts with a challenging task, for retail is really comprised of many different types of business operating within a complex acquisition and distribution system.²¹ The competitive landscape for retailers continues to change at a dizzying rate. Key differences among retailers include location, products sold, and chain/ownership.²² However, with globalization has come increased susceptibility to international politics and economics, making location, product and organizational decisions all the more challenging. Rapid technological innovation and changing consumer demographics further complicate the retail

¹⁹ Plunket Research Ltd., "Retail Industry Trends," www.plunketresearch.com/. (accessed, May 17, 2006)

²⁰ U.S. Business Reporter, "Industry Report: Specialty Retailing Industry," February 15, 2005, Publishing Services Group, U.S. Business Reporter, Reprint No. RETS5640, <http://www.usbrn.com/>. (Accessed May 10, 2006).

²¹ Robert Larson, CUED Presentation, Taubman Realty Group, referenced in, Bill Ryan and Gerry Campbell, "Retail Development Strategies and Your Community: Strategies that Work Elsewhere May Not Work Here," Center for Community Economic Development, University of Wisconsin-Cooperative Extension, October 1996 No.2. <http://www.uwex.edu/ces/cced/lets/letsrd.html> (accessed on May 16, 2006).

²² Bill Ryan and Gerry Campbell, "Retail Development Strategies and Your Community: Strategies that Work Elsewhere May Not Work Here," Center for Community Economic Development, University of Wisconsin-Cooperative Extension, October 1996 No.2. <http://www.uwex.edu/ces/cced/lets/letsrd.html> (accessed on May 16, 2006).

landscape. Today, retailers require an ever deepening set of organizational core competencies to be competitive.

2.1 North American Retail Trends

2.1.1 Consolidation and Globalization

Consolidation in the retail industry has been a constant theme over the past two decades. An increasingly competitive retail environment and the accompanying pressures on sales growth and profit margins have been forcing retailers to pursue consolidation strategies and globalization through mergers and acquisitions. With consolidation have come greater operational efficiencies and economies of scale and the ability of large buying groups to place downward pressure on supplier prices. This has given rise to the large discount stores such as Kmart, Target and Wal-Mart which, through their ability to pass on cost savings to customers and to offer products across an ever increasing range of categories, has fuelled the consolidation trend even more.

Department stores have also been forced to consolidate or close in the face of the emerging discount stores. Montgomery Ward & Company, which was once heralded as the greatest American retailer, is a strong case in point. Montgomery Ward, after first filing for bankruptcy in 1997 and then re-emerging as a subsidiary of General Electric, finally announced in 2000 that it was closing for good.²³ Federated Department Stores, Inc., on the other hand, has survived by steering clear of the low-end market. Federated has emerged as the leading operator of mid to upper-end department stores after acquiring R.H.Macy & Co. in 1994, and May Department Stores in 2005. It is currently working toward repositioning its stores under the Macy's name.²⁴ Other successful department stores are those that have managed to differentiate themselves on the basis of service and quality. Nordstrom, for example, has become known for its

²³ Leslie Kaufman and Claudia Deutsch "Montgomery Ward to Close Its Doors," The New York Times, December 29, 2000, <http://www.xent.com/dec00/0283.html> (Accessed on May 2006).

²⁴ Plunket Research, "Retail Industry Trends," www.plunketresearch.com, (accessed on May 17, 2006)

high level of personalized service and its unique, high-value merchandise. Other stores, such as Neiman Marcus, that have focused on the high-end luxury market have continued to profit.

In addition to an ongoing consolidation trend and an increasing dependency on global sources of low-cost products, low population growth in industrialized nations has forced large retailers to pursue international markets in order to sustain their growth. This globalization trend continues to accelerate, particularly as China and India become more affluent and the international power balance continues to shift in their favour. Increased investment in these markets by large retailers has resulted in improvements in foreign production and increasing availability of higher quality products for import into North America.

2.1.2 From Standardization to Localization

One of the most significant retail trends of today is the shift from standardization strategies to localization strategies. Big box retailers like Wal-Mart and Best Buy, that once saw standardization as their key to success, are now realizing that standardization has its drawbacks and has reached the point of diminishing returns.²⁵ Although standardization across stores and processes has increased operational efficiencies, streamlined supply chains, and facilitated rapid expansion to into new markets, it has also limited large retailers' ability to cater to the diverse tastes of local consumer markets.

The shift from standardization to localization is in fact being driven by three primary factors. The first concerns demographic changes and the increasing diversity of ethnicity, lifestyle, wealth and values in consumer communities. "Claritas [a world leader in Demographics, Segmentation, Population, Market Research] determined in the 1970s that 40 lifestyle segments

²⁵ Darrel K. Rigby, and Vijay Vishwanath, "Localization: The Revolution in Consumer Markets," *Harvard Business Review*, 00178012, April 2006, Vol. 84, Issue 4

were sufficient to define the US populace. Today, that number has grown to 66, a 65% increase.”²⁶

The second factor that is forcing big-box retailers to pursue localization strategies is the lack of room to expand. Not only are companies like Wal-Mart and Best Buy hard pressed to find new locations of suitable population density, but they are also encountering increasing resistance from community activists that are pushing for limits to size and style of new stores. Wal-Mart’s recent effort to obtain approval for a new store in Vancouver, Canada is a good example. Despite the development of what Wal-Mart claims is a very environmentally friendly design, Vancouver City Councillor Anne Roberts argues that the store would create traffic congestion and excessive pollution. Roberts comments that Vancouver “...wants to be a city of neighbourhoods; to get away from the car.”²⁷ Community and political opposition like this puts pressure on big box retailers to downsize new stores and to rethink store formats. They are forced to break from the cookie cutter approach and to adjust the product mix and store design to meet local consumer tastes.

Finally, and perhaps most importantly, big box retailers are finding that standardization has begun to weaken their competitive advantage by limiting innovation.

“Managers become so focused on meeting tight operational targets and stamping out exceptions that they begin to consciously avoid the experimentation that leads to attractive new products, services and processes. In the end, standardization erodes strategic differentiation and leads inexorably toward commoditization- and the lower growth and profitability that accompany it.”²⁸

²⁶ Darrel K. Rigby, and Vijay Vishwanath, “Localization: The Revolution in Consumer Markets,” *Harvard Business Review*, 00178012, April 2006, Vol. 84, Issue 4, p.2

²⁷ CTV.ca News Staff, “Wal-Mart pitches green design for Vancouver,” *CTV NewsNet*, www.CTV.ca, March 29, 2005 (accessed June 6, 2006)

²⁸ Darrel K. Rigby, and Vijay Vishwanath, “Localization: The Revolution in Consumer Markets,” *Harvard Business Review*, 00178012, April 2006, Vol. 84, Issue 4, p.2

2.1.3 Customization-by-Cluster Strategy

Localization is proving to be a costly undertaking that presents retailers with significant management and organizational challenges. Pursuing strategic differentiation requires decentralization and the handing over of more decision-making authority to managers at the store level. If not managed carefully, this presents the risk of undermining much of the efficiencies and cost-competitiveness that have been achieved through standardization. Compromise has come in the form of clustering techniques. Clustering strategy involves the careful analysis of local buying patterns to identify communities that have similar characteristics. Store formats, product mix, and marketing promotions are then developed to create a limited number of store templates that can be applied in locations with common characteristics. Ultimately, the goal of clustering is to maintain scale economies while still being able to more or less satisfy local consumer demands. Best Buy has applied the clustering strategy with considerable success, reporting that the 85 stores that were localized by early 2005 had demonstrated sales gains that were two times the company's average.²⁹

2.1.4 Direct Marketing and Non-Store Selling

Although non-store selling has been with us for decades in the form of mail-order catalogue companies and multi-level marketers such as Avon and Amway, this sector of the industry has grown rapidly in recent years.³⁰ Today, the non-store category consists of retailers involved in the following direct selling activities:

- Catalogues, direct mail and mail-order advertising;
- Television home-shopping programs and infomercials, along with direct-sales offers broadcast by radio;
- Merchandise or services offers via interactive television programming;
- Internet-based retailing;

²⁹ Darrel K. Rigby, and Vijay Vishwanath, "Localization: The Revolution in Consumer Markets," *Harvard Business Review*, 00178012, April 2006, Vol. 84, Issue 4, p.4

³⁰ Plunket Research, "Retail Industry Trends," www.plunketresearch.com, (accessed, May 17, 2006)

- Direct sales offers via Internet-based advertising;
- Door-to-door and “ party ” selling; and,
- Telemarketing.³¹

The growth in non-store selling can be largely attributed to the increasingly sophisticated direct marketing techniques and the use of database software that enables marketers to easily profile and target customers according to a wide range of variables.

Although non-store selling techniques are used extensively by brick-and-mortar retailers to drive traffic to their stores or as part of an integrated multi-channel strategy, there are a growing number of companies that operate purely in the non-store category.³² These companies continue to erode the market share of brick-and-mortar retailers.

2.1.5 Growth of Multichannel Retailing

Since the burst of the dot.com bubble in 2000, the threat of the Internet pure-plays to brick-and-mortar retailers has been downplayed. However, the lost opportunity that many retailers face by not getting involved in the online channel can be significant. With the growth of online retailing, a new breed of shopper has emerged that retailers cannot ignore. This is the multi-channel shopper, a rapidly growing consumer group that when well served, can significantly increase a retailers profitability.

“Recent studies of consumer shopping behaviour indicate that multi-channel shoppers show a significantly higher value and frequency of purchase than single channel shoppers. Over 65% of online shoppers also use catalogs and 60% of retailers found multi-channel customers more profitable than single channel buyers.”³³

Recognition of the value of multi-channel consumers has placed increasing importance on multi-channel retailing strategies and the thoughtful integration of stores, web sites, call centres and catalogue operations. However, for the majority of retailers, the emphasis in multi-

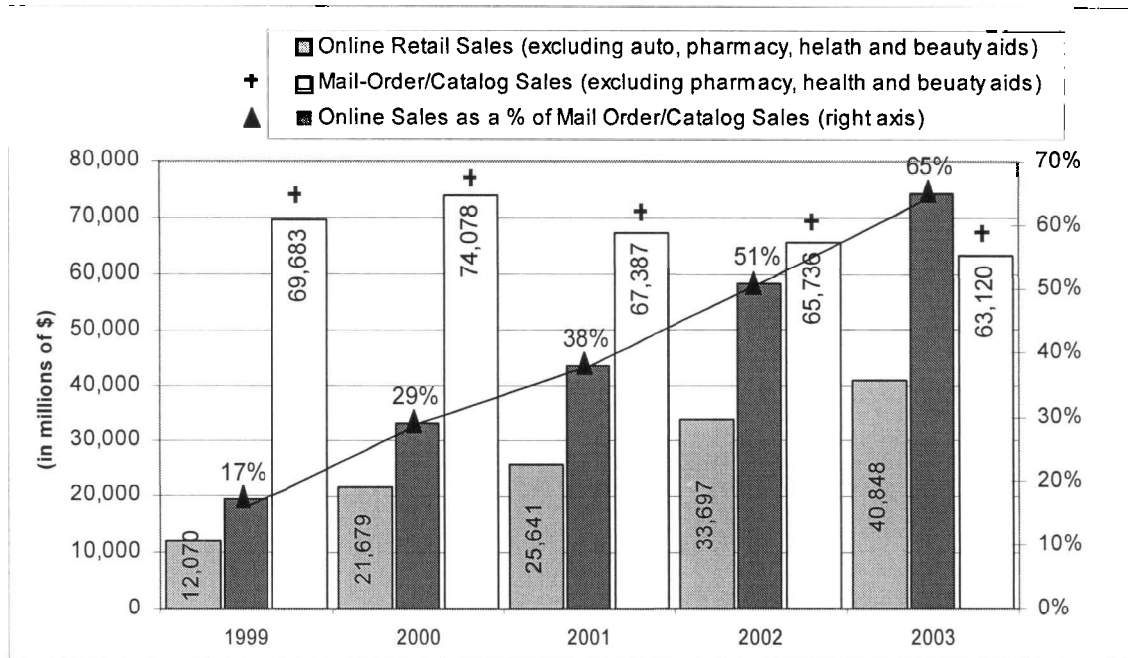
³¹ Plunket Research, “Retail Industry Trends,” www.plunketresearch.com, (accessed, May 17, 2006)

³² Ibid.

³³ Ashish Jandial, Patrick Ogawa and Preetha Sekharan, “Multi-Channel Retailing Goes Mainstream,” Infosys Technologies Ltd., July 2005, <http://www.infosys.com/>. (accessed June 6, 2006)

channel strategy implementation has been on the integration of the online and in-store channels. As Figure 2 shows, although catalogue and mail-order operations continue to figure prominently, their aggregates sales have been declining while online retail sales have been increasing.

Figure 2: Comparison of Online Retail Sales to Mail Order/Catalogue Sales³⁴



Retailers have also begun to increase their spending on online advertising as they realize the influence that the online channel has on in-store sales. “Senior-level managers at both Target and Sears are on record as saying though online commerce represents under 5 percent of their overall sales, they’re convinced 40 to 50 percent of in-store sales are influenced by the online channel.”³⁵

The trend toward multi-channel strategy is closely tied to the demographic shift toward an older population that demands better service and convenience and represents an active online

³⁴ Data source: Kevin Regan and John Yozzo. “2005 Online Retail Report,” July 2005, FTI Consulting Inc. <http://www.fticonsulting.com/>, (accessed on June 05, 2006)

³⁵ David Cohen, “Online Retail: Multichannel Consumers Equal Multichannel Marketing,” January 19, 2005, www.clickz.com, http://www.clickz.com/experts/brand/emkt_strat/article.php/3460631, (accessed May 28, 2006)

consumer segment. According to Jupiter Research, the two fastest growing segments for online retail are adults over 50 and lower income consumers with household incomes under \$15,000.³⁶ With these two segments expected to grow 147 percent and 44 percent respectively by 2009, it is clear that strengthening the integration of online and offline channels would appeal to high-end specialty retailers and discount stores and alike.³⁷

2.1.6 Growth of Yahoo, eBay and Amazon

In considering current retail trends, and particularly those in the online retail sector, one cannot ignore the remarkable growth and success of online markets for small retailers and entrepreneurs. In particular the growth of eBay and Amazon.com represents a new competitive force that further complicates the retail landscape. Although online retail still only represents a small percentage of the total retail market, the success of eBay and Amazon.com may have great significance to large retailers.

Dan Nisannoffs' book, *FutureShop*, "... forecasts a fundamental evolution of consumer behavior as a result of eBay's entrenchment into our society, slowly changing the way consumers buy new and used products. We are rapidly approaching a tipping point (driven by eBay's fast-growing liquidity in consumer goods) that is destined to impact deeply our consumer culture and perhaps change it forever."³⁸

In view of the considerable influence that the online channel is being found to have on offline consumer behaviour, large retailers cannot ignore the growth trend of online marketplaces. In addition, this evolving online consumer culture creates new opportunities for smaller retailers like Creative Cushions, thus further eroding large retailers' market share.

³⁶ David Cohen, "Online Retail: Multichannel Consumers Equal Multichannel Marketing," January 19, 2005, www.clickz.com, http://www.clickz.com/experts/brand/emkt_strat/article.php/3460631, (accessed May 28, 2006)

³⁷ Ibid.

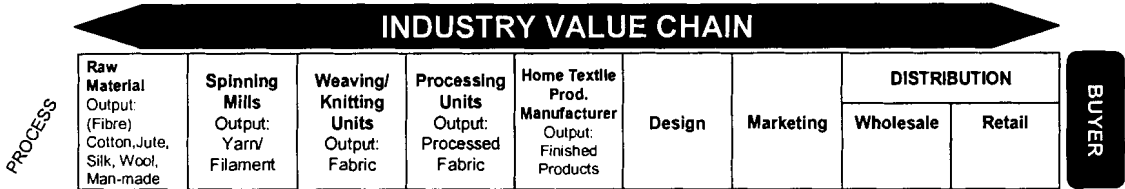
³⁸ RadioInk.com, "How the 'Auction Culture' will Affect Radio," Publishers Notes, February 13, 2006 <http://www.radioink.com/listingsEntry.asp?ID=421413&PT=publishersnote> (accessed May 22, 2006)

3 THE GLOBAL HOME TEXTILES INDUSTRY VALUE CHAIN

The recent elimination of quantitative import restrictions under the World Trade Organization (WTO) agreement on Textiles and Clothing is having a profound impact on the home textiles industry. Throughout the entire industry, from the producers of natural fibre to consumer distribution channels, almost all industry players are undergoing change and transformation as they reassess their competitive positions and respond to the opportunities and threats of a new global trade environment. For the most part, firms that are not actively engaged in this process are either destined to exit the market or will be rapidly absorbed by competitors or firms either upstream or downstream in the value chain.

As indicated in Figure 3, the global home textiles industry value chain can be broken down into nine primary processes or areas of activity. The upstream activities include the production of raw materials, the output of yarn, the knitting and weaving process, fabric processing, and manufacturing of finished products. Downstream activities include marketing, wholesale and retail distribution. Occurring at multiple stages in the chain are design activities that ultimately contribute most significantly in the creation of value. Although design is important from the weaving stage down to retail, for simplicity it is indicated only once in the accompanying value chain diagrams.

Figure 3: The Home Textiles Industry Value Chain



3.1 Upstream Processes

3.1.1 Raw Materials

Fibre, either natural or man-made is the output of the raw materials process. Natural fibres for home textiles include vegetable fibres (cotton, linen, jute, flax, ramie, sisal and hemp) and animal fibres (silkworm, hair). Man-made fibres are derived from natural cellulose (such as rayon), or are based on synthetic chemicals (such as nylon and polyester). Fibres are produced through both labour intensive agricultural processes and technical processes. Fibres are also produced for very specific uses and their value is derived through the combination of unique quality, scarcity of resources, and cost of production.

3.1.2 Spinning

Spinning is the process of creating yarn and filament from raw fibre materials. Except in the case of small scale artisan spinners, this process is highly mechanized and technical and the output is highly dependent on the quality of fibre. Fibre costs can account for as much as 70 percent of production costs. In the spinning process fibres of different quality, properties and type are mixed, cleaned and opened to create yarn of different densities. Yarns may be dyed and chemically treated prior to or after the weaving stage.

3.1.3 Weaving/Knitting

A wide range of looms are used in the weaving process, however, the majority of commercial fabrics are woven through the use of computerized Jacquard looms, modern weaving machines that can produce complex patterns and designs with great precision and detail. Weaving processes vary considerably in the production of different fabrics with yarns, technical skill, labour and equipment being the primary cost factors.

3.1.4 Processing

Following the weaving and knitting stage, fabrics are processed in a number of ways. For example, they may be dried, shrunk, dyed, bleached, scorched, embossed, creased or layered to produce a wide range of final looks, textures and finishes. Processing techniques are often closely guarded by firms as they can be used to differentiate fabrics and command premium prices.

3.2 Downstream Processes

Moving downstream in the industry value chain we find the players involved in the design, marketing, wholesale and retail activities. Firms engaged in these activities have been primarily concentrated within the developed nations and in close proximity to consumer markets. Traditionally, the most value has been created and the greatest profits realized at this end of the chain. However, included among these local market beneficiaries have been the domestic manufacturers who, until recently, have also profited through trade-policy rents and global sourcing strategies that focus on low-cost inputs from a network of decentralized producers in developing countries.

The unique combinations of downstream activities including research, sales, marketing and design, are what create the most value in buyer-driven commodity chains.³⁹ Within the home textiles value chain, marketing and design activities are the critical links enabling retailers and wholesalers to identify and communicate consumer demand to suppliers and producers upstream in the chain. Either outsourced, or performed in-house, competencies in these activities, along with the activities of global sourcing, production contracting, supply chain management and distribution have been the primary determinants of competitive strength for large retailers and wholesalers within the protectionist trade environment of the recent past.

³⁹ Gary Gereffi, "International Trade and Industrial Upgrading in the Apparel Commodity Chain," *Journal of International Economics*, 48 (1999)

3.3 Vertical Integration in the Textiles Industry

The industry value chain has historically been highly fragmented, particularly in the upstream processes described above. Until recently, this industry structure has been maintained by the concentration of demand in developed countries and protectionist trade policies (import quotas and tariffs) that have kept consumer prices high and that have concentrated profits among developed country manufacturers and large retailers. This trade environment, among other factors, prevented developing countries from moving beyond a fragmented network of many small industry players engaged in the various stages of production, to a more efficient textile industry with greater vertical integration and economies of scale. Protectionist policies also served to increase their competitive capabilities. They became highly skilled in their areas of specialization and in managing the linkages with firms engaged in the immediate upstream and downstream processes.⁴⁰

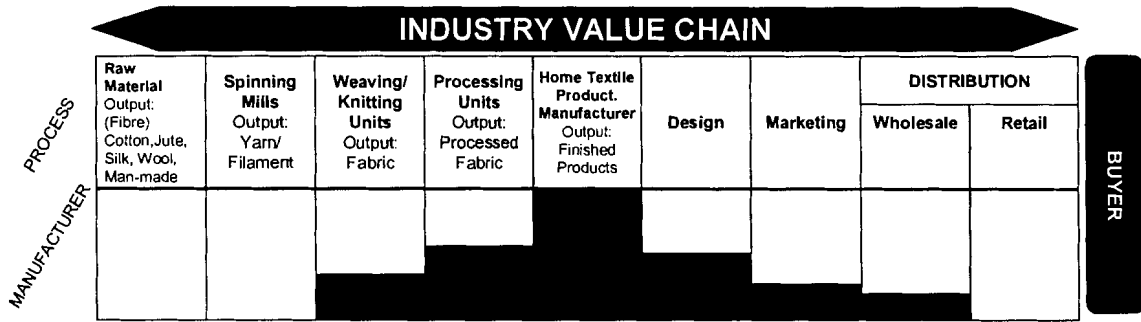
Whereas the protectionist policies of the past limited integration of the value chain throughout the production stages, the post-quota environment is encouraging vertical integration particularly among firms in the most competitive developing countries such as China and India.

3.4 The Role of Manufacturers in the Value Chain

Figure 4 illustrates the changing footprint of manufacturers as they are integrating backward and forward in the chain. While backward integration leads to greater efficiencies, forward integration involves the creation of value through engagement in the processes of design and marketing.

⁴⁰ Gary Gereffi, "International Trade and Industrial Upgrading in the Apparel Commodity Chain," *Journal of International Economics*, 48 (1999)

Figure 4: Industry Value Chain – Manufacturer Involvement

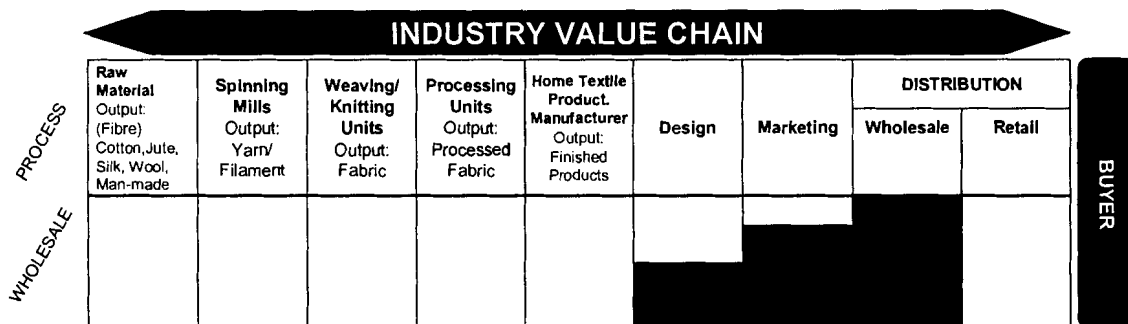


The hiring of Western designers and skilled marketers gives manufacturers the ability to wholesale directly to a larger and more diverse base of retailers in foreign markets and greatly speeds up the time to market for new products. Furthermore, it also enables them to develop brand names and retail strategies within their local markets that may eventually allow them to compete head-to-head with large retail chains in foreign markets. Manufacturers' involvement in the industry value chain is therefore the most extensive of all industry players.

3.5 The Role of Wholesalers in the Value Chain

Within North America, wholesalers serve primarily the medium to small retailers that do not have global sourcing capabilities or access to detailed market information, and that are not involved in the design process. As indicated in Figure 5, wholesalers add value through a footprint that includes marketing and design (outsourcing and in-house) and contract relationships with global and domestic producers.

Figure 5: Industry Value Chain – Wholesaler Involvement

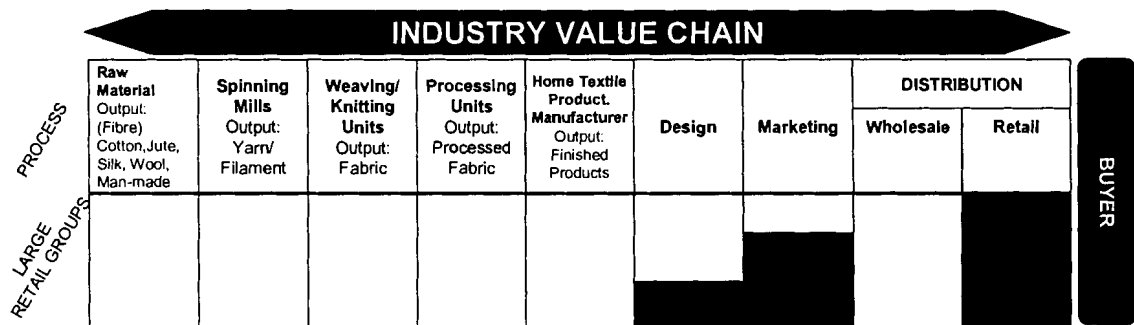


Marketing activities for wholesalers include catalogue production and direct mail, and extensive tradeshow participation, where they are able to network and sell directly to retail buyers. Within the liberalized trade environment, wholesalers must move quickly to align themselves more closely with a smaller select number of producers to which they can bring their marketing and design experience. However, wholesalers will increasingly find themselves in competition with global manufacturers that are also extending their footprint through design, marketing and wholesale activities.

3.6 The Role of Large Retailers in the Value Chain

Figure 6 shows the footprint of large retail groups that have core competencies in retail distribution, marketing and design. Both marketing and design services may be outsourced, however, large retail groups typically have extensive marketing departments. Nonetheless, with large marketing budgets, a much greater percentage of their marketing activity is likely to be outsourced to marketing and advertising firms.

Figure 6: Industry Value Chain – Large Retailer Involvement



Design services are often contracted out but closely managed by the retail groups. Like wholesalers, these retail groups have very close linkages with manufacturers and their operations are supported by superior supply chain management systems. With the elimination of import quotas, many large retail groups are reducing the number of global suppliers they are working with to focus on closer integration with highly efficient, vertically integrated producers in

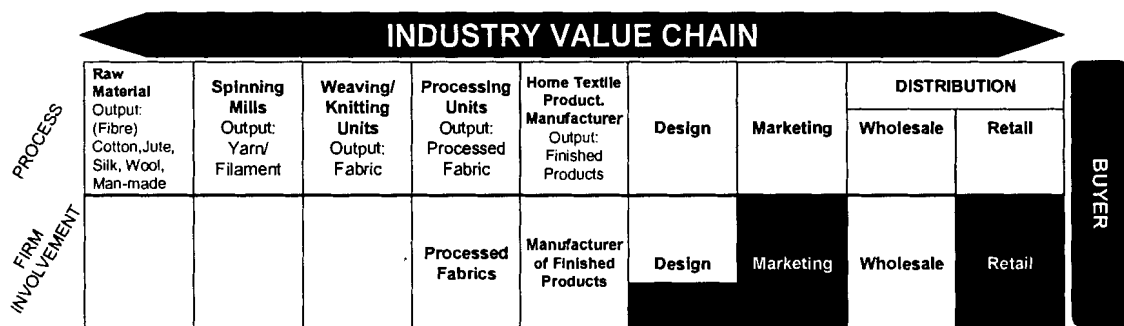
countries such as China and India. Design and marketing activities can then be even more closely coordinated between the large retail groups and their manufacturers. This further enhances these retailers' ability to respond to consumer demand and to bring new products to market faster.

3.7 Creative Cushions' Involvement in the Industry Value Chain

Figure 7 indicates the footprint that Creative Cushions occupies in the value chain.

Creative Cushions is directly involved in design, marketing, and retail activities.

Figure 7: Industry Value Chain – Creative Cushions' Involvement



However, the firm's involvement in the chain, through interaction with other industry players, reaches upstream as far as textile processing. Creative Cushions buys from several manufacturers that, in addition to the stitching and assembling of finished products, also provide final fabric processing services. These firms allow Creative Cushions to specify colours and finishes for fabrics. These fabrics are then treated and dyed at the time of order before being sewn into the final product. However, at the present time, the majority of Creative Cushions' upstream interactions are with manufacturers that are selling ready-made products or are assembling to order with some customization in finishing. Such customization might be in selection of trim and tassels, fabric choices, dimension, fill, or closure system (ie. zipper, overlap, and button). Creative Cushions' flexibility to source from a large number of smaller manufactures gives the company a competitive advantage against large retailers in that it can offer its customers a much wider range of products.

Design activities are where a great deal of value is added in the home textiles industry. Creative Cushions is currently doing a limited amount of in-house design. In addition, the firm is working with local cottage industry designers in the creation of high-end products for sale exclusively through Creative Cushions. The majority of design services are otherwise provided through the manufacturers, and in a few cases, wholesalers from which Creative Cushions buys. Because of its limited in house design, Creative Cushions' ability to find manufacturers with strong design capabilities is an important factor that will contribute to the company's success.

Creative Cushions' marketing activities are performed almost entirely in-house. At present, less than 10 percent of marketing activities are outsourced. As a specialty retailer, marketing competencies will be central to the Creative Cushions' success. However, as the company grows, other strategic marketing firms will most likely be contracted to provide services in the areas of branding and promotion.

At this stage Creative Cushions has not become involved in any wholesale activities. However, wholesale activity will increase as the firm strengthens its supplier network and inventory management. Participation in the wholesale market is contingent on sufficient sales volumes through the company's retail operations; a requisite for the lower supply costs that are desired for wholesale.

Retailing, online and in-store, is where Creative Cushions' involvement in the home textiles value chain is greatest. It is here that cumulative value of production, design and marketing activities are realized through the sale of product to the consumer. Creative Cushions has, in a short time, achieved a strong online market presence, as measured through North America wide website traffic volume and search engine rankings. Meanwhile, local Vancouver market awareness is gradually increasing through word of mouth and local print advertising.

4 THE HOME TEXTILES RETAIL INDUSTRY

Home textiles retailing is a sub-sector of the home décor market. The home décor market has exploded in recent years. Aging baby boomers and the increasing popularity of home decorating shows have combined to create the ideal climate for home décor retailers. The sudden growth of home décor as a major retail category can be traced back to 2000 when major Canadian and American retailers began to respond to market changes that were occurring as a result of the aging baby boomer generation. Retailers began to recognize the emergence of a new décor-crazy demographic consisting not only of retiring baby boomers, but also of a much more style and fashion conscious generation of adults currently moving through their 30's. A study done by the Television Bureau of Canada notes that "...the home décor industry is booming thanks to burgeoning consumer interest in stylish domesticity, home renovation and interior decorating, as well as from the need to fill the ever-larger floor plans for new houses".⁴¹ Although many retailers such as Sears, Pier1 Imports, and Pottery Barn have been aggressively pursuing this market, analysts have predicted that the tremendous diversity in personal tastes makes it very difficult for them to dominate the market.⁴²

In Canada, ethnic accessories and décor items are very popular, a trend which is believed to be a result of the increasing influence and demand from the country's diverse multicultural population. According to Joseph Wuest, General Manager of advertising at the Brick, "... interest in all decorative products is on the rise in Canada."⁴³ In the Canadian market alone the home décor industry is estimated to be worth over \$30 billion. Furthermore, the average Canadian

⁴¹ Television Bureau of Canada, "Home Décor Industry Report," www.tvb.ca, Posted August 2004, (accessed on May 08, 2006)

⁴² Ibid.

⁴³ Ibid.

annual household expenditure on home furnishings and equipment is estimated to be \$1,793.⁴⁴ A 2004 Scan/US survey of 147,953 U.S. households found the average annual expenditure on home furnishings and equipment to be US \$2,556.⁴⁵

4.1 Home Textiles Retail Industry Analysis⁴⁶

Michael Porter's five-factor model provides a useful framework for analyzing the overall attractiveness of the home textiles industry.⁴⁷ Porter recognized that a firm's ability to compete and profit in any given industry is dependent on five factors. As shown in Figure 8, these are: rivalry among existing firms, threat of entry from potential competitors, the availability of substitute products, the bargaining power of customers, and the bargaining power of suppliers. In addition to providing a framework for analysing industry attractiveness, Porter's model also aids in the identification of key success factors that are needed to be competitive.

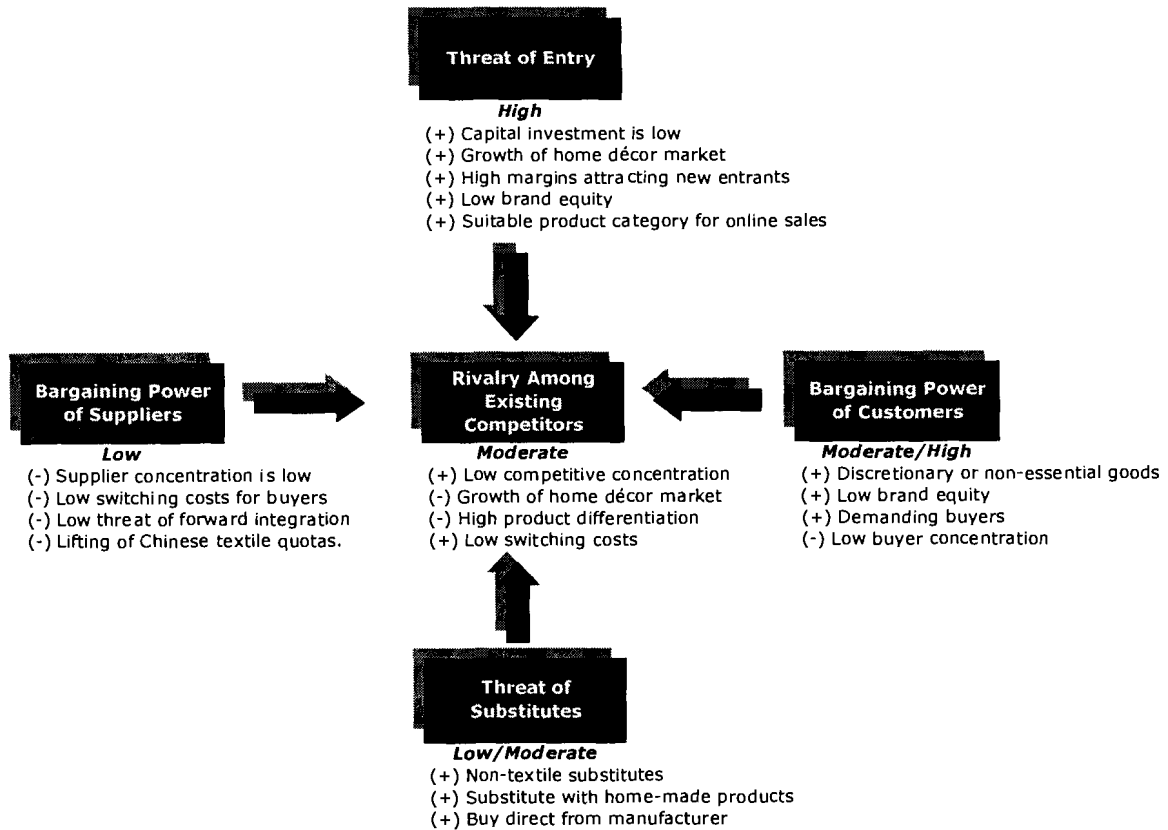
⁴⁴ Television Bureau of Canada, "Home Décor Industry Report," www.tvb.ca, Posted August 2004, (accessed on May 08, 2006)

⁴⁵ Scan/US Inc. "Consumer Expenditure Potential 2004," September 30, 2004, [www.Scanus.com](http://www.scanus.com), <http://www.scanus.com/pdf/rpts11.pdf> (accessed on June 16, 2006)

⁴⁶ Adapted from Porter (1979), and Bukszar (2006)

⁴⁷ Michael Porter, "How Competitive Forces Shape Strategy", Harvard Business Review, Mar-Apr. 1979.

Figure 8: Industry Forces



Source: Adapted from Porter (1979), and Bukszar (2006)

4.1.1 Rivalry Among Existing Competitors (Moderate)

4.1.1.1 Competitive Concentration

Although competitive concentration is low overall, the home textile retail industry is characterized by a wide range of firms competing across very different market segments through different distribution channels. These range from small boutique stores to large discount stores like Wal-Mart and Kmart, and home furnishing retailers such as Pottery Barn, Pier 1 Imports, and Restoration Hardware.

Competitors can be roughly broken down according to the following channels:

- **Home accent specialist:** Where home accents and gifts are the total business or largest product category. Includes Kirklands and local home accent and gift stores.

- **Traditional furniture store:** Where furniture and accessories is the total business or the largest category. May also carry appliances and/or electronics. Examples include Rooms To Go, Haverty's, Ethan Allen, and local, independent furniture stores.
- **New-mix furniture store:** Stores and chains that generally carry soft goods, in addition to furniture and accessories and may also carry housewares. Examples include Pier 1 Imports, Pottery Barn, IKEA, Crate & Barrel and Restoration Hardware.
- **Department store:** Full-line operations carrying a variety of merchandise, including national and regional stores. Examples include JC Penney, Macy's, Bloomingdale's, Dillard's, Robinsons-May, Hecht's and Sears.
- **Direct-to-consumer:** Retailers who sell primarily through catalogs, television, the Internet and/or home parties. Examples include QVC, Lillian Vernon, PartyLite, Home Interior & Gifts, Red Envelope and Longaberger Baskets.
- **Textile specialist:** Home textiles is the total business or single largest category. Includes local and regional specialty stores, as well as Bed Bath & Beyond, Linens 'N Things and HomeGoods.
- **Home improvement center:** Examples include Home Depot, Lowe's, EXPO Design Center and Sears' The Great Indoors.
- **Warehouse membership club:** Examples include Sam's Club, Costco and BJ's Wholesale.
- **Off-price retailer:** Examples include Stein Mart, T.J. Maxx, Tuesday Morning and Big Lots. Also includes dollar stores such as Dollar General and Family Dollar.
- **Discount department store:** General merchandise retailers, including national, regional and local stores. Examples include Wal-Mart, Target, Kmart, ShopKo, Meijer and Fred Meyer.
- **Other:** Includes interior designers, designer showrooms, antique shops, variety stores, military exchanges, fabric/craft stores, used/pre-owned, custom-made, supermarkets and drug stores, among others.⁴⁸

Low competitor concentration has the effect of increasing rivalry but due to rapid market growth, a highly segmented market and highly differentiated products, its overall impact on rivalry is somewhat reduced. However, competition among retailers within each distribution channel varies considerably. In the department store channel, for example, competition is high due to their cost-based strategies and less differentiated product offerings. For this reason, department stores have also been particularly hard hit by the growth of the large discount superstores. In comparison, competition is lower in the home accent and textile specialist

⁴⁸ Dana French, "Pretty Pillows Plump Sales," *Home Accents Today*, October 2004, <http://www.highbeam.com/> (accessed May 12, 2006).

channels as firms within these channels are typically focused on specific market segments with more differentiated product offerings.

Table 2 lists the percentage of sales from the top 50 home textile retailers by distribution channel for 2002. This table clearly shows the strength of the discount store channel in the home textiles market.

Table 2: 2002 –Percentage of top 50 sales by distribution channel⁴⁹

Discount Stores/ Supercenters	43%
Specialty Stores	22%
Department Stores	20%
Direct to Consumer	9%
Other	5%
Warehouse Clubs	1%

4.1.1.2 Market Growth

Rivalry among home textile retailers is reduced by strong market growth. Home textiles has been one of the fastest growing categories in the home décor market and in 2003 it constituted a \$19.4 billion dollar industry.⁵⁰ The home textiles market includes sheets, bed pillows, towels, draperies, carpets and rugs, blankets, throw pillows and cushions and upholstery. Home textiles are a considerably higher margin business than furniture and with many baby boomers beginning to downsize, they are spending less on large household items and more on decorative household items such as textile products. “American spending on household textiles increased 54% from 1997 to 2002, according to a 2002 US Bureau of Labour Statistics report. During that same time period, spending on household textiles as gifts increased 57%, representing

⁴⁹Data Source: Carole Sloane, “ Specialty players gain more share: changing channels,” Home Textiles Today, July 21, 2003 www.highbeam.com (accessed on June 3, 2006)

⁵⁰ Cheryl Lu-Lien Tan, “IKEA to Add Seasonal Collections,” *Wall Street Journal*. New York, N.Y.: Feb 3, 2005. p. D.4

the largest increase in any of the surveyed consumer categories, many of which saw decreases during that period.”⁵¹

Another important development in the home textiles market is the push by major retailers to encourage consumers to replace home furnishings seasonally. The 2002 Consumer Expenditure Survey reported that at that time, 15 percent of Americans were already buying bathroom and bedroom linens quarterly.⁵² The popularity of home textile products as gift items and the trend toward seasonal replacement of textile products significantly enhances home décor retailers’ ability to develop seasonal marketing strategies and to increase customer life time value.

4.1.1.3 Differentiated Products

Home textiles are highly differentiated on the basis of quality, construction, style and design and prices range accordingly. Such product differentiation decreases rivalry by enabling firms to differentiate themselves by product mix and by creating opportunities for higher firm concentration within specific niche markets. Overall, wide diversity in consumer tastes allows for the existence of many firms across the entire market.

4.1.1.4 Low Switching Costs

Switching costs in the home textile retail industry are low and are limited to consumer search costs that stem from individual price sensitivity and tastes. Rivalry among competitors is therefore intensified in their effort to retain customers. With the exception of a few retailers that are able to provide added value to consumers by tracking detailed customer information, there is very little that firms can do to lock-in customers. An example of the existence of switching costs in the home décor market can be found among painting stores such as General Paints and Benjamin Moore. These stores keep detailed records of customers’ home colour schemes and

⁵¹ Cheryl Lu-Lien Tan, IKEA to Add Seasonal Collections, *Wall Street Journal*. New York, N.Y.: Feb 3, 2005. p. D.4

⁵² Ibid.

paint numbers. Customers that switch paint suppliers lose the ability to easily match existing paint. There is less opportunity for this in the home textiles retail market. Retailers carrying exclusive and unique product lines can increase consumer switching costs as long as their customers' tastes remain consistent over time or as long as they can differentiate themselves on the basis of service and product selection.

4.1.2 Threat of Entry (High)

4.1.2.1 Low Capital Costs and Rapid Market Growth

Barriers to entry are very low for smaller home décor and home textile retailers. This explains the rapid proliferation of specialty and gift stores over recent years. Low capital investment requirements and rapid market growth are the two variables that increase threat of entry most significantly. However, risk of market saturation may be a deterrent for potential market entrants that fall within the textile specialty retailer strategic group. Uncertainty regarding long-term growth prospects increases concerns of market saturation and falling prices. Overall, current market growth forecasts are sufficiently high so as to increase threat of entry.

4.1.2.2 High Margins

Potential entrants into the home textile retail industry are attracted by strong retail product mark-ups. It is for this reason that many small gift stores and multi-category home décor retailers have been actively adding home textile products to their product mix. With home textile product mark-ups being as much as four to eight times manufacturer costs, home textile retailing offers the potential for very high profit margins.

4.1.2.3 Low Brand Equity

Brand is of limited importance to consumers of home textile products and although established manufacturers and retailers continue to try to build brand recognition for their home

textile products, they have been met with limited success. New market entrants therefore face one less obstacle in their efforts to capture market share. To the extent that new entrants can succeed at conveying quality and reliability through their stores and websites, product brand is a very weak barrier to entry.

4.1.2.4 Suitability for Online Sales

There is considerable threat of entry from existing retailers considering the addition of home textile products to their online channel. With regards to shipping costs, many home textile products have a high value to volumetric weight ratio, adding to their attractiveness for online sales. Although it can be difficult for online consumers to determine the actual quality, colour and texture of many home textile products, consumers that are looking for a specific product to match their existing décor are motivated to search online because of the high costs associated with conducting an offline search. Good security and return policies, high customer service levels, and presenting their business as an authority or an expert can all help online retailers increase sales.⁵³ Those businesses that can successfully overcome the barriers associated with selling ‘high touch and feel’ goods online, stand to reap much higher profits than online retailers of commodity type goods.⁵⁴ This increases the threat of entry by both small retailers and large established firms interested in expanding their product mix. Furthermore, the low cost of setting up an online business or selling through online markets such as eBay or Yahoo further reduces barriers to entry for the small direct-to-consumer retailers.

⁵³ John M. de Figueiredo, “Finding Sustainable Profitability in the E-Commerce Continuum,” April 2000, Sloan School of Management, <http://ebusiness.mit.edu/> (accessed on May 28, 2006)

⁵⁴ Ibid.

4.1.3 Bargaining Power of Customers (Moderate/High)

4.1.3.1 Discretionary or Non-essential Goods

For highly differentiated products, such as unique or one-of-a-kind pillows, consumer bargaining power decreases as the search costs for a product of similar design and quality increase. However, to the extent that many home textile products, such as decorative pillows, can be considered discretionary or non-essential goods, consumers will be price-sensitive and may be quick to postpone their decision to purchase. Consumers therefore have greater bargaining power when they perceive the item as being non-essential.

4.1.3.2 Low Brand Equity

Unlike the apparel industry where brand equity can command premium prices, home textiles are rarely valued on the basis of retail brand. The unimportance of retail brand to home textile consumers is another variable that may increase customer bargaining power. Consumers will readily buy through another channel that can more easily satisfy their tastes and budget.

Retailers may seek to differentiate their products through the promotion of country of origin with textile products from Italy, France, and Spain often commanding top dollar because of perceived quality differences. Furthermore, with the increasing number of fashion designers moving out of apparel design and into home textiles design, the emergence of designer brand home textiles may weaken customer bargaining power for higher-end products. Overall, however, low brand equity in the home textiles market increases customer bargaining power.

4.1.3.3 Demanding Buyers

The largest consumer group for home textiles (women between the ages of 35 and 55), and the primary target market for Creative Cushions, is a very demanding group. The baby boom generation in North America is becoming increasingly demanding of high customer service and of high perceived value for money. If a retailer serves a highly fragmented market characterized

by a large numbers of buyers, consumer buying power is generally weak. However, for small niche retailers serving a very specific market segment, buyer power is much higher. Achieving a deep understanding of their target market and customer base is central to small niche retailers' ability to meet customer demands, ensure customer satisfaction and to build customer loyalty.

4.1.3.4 Low Buyer Concentration

Fragmented and large numbers of buyers weaken consumer buying power in the home textiles retail industry. Consumers of decorative pillows are a diverse group and there are no significant demographic characteristics that would serve to increase the overall buying power that consumers have as a group or individually. This is a significant factor in reducing the overall bargaining power of customers.

4.1.4 Threat of Substitutes (Low/Moderate)

4.1.4.1 Substitution with Non-Textile Products

There are few substitutes for home textile products. However, in some cases particular products face threat of substitution from non-textile products. Area rugs for example, may be replaced with wood flooring, cork or other synthetic products such as rubber mats. Similarly, fabric window coverings may be substituted by wooden or plastic or metal blinds. Vinyl products are also popular substitutes for table cloths and place mats.

Although there are no easily identifiable non-textile substitutes for decorative pillows, as discretionary items consumers may choose not to purchase them at all or they may decide to buy a different home accent product instead. It is important to note that if the functional value of decorative pillows increases (for example, through the benefit of back support), they become less of a discretionary purchase and risk of substitution decreases. Overall the threat of substitution by non-textile products can be considered moderate.

4.1.4.2 Substitution with Home-Made Products

Another threat of substitution is in the form of ‘do-it-yourself’ home-made products. This threat is greatest for the low-end products of simple design. However, with a wide range of increasingly sophisticated product designs available in the \$20 to \$60 price range, this threat has little impact on overall retail revenue. Substitution with home-made products poses low threat.

4.1.4.3 Buy Direct from Manufacturer

There is a low to moderate threat to North American home textile retailers from consumer access to local North American manufacturers that are willing to sell direct to consumer. These are primarily furniture upholsterers and cottage industry manufacturers. Indian, Chinese and other Asian home textile manufacturers dominate the home textiles market. However, due to their economies of scale and high distribution costs to the North American market, they are unwilling to sell direct to consumer.

4.1.5 Bargaining Power of Suppliers (Low)

4.1.5.1 Low Supplier Concentration

There is a wide range of suppliers for home textile retailers. These include large manufacturers selling direct to retailers, smaller cottage industry manufacturers, and wholesalers. Low supplier concentration decreases supplier bargaining power considerably. High volume manufacturers span the globe but as previously noted the majority of the home textile products that are sold into the North American market are produced in India and increasingly China. Not only are suppliers in these regions numerous and eager to increase their exports to the United States, but rivalry among them is intense. Access to low-cost inputs, primarily labour and fabric, gives Indian and East Asian manufacturers a considerable cost advantage over North American producers. North American manufacturers are continually challenged to maintain market share and have been dependant on U.S. protectionist policy.

4.1.5.2 Low Switching Costs

With a large number of smaller manufacturers and wholesalers willing to fulfil relatively low quantity orders, switching costs are low for retailers that are not competing on a cost basis. Small home accent stores and gift stores, for example, are interested in differentiating their product mix by sourcing unique products. These small retailers buy in small quantities from numerous suppliers, placing orders at tradeshows and gift shows. Because of low switching costs, manufacturers are challenged to retain customers.

4.1.5.3 Threat of Forward Integration

Forward integration in the textiles industry is happening rapidly among Indian manufacturers of textile yarns and filaments in response to reduced margins resulting from quota abolition. Many filament and yarn manufacturers that sell to garment and home textile manufacturers are now producing these products themselves. However, while some may be integrating North American wholesale operations as well, forward integration as far as the retail channel is much less likely because marketing and retail distribution are well outside their core competencies.

Greater risk of forward integration exists among North American manufacturers as they can more easily compete in the direct-to-consumer product catalogue business. However, with the low significance of brand in the home textiles market, forward integration would most likely not be in their best interest as it would limit their ability to sell through the wider range of retail channels. Overall, the threat of forward vertical integration by manufacturer's and wholesalers is low.

4.1.5.4 Lifting of Chinese Textile Quotas

In January of 1995, the U.S. lifted quotas on Chinese textile exports. Many of these quotas have since been reinstated for apparel but not for home textiles. As a result, Chinese home

textile manufacturers are competing aggressively with Indian manufacturers and are actively seeking U.S. buyers (wholesale and retail). The heightened competition, not only between Chinese and Indian manufacturers but also between textile manufacturers worldwide that are hungry for their share of the market, greatly reduces supplier bargaining power.

4.1.6 Assessment of Industry Attractiveness

The home textile retail industry presents some daunting challenges, yet the threat of entry remains high. With rapid market growth and high product margins, the industry offers the potential to extract high profits. However, retailers must be able to satisfy a very demanding market and must excel at creating competitive advantage within a well defined market niche. Rivalry is intense between players that are pursuing a cost-based strategy. However, within niche markets, rivalry may be very low for retailers that are able to offer highly differentiated products and services and for those able to build exceptional value into the buying process and post purchase experience. Overall, the industry is attractive to those with the ability to meet the needs of consumers within their market niche. Fortunately, in home textiles retail business, low capital requirements also mean that new entrants can easily exit the market leaving those with the necessary competencies to focus on ways to further differentiate their business and deepen their competitive advantage.

4.1.7 Key Success Factors

Table 3 outlines some of the key success factors for firms operating in the home textiles niche retail strategic group. These are all important considerations for Creative Cushions. As a start-up, Creative Cushions must focus on those that will help grow and sustain the business in the short term, while remaining cognizant of the competencies that it must build upon to ensure its competitiveness in the long run.

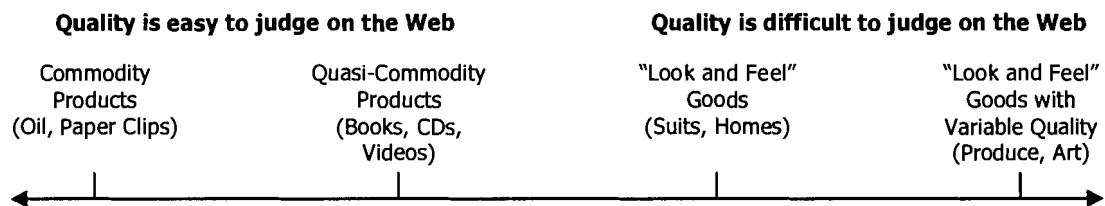
Table 3: Key Success Factors for the Home Textiles Niche Retail Strategic Group

Key Success Factors (KSF)	Competitive Necessity (CN) / Competitive Advantage (CA)	Present KSF (P) / Future KSF (F)	Drivers: Most Relevant Industry Trend(s) /Forces
Ability to target market niche with a wide selection of highly differentiated products and related services and to satisfy demand for wide range of styles.	CN	P	Localization of large discount and specialty stores, high threat of new entrants
Deep customer knowledge – increase customer loyalty and switching costs by knowing the customer and their preferences. Ability to build value beyond cost through the buying process and post-purchase experience.	CN	P	Localization of large specialty stores, demographic shift, high customer power, demand for service and value
Ability to identify and work with manufacturers that can add value through expertise in product design or strong in-house design capabilities.	CN	P	Demographic shift, very demanding consumers that value personal style and service
Effective 'pull' marketing strategies and expertise in direct marketing offline and online.	CN	P	Increasing sophistication of direct marketing techniques
Ability to overcome 'touch and feel' barriers to online sales.	CA Online Retail	P	Growth of multichannel retailing, growth of non-store Selling
Strategies to maximize repeat business and customer lifetime value.	CN	P	Rivalry among competitors, market growth (risk of growth rate not meeting expectations)
Ability to use technology to integrate channels and reduce costs.	CA	P/F	Growth of multichannel retailing, localization of large discount and specialty stores
Ability to increase bargaining power with suppliers to lower costs, increase supplier responsiveness and move toward lean inventory management practices.	CA	F	Consolidation, globalization, and localization of discount and large specialty stores
Build reputation, credibility and position as expert.	CN	P	Growth of multichannel retailing, high buyer power

4.1.7.1 Overcoming the Touch and Feel Barrier to Online Sales

Given Creative Cushions' initial emphasis on online retail, one key success factor warrants special attention - the ability to overcome the 'touch and feel' barriers to selling textile products online. In considering the suitability of decorative pillows for online retail, a valuable framework for analysis is provided by John M. de Figueiredo. Figueiredo constructed an online retail 'product continuum' through which he classifies various products based on the ease with which consumers can ascertain product quality in the online environment.⁵⁵ This continuum, as shown in Figure 9, groups products into four primary classifications: commodity products, quasi commodity products, look-and-feel goods, and look-and-feel goods with variable quality.

Figure 9: The Online Product Continuum⁵⁶



Commodity products are those such as oil, paper clips or nails and their quality can be easily determined by a simple product description. Consumers of commodity products are not concerned with the identity of the vendor providing they are confident in the security and reliability of their online transaction. They are, however, very price sensitive and will base their purchase decision largely on price and terms of delivery.

Quasi-commodity products are those such as CDs, books and toys. These products are differentiated to the extent that there are many different kinds of each. However, having selected one particular product, the consumer can find the same product of identical quality available from

⁵⁵ John M. de Figueiredo, "Finding Sustainable Profitability in the E-Commerce Continuum," April 2000, Sloan School of Management, <http://ebusiness.mit.edu/> (accessed on May 28, 2006)

⁵⁶ Ibid.

other vendors. At this stage the consumer is again primarily concerned with price and will seek the vendor that can provide the best price while still satisfying his/her need for security and reliability.

Look and feel goods, such as suits, homes, and used cars, are those for which quality cannot be easily determined from a distance. Detailed product information is important to consumers of look and feel goods, as is credibility and the reputation of the vendor. To the extent that a company brand or product brand signifies quality, product consistency and reliability, brand also becomes much more important. Given a sufficient comfort level that the product that they are buying is of good quality, a consumer will be very hesitant to buy a competing product of lesser known quality. Figueiredo comments that, "...once a consumer has selected a product, there are likely few substitutes. The characteristics of other competing products will likely differ on many dimensions, including quality, look, feel, and reliability."⁵⁷

The final classification of goods described by Figueiredo is the class of goods that have the distinguishing feature that "each and every individual product is different from every other."⁵⁸ These he calls "Look and feel goods with variable quality", goods whose true attributes and quality can only be determined through physical inspection. Included in this classification are used cars, original artwork, and fresh produce.

Decorative pillows fall primarily into the category of look and feel goods in that they are highly differentiated and may require lengthy descriptions to convey their attributes and quality. Figueiredo suggests that the most successful online retailers of look and feel goods are likely to be those that combine online and offline distribution channels and that can signal quality online through brand strength. Figueiredo sites incumbent brand strength as being one of the most

⁵⁷ John M. de Figueiredo, "Finding Sustainable Profitability in the E-Commerce Continuum," April 2000, Sloan School of Management, <http://ebusiness.mit.edu/> (accessed on May 28, 2006)

⁵⁸ Ibid.

significant barriers to entry for online retailers of look and feel goods. However, as previously noted, brand has been found to be of low importance to consumers of decorative pillows. Figueiredo also notes that the 'Look and feel' market becomes an attractive one for online retailers who can overcome entry barriers as a high degree of product differentiation reduces price competition.

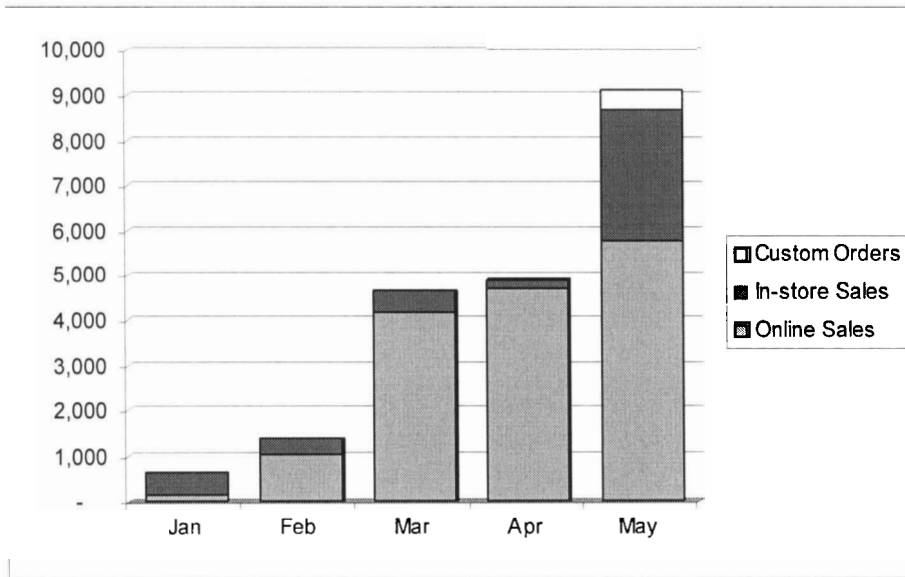
5 INTERNAL ANALYSIS

The online retail and local in-store retail markets present unique challenges and involve different sets of activities. One of the most significant questions facing Creative Cushions is how to allocate scarce resources efficiently between the two channels. Creative Cushions has invested most heavily in establishing its online business but has begun to pursue other opportunities in an effort to determine real costs, market response and profitability. Costs and pricing strategies differ for each channel, but Creative Cushions has attempted to establish an infrastructure that will give the company the flexibility to develop both channels as it pursues the most profitable markets opportunities.

5.1 Total Revenues by Month since Inception

Most of the company's revenues are being generated through its U.S. online sales. However, with sales having only started in January 2006, this is expected to change quickly. In May 2006, Creative Cushions started local advertising which is expected to increase local sales considerably. Figure 10 shows revenue contribution from in-store sales, online sales and custom orders for the first five months of 2006.

Figure 10: Monthly Revenue (Jan. -May, 2006)



Key Dates:

- September 15, 2005 – Creative Cushions was incorporated
- October 10, 2005 – E-commerce platform decision finalized
- October 15, 2005 – Showroom/office space leased with 3 month grace period
- December 16, 2005 – Website submitted to search engines for indexing
- January 20, 2006 – Website payment gateway enabled
- February 25, 2006 – Google Adwords online ad campaigns commenced
- May 20, 2006 – First test of local print advertising

5.2 Summary of Revenue by Channel (January – May 2006)

The two company founders focused on the online channel for several reasons. First, the company had the expertise to quickly and inexpensively launch a professional website that could provide an immediate source of revenue. Second, the company recognized that it may take a year or more for the website to gain a strong position in major search engine rankings and that the process needed to begin as soon as possible. Third, the company founders believe that a good website is a necessity to support any brick-and-mortar retail business. Fourth, a professional website lends immediate credibility to the business which is important in negotiating the best possible prices with initial suppliers.

5.2.1 Online Revenue

Website creation began in early November 2005 and was launched in January 2005. The site was immediately submitted to the search engines and based on a sudden increase in the number of ‘organic hits’ occurring through Internet searches the website was indexed by the major search engines around March 12, 2006. Table 4 shows online sales by month from January to May, 2006, which totalled \$15,810 for the five month period.

Table 4: U.S. Online Sales (Jan-May 2006) CDNS

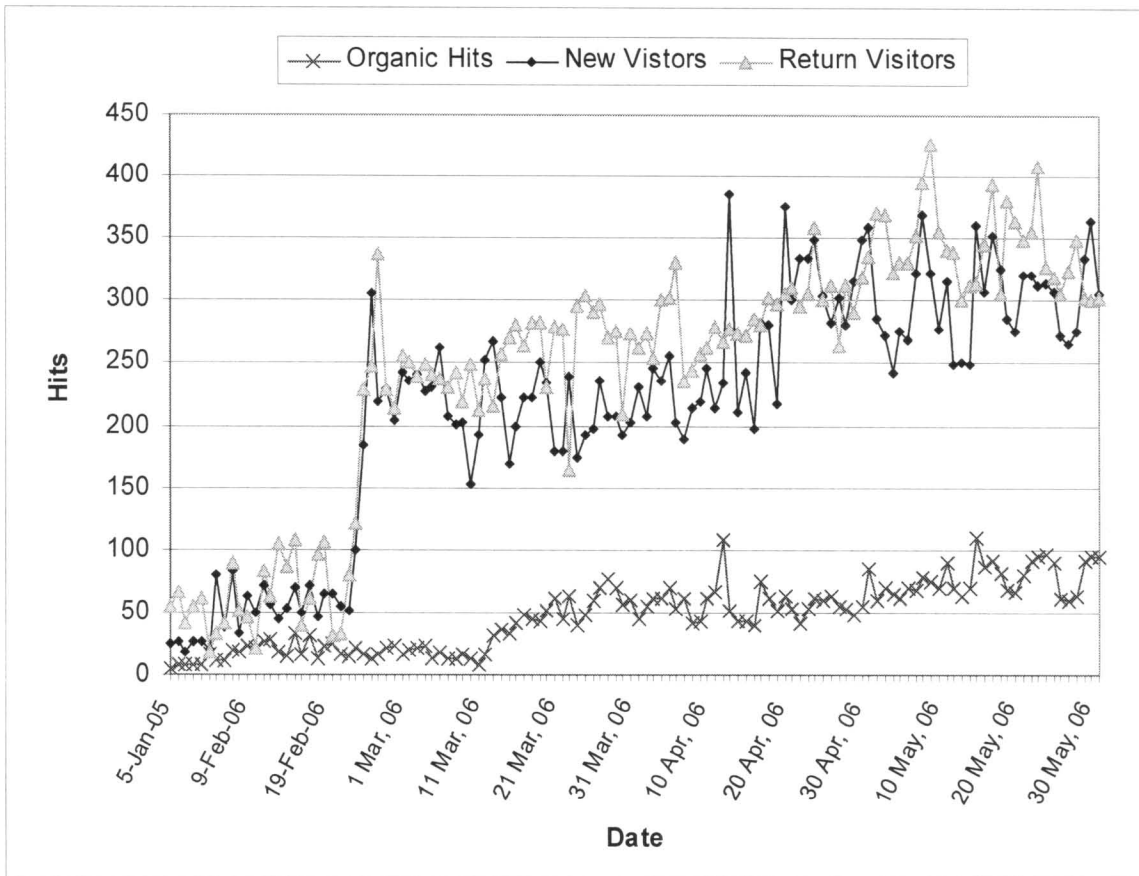
Month	Order Count	Online Sales	Avg. Order Value	Pieces Sold	COGS	Returns	Ship Charge	Ship Cost	Gross Profit	Gross Margin % (profit as % of sales)
Jan	1	129	129	4	(38)	-	17		108	84%
Feb	7	1,041	149	26	(283)	-	121	(88)	791	76%
Mar	27	4,170	154	100	(1,026)	(75)	391	(399)	3,061	73%
Apr	37	4,707	127	174	(1,477)	(154)	268	(493)	2,850	61%
May	47	5,764	123	198	(1,488)	(281)	419	(537)	3,876	67%

A total of 119 online orders were placed between January and May and all came from U.S. customers. The average order value was \$123. A 400 percent increase in sales from February to March reflects the commencement of the company’s Google pay-per-click advertising campaign. Month over month increases of 11 percent and 12 percent for April and May respectively were the result of continued optimization of the pay-per-click campaigns and growth of organic website traffic.

Between January 1 and May 31, Creative Cushions’ website received a total of 26,955 new visitors and 31,336 return visitors. A new visitor represents a visit by a computer that has not yet been to the website within the time period, whereas a return visit is counted when a computer that has already been to the site before returns for another visit. The increase in website traffic is shown in Figure 9. The March spike in visitors that resulted from the commencement of the pay-

per-click campaigns is clearly visible, as is the March 12 increase in organic hits resulting from search engine indexing.

Figure 11: Organic, New and Return Website Visitors (Jan-May)



With 119 sales generated from 26,955 new visitors, Creative Cushions’ conversion rate can be estimated at 0.44 percent. Creative Cushions must continue to work toward increasing this conversion rate. This can be accomplished by enhancing site content, improving pay per click ad content, directing prospective customers to relevant pages within the website, and by improving site elements that build trust and credibility.

Table 5 shows the breakdown of orders by state. Phone order sales totalling \$482 are not reflected in the total revenue. Not surprisingly the states from which the most orders were placed are also the most populated. Although there is not yet sufficient data to be statistically significant,

Florida has emerged as the leading source of revenue, followed closely by California and New York. Florida had the second largest number of orders and an average order value of \$188. Tracking this data provides Creative Cushions with valuable information for the future planning of targeted geographical online campaigns or for direct mail campaigns.

A small percentage of online sales were processed as phone order sales but Creative Cushions does not separate the two as these phone order sales are all being generated through the online channel. Creative Cushions provides toll-free phone service to ensure that customers with concerns regarding the security of online credit card transactions do not abandon their shopping cart at checkout. 'Credit Card by Phone' is included as a payment option at checkout for this reason. A separate class for phone order sales will be created if Creative Cushions experiments with print catalogue direct mail.

Table 5: Online Sales by State (Jan – May, 2006)

State	# Orders	Revenue	Avg. Order Value
FLORIDA	13	\$2,449.50	\$188.42
CALIFORNIA	14	\$1,718.39	\$122.74
NEW YORK	11	\$1,557.00	\$141.55
MASSACHUSETTS	9	\$1,185.04	\$131.67
NEW JERSEY	8	\$990.85	\$123.86
PENNSYLVANIA	5	\$503.29	\$100.66
NEW MEXICO	3	\$496.59	\$165.53
TEXAS	3	\$474.38	\$158.13
INDIANA	4	\$462.43	\$115.61
COLORADO	2	\$441.93	\$220.96
CONNECTICUT	5	\$421.79	\$84.36
WASHINGTON	4	\$384.65	\$96.16
Kentucky	2	\$359.73	\$179.87
MARYLAND	3	\$348.84	\$116.28
VIRGINIA	3	\$336.65	\$112.22
DELAWARE	4	\$330.66	\$82.66
WYOMING	1	\$329.95	\$329.95
MAINE	1	\$305.42	\$305.42
ILLINOIS	3	\$304.27	\$101.42
HAWAII	2	\$262.74	\$131.37
WISCONSIN	3	\$244.12	\$81.37
NORTH CAROLINA	2	\$178.90	\$89.45
MICHIGAN	2	\$165.58	\$82.79
VERMONT	1	\$155.57	\$155.57
OREGON	2	\$138.75	\$69.37
ARIZONA	1	\$136.36	\$136.36
OKLAHOMA	1	\$114.17	\$114.17
RHODE ISLAND	1	\$111.65	\$111.65
DC	1	\$108.53	\$108.53
SOUTH CAROLINA	1	\$93.96	\$93.96
MONTANA	1	\$78.28	\$78.28
KANSAS	1	\$51.48	\$51.48
OHIO	1	\$44.73	\$44.73
MINNESOTA	1	\$42.44	\$42.44
TOTAL	119	\$15,328.60	\$128.81

5.2.1.1 Shipping Costs

High shipping charges relative to the total value of online orders have been found to be directly correlated with shopping cart abandonment rates.⁵⁹ According to a study by User Interface Engineering, a research and consulting firm specializing in web site usability, "...high

⁵⁹ Bruce D. Temkin, "Flash Shopping Cart Boosts Conversion Rates," February 2005, Forrester Research Inc. http://www.fotoplayer.com/flash_shoppingcart_boosts_conversion_rates.pdf (accessed on June 10, 2006)

shipping costs proved to be the single greatest predictor of abandoned orders, displacing the previous top problem, which was asking for payment before specifying the payment amount.”⁶⁰

In contrast, free shipping promotions have been found to be one of the most effective promotions for increasing conversion rates. In an article by Robin Steif, CEO of LunaMetrics, she writes, “...free shipping without conditions continues to be the most popular promotional offer for influencing conversion, followed by free shipping with conditions (e.g. minimum order size, free shipping on certain items, etc.).”⁶¹

Creative Cushions has recently begun to offer free shipping for all orders over \$100 within continental North America. For orders under \$100 the company charges a flat rate of US \$9.99. Prior to setting the free shipping threshold, Creative Cushions reviewed average shipping charges and average purchase values. These were found to be \$14 and \$89 respectively. The free shipping threshold was then set at \$100 in the hope that it would induce customers to increase the value of their order to obtain free shipping. It was also hoped that this would increase the conversion rate for those whose order values already exceeded the threshold. Since the free shipping offer was introduced, average order value has increased to \$123 while the shopping cart abandonment rate decreased by 3 percent over the following two months. Although it is likely that the free shipping offer had much to do with this, many other factors may have contributed. For example, the website was still undergoing enhancements in the form of new content and products. This may have resulted in an increase in consumer trust which has also been closely linked to increases in order size and conversion rates.⁶²

⁶⁰ Ibid. p.3

⁶¹ Robbin Steif, (January 2006). “Online Holiday Recap,” LunaMetrics Web Log: <http://lunametrics.blogspot.com/2006/01/online-holiday-recap.html> (accessed on June 12, 2006)

⁶² Iakov Y. Bart, et al, “Are the drivers and Role of Online Trust the Same for all Web Sites and Consumers? A Large Scale Exploratory Empirical Study” April 2005, Paper 217, Sloan School of Management, <http://ebusiness.mit.edu/> (accessed on June 10)

5.2.2 In-Store Revenue

Between January and April 2006, Creative Cushions had very little revenue from in-store sales. However, on May 20, the company tested its first local print advertisement through the purchase of a one-third page ad in the Georgia Straight Living Magazine. There was an immediate response to this ad and within 10 days the company generated over \$2000 in revenue to bring the total sales for May up to \$2,900. Table 6 shows in-store sales by month from January to May 2006.

As the first specialty decorative pillow store in Vancouver, Creative Cushions has received a very favourable response from its local customers. Approximately 50 percent of the store traffic that resulted from the Georgia Straight Living Magazine advertisement consisted of interior decorators and designers. Of these, roughly one-third purchased pillows.

Table 6: In-Store Sales (Jan - May, 2006)

Month	# Sales	In-store Sales	Average Order Value	Units Sold	Returns	COGS	Gross Profit	Gross Margin
Jan	4	495.33	\$123.83	14	-	187.87	307.46	62%
Feb	2	331.74	\$165.87	10	-	92.64	239.10	72%
Mar	4	480.11	\$120.03	8	-	196.37	283.74	59%
Apr	1	181.21	\$180.21	3	-	54.44	126.77	70%
May	21	\$2,900.18	\$138.11	68	242.64	1082.36	1575.18	54%

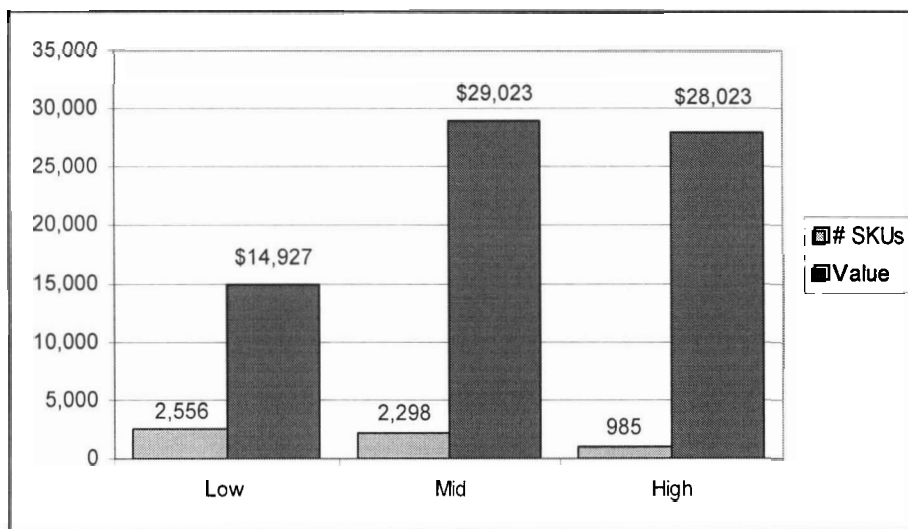
5.2.3 Custom Orders

In addition to the online and in-store revenues, Creative Cushions had one custom order worth \$449. This was a small order of custom pillows which were produced for a customer in California.

5.3 Inventory and Cost of Goods Sold (COGS)

Creative Cushions is currently carrying an inventory of approximately 350 unique products which was valued on May 31 at \$72,180. Creative Cushions breaks down its inventory into low, mid and high-end products which is largely determined by manufacturer price. Products in each category comprise 44 percent, 39 percent and 17 percent of total inventory respectively. Figure 12 shows the number of stock keeping units (SKUs) and inventory value by category.

Figure 12: Inventory Composition and Value



Creative Cushions has found that quality varies considerably from manufacturer to manufacturer. Country of origin seems to be the greatest determinant of value for money with manufacturers in India and Turkey offering the highest quality products at the best prices, followed by manufacturers in Thailand and China. However, high-end products have been difficult to source from these countries, primarily due to a lack of design expertise among these manufacturers. Creative Cushions has therefore purchased most of its high-end products from manufacturers in developed countries including France, Germany and the United States.

Creative Cushions is currently sourcing its pillow inserts from manufacturers in North America. Polyfill inserts are purchased from a supplier in Eastern Canada and feather inserts are purchased from a supplier in California.

Average manufacturer costs and average landed costs (including duties, shipping and handling charges) for pillow inserts and pillow covers in each category are shown in Table 7.

Table 7: Product Costs

Pillow Covers	Average Manufacturer Price	Average Landed Cost	#SKUs as % of Total Inventory	Value as % of Total
Low	\$4.00	\$5.84	44%	21%
Mid	\$8.65	\$12.63	39%	40%
High	\$19.49	\$28.45	17%	39%
Weighted Average	\$9.30	\$13.60		

Pillow Inserts	Average Manufacturer Price	Average Landed Cost
Polyfill	\$2.95	\$3.18
Feather	\$6.66	7.94

Duty rates are in the range of 14 percent while inbound shipping and handling costs for current order sizes add approximately 32 percent to total costs.⁶³ Creative Cushions has felt it necessary to include duty and shipping in the cost of goods sold for several reasons. First, duty and shipping costs currently account for 46 percent of total landed costs. It was felt that this amount is too significant to be expensed. Secondly, duty and shipping costs vary considerably based on country of origin, and product composition. It was therefore considered essential that duties and shipping costs be reflected in the cost of goods when making purchasing decisions.

⁶³ Creative Cushions is refunded duties for all products that are sourced from U.S. suppliers and sold back into the U.S. market.

Creative Cushions anticipates that it will be able to negotiate better pricing from its manufacturers and that shipping and handling costs per unit will decrease as order sizes increase. Based on manufacturer price quotes, Creative Cushions estimates that by doubling its current order sizes it will be able to reduce landed costs by as much as 30 percent or to \$9.52 per unit. In addition, Creative Cushions estimates that it will be able to decrease the cost of its pillow inserts by as much as 50 percent when it starts ordering large quantities directly from manufacturers in China.

Inventory decision making is one of the greatest challenges that Creative Cushions faces. Creative Cushions is currently buying from manufacturers that have relatively low minimum order quantities. This has enabled the company to establish a starting inventory that offers a wide selection but that is not very deep in any one product (average SKU depth is 20 pieces). However, as Creative Cushions' sales volume increases, the company must try to replenish faster moving items while finding ways to prevent its inventory from becoming bloated with slower moving items. Fortunately, other than the time value of the capital tied up in inventory, inventory carrying costs are low. Decorative pillow covers are easy to store and the risk of depreciation through damage is minimal. Furthermore, unlike apparel, decorative pillows are not susceptible to rapid depreciation due to seasonal fashion trends.

Creative Cushions will make use of two methods to eliminate slow moving inventory. The first will involve deep discounting through the local retail channel, and the second will involve the use of e-Bay as an online liquidation channel. To protect its online brand image as a provider of mid-to high-end quality products, Creative Cushions will not offer deep discounts on its website. Products listed on e-Bay will not appear on the company website nor will the Creative Cushions brand name be used for e-Bay sales.

In order to maintain an ever changing product selection, Creative Cushions will continue to buy new products in small quantities. Although this increases inventory processing costs as

every new item must be photographed and written up for sale online, it will enable Creative Cushions to continue to evolve and optimize its product mix. Re-order points and lead times for popular products will be carefully managed to help control inventory carrying costs.

5.4 Pricing Strategy

In cases where products can be easily compared to similar products available through other retailers, Creative Cushions uses market-based pricing. However, because decorative pillows are so highly differentiated it is often hard to make direct product comparisons. In these cases, Creative Cushions starts by pricing the products at least three times above the full cost of goods sold with the objective of maintaining a minimum gross margin of 67 percent. Creative Cushions' goal is to achieve over time a 75 percent gross margin on all but the high-end products by obtaining lower manufacturer rates and lower shipping costs through volume. Table 7 outlines the online and in-store pricing and the respective profit margins.

Table 8: Online and In-Store Pricing and Profit Margins

Pillow Covers	Avg. COGS	Avg. Online Retail Price	Online Profit Margin	Avg. In-store Retail Price	In-Store Profit Margin
Low	\$5.84	\$24.67	76%	\$19.74	70%
Mid	\$12.63	\$42.68	70%	\$34.14	63%
High	\$28.45	\$80.59	65%	\$64.47	56%

Pillow Inserts	Avg. COGS	Avg. Online Retail Price	Online Profit Margin	Avg. In-store Retail Price	In-Store Profit Margin
Polyfill	\$3.18	\$14.39	78%	\$7.66	58%
Feather	7.94	\$20.10	60%	\$19.92	60%

If necessary, prices are adjusted upwards or downwards to what the company believes will be competitive price points. For example, pillows sourced from U.S. wholesalers may be adjusted downward if the same products are readily available through other U.S. retailers.

However, at this stage, care is being taken not to undervalue the goods. Online, prices are currently being set approximately 20 percent higher than in-store prices. This is done to provide additional margin to offset order processing and shipping costs, and to allow for more substantial online discounts and promotions. Creative Cushions also offers interior designer and decorator discounts which vary by product line and ranges from 15 percent to 30 percent.

5.5 Overview of Income Statement (January-May, 2006)

The income statement shown in Table 8 is for Creative Cushions' first five months of operation. It has been modified to separate revenues and expenses by channel.

Table 9: Income Statement (Jan - May, 2006)

Income Statement						
	Jan-May, 2006					5 Month Total
Month	Jan	Feb	Mar	Apr	May	Total
REVENUE						
Custom Orders					449	449
Cost of Goods Sold					(209)	(209)
Shipping Charge					46	46
Shipping Cost					(48)	(48)
Gross Margin					238	238
Gross Margin %					53%	53%
In-Store Retail	495	332	480	181	2,900	4,388
Returns					(243)	(243)
Cost of Good Sold	(188)	(93)	(196)	(54)	(1,082)	(1,614)
Gross Margin	307	239	284	127	1,575	2,532
Gross Margin %	62%	72%	59%	70%	54%	58%
Internet Sales	129	1,041	4,170	4,707	5,764	15,811
Returns			(75)	(154)	(281)	(510)
Cost of Good Sold	(38)	(283)	(1,026)	(1,477)	(1,488)	(4,312)
Shipping Charge	17	121	391	268	419	1,216
Shipping Cost		(88)	(399)	(493)	(537)	(1,517)
Gross Margin	109	791	3,061	2,850	3,877	10,687
Gross Margin %	84%	76%	73%	61%	67%	67.6%
Total Revenue	624	1,373	4,650	4,888	9,113	20,648
Total Gross Margin	416	1,030	3,344	2,977	5,690	13,457
Gross Margin %	67%	75%	72%	61%	62%	65.2%

Income Statement						
Jan-May, 2006						5 Month
Month	Jan	Feb	Mar	Apr	May	Total
EXPENSES						
<u>Operational & Administrative</u>						
Accounting fee				1,200		1,200
Alarm	28	28	28	28	28	140
Consultants			600		1,790	2,390
Insurance	132	132	132	132	132	660
Office Supplies	1,401					1,401
Telephone/ADSL	299	187	172	173	178	1,009
Rent		1,779	1,983	1,983	1,983	7,729
Bank Charges & Merchant Accounts	94	173	78	109	51	505
Management Salary	2,500	2,500	2,500	2,500	2,500	12,500
Payroll Expenses	632			811	919	2,362
Trade shows			601	1,513		2,114
Misc. Expenses						-
Total Ops and Admin	5,086	4,799	6,094	8,449	7,581	32,009
<u>Online Expenses</u>						
Credit Card Discount (2.5%)	3.23	26.04	104.25	117.67	144.09	395.27
Marketing						
- Google		119	776	1,592	1,640	4,128.30
- Overture		35	702			736.67
Packing Supplies			393			392.97
Website Design			200		280	480.00
Web site hosting	95	91	92	166	211	654.69
Pack/Ship Labour						-
Total Online Expenses	98	271	2,267	1,876	2,276	6,787.90
<u>In-Store Retail Expenses</u>						
Marketing						
- Print Advertising					1,576	1,576.09
- Print Collateral						-
In-Store Merchandising	854					853.94
Display						-
Retail Labour						-
Credit Card Discount (2.5%)	12.4	8.3	12.0	4.5	72.5	
Total In-Store Retail Expenses	866	8	12	5	1,649	2,539.74
Total Expenses	6,050	5,078	8,373	10,329	11,506	41,337
EBIT	(5,634)	(4,048)	(5,029)	(7,352)	(5,816)	(27,879)

5.5.1 Revenue, Cost of Goods Sold, Gross Margin

Creative Cushions saw a rapid increase in sales over its first five months of operation which totalled \$20,648. This is attributable primarily to Google pay-per-click promotions which began in mid-February and resulted in steady growth of online sales. Online sales accounted for 77 percent of total revenue. In-store sales accounted for 21 percent of total revenue, the bulk of which came in May as a result of Creative Cushions' first print advertisement. One custom pillow order generated the remaining 2 percent.

Cost of goods sold for the same period totalled \$6,135 and the gross margin percentage was 65.2 percent. Creative Cushions expects gross margin to remain at or around 65.2 percent for the remainder of the year.

5.5.2 Marketing Expense

Marketing expenses totalled \$6,441 (38 percent of sales) for the first five months. Creative Cushions anticipates that marketing costs as a percentage of sales will decrease considerably. Online marketing costs alone were at 24 percent of sales. This was due to extensive testing of Google pay-per-click campaigns and to a lesser extent, of Yahoo Overture pay-per-click campaigns. Print advertising costs of \$1,576 were incurred in May for the purchase of ad space in the Georgia Straight Living Magazine. Creative Cushions has not produced any print collateral in the form of brochures or print catalogues and does not anticipate doing so in 2006.

A simple calculation of return on marketing investment measured as channel gross margin over channel marketing expense yields an ROI of 208 percent for the online channel (based only on the months of March, April and May when pay-per-click campaigns were running). The initial 10 day response to Creative Cushions' first local marketing trial yields a 100 percent ROI. Assuming a continued return on this investment, and since other variable costs

related to in-store retail are minimal, this indicates that at the very least local print advertising is contributing to fixed costs. A minimum of a 200 percent ROI for print advertising is expected. Frequency effects of ongoing local advertising can also be expected to continue to push ROI upwards.

5.5.3 Accounting

Creative Cushions' 2005 year-end accounting costs were \$1,200. With a certified general accountant already on pay-roll as a part-time employee, Creative Cushions does not anticipate additional accounting costs until year-end tax accounting in 2007.

5.5.4 Facility Lease Costs, Security, and Insurance

Creative Cushions' lease costs total 1,983 per month and include utilities. Creative Cushions was given a three month grace period from the start of the lease, which ended in early February. The company has a three year lease expiring in early November, 2008. Security services (alarm monitoring) are an additional \$28 per month. Insurance costs have been amortized over the year and are shown at \$132 per month. Creative Cushions does not anticipate the purchase of additional computer equipment, significant increase in inventory value, or the addition of any other high value items that might cause insurance costs to increase over the short-term.

5.5.5 Management Salary

Management salary expense is currently being kept to a minimum. A total of \$2,500 is being paid out monthly to one of the founders in compensation for a greater time commitment to the business. The other founder, who is currently only involved on a part-time basis, is in the process of trying to sell another company. He is expected to be involved on a full-time basis by

year-end. At this point management salary expense will either be reduced to zero or, if cash flow permits, the founders will begin to draw equal salaries from the company.

5.5.6 Payroll

Payroll expenses for the first five months of 2006 totalled \$2,362. This was compensation for one part-time employee whose hours will increase with sales until such time as she can be offered a full-time position with the firm. The employee is a junior certified general accountant whose responsibilities include book-keeping and order processing. Because this arrangement presents some risk of losing this employee, she has also been employed on a part-time basis in one of the founders' other businesses.

5.5.7 Consulting

Consulting expenses totalled \$2,390 for the five month period. This was compensation for an interior decorator who has expressed interest in a long-term position with the firm. She is currently on a consulting contract as she is still providing interior design services to a handful of Vancouver clients. This arrangement has turned out to be very mutually beneficial.

5.5.8 Telephone, Internet Service, Toll-Free Service

Creative Cushions is currently able to operate easily with one voice line and one data line provided by Telus. High speed ADSL Internet service and fax service are both supported by the data line. Monthly fees for the two lines and Internet service total \$135 per month. Creative Cushions does not expect this to change until the end of year two at which time an additional phone line will most likely be required.

Creative Cushions also promotes a toll-free number on its web site. Toll-free service is provided by AllStream Inc. and is charged purely on a usage basis. In-bound toll-free calls from anywhere in North America cost \$0.06 per minute. Creative Cushions' toll-free number is

overlaid on top of the company's voice line. This will increase the need for an additional phone line as customer service demands increase with sales.

Creative Cushions uses Less2Talk to make all outbound long distance calls. The majority of these calls are to customers within North America and are charged at \$0.05 per minute. Long distance rates to international countries vary, with Turkey being the most expensive at \$0.39 per minute. However, communication with suppliers is handled primarily by email and fax so long distance charges are minimal. Nonetheless, Creative Cushions can expect toll-free and long distance phone charges to increase gradually with sales.

5.5.9 Office Supplies

Office consumables are very limited and are expensed separately from shipping supplies. Creative Cushions makes extensive use of an electronic file system which is backed-up daily and stored off site thus minimizing paper costs. However, office supply costs can be expected to increase with sales and staff.

5.5.10 Bank Charges and Merchant Account Fees

Creative Cushions paid an average of \$100 per month for bank charges and merchant account fees from January to May. Creative Cushions' Canadian and U.S. dollar account maintenance fees total approximately \$30 per month. In addition, bank charges include bank transaction and cheque fees. These are minimal and can be expected to increase very slowly over time. The fixed costs portion of Creative Cushions' U.S. and Canadian online merchant account fees total \$65 and will remain fairly consistent over time.

5.5.11 Credit Card Discount Fees and PayPal Transaction Fees.

Overall, credit card transaction fees represent a considerable expense that will increase directly with sales. Creative Cushions accepts VISA, MasterCard and PayPal payments. Creative

Cushions has negotiated a credit card discount rate of 2.5 percent for online and in-store transactions through the Moneris eSelectPlus™ web-based payment gateway. Although the in-store rate is higher than could be negotiated for a pure brick-and-mortar retail business (1.75 percent is common), 2.5 percent is a good rate for a start-up wanting to accept online payments from customers in the U.S.

PayPal transaction fees are 3 percent of sales. As a recognized and trusted third party payment solution owned by eBay, PayPal is preferred by some customers. However, of the 119 transactions processed from January to May, only six were PayPal transactions.

5.5.12 Trade Shows

In February, Creative Cushions was invited to participate in an all expenses paid trip to Mumbai, India to attend a textiles trade show sponsored by the Indian government. A stop over in Frankfurt, Germany was arranged to attend the Heimtextiles Tradeshow. Total expenses for the Frankfurt stop and incidental expenses while in India totalled \$2,114.

Creative Cushions plans to attend at least two major industry tradeshow each year to source new products and to meet with existing suppliers. A budget of \$10,000 has been allocated for this purpose in year two.

5.5.13 Packing Supplies

Based on the first five months of operation, Creative Cushions estimates packing costs for online orders to be approximately \$1.50 per shipment. Packing materials include barrier bags used for vacuum packing inserts, corrugated boxes and packing tape. A total of \$262 was spent on packing supplies between January and May. Monthly packing expenses will increase with sales. However, bulk purchases of packing materials will help reduce the per shipment costs.

5.5.14 Website Design and Programming

Creative Cushions' web design and programming expenses totalled \$480. Creative Cushions contracts an independent web designer and ASP/HTML programmer on an hourly basis as needed. However, as one of the founders has previous web design experience, most minor changes are currently done in-house. Web design expenses are expected to increase in year two as Creative Cushions begins to implement more frequent online promotions and seasonal changes to the website.

5.5.15 Website Hosting

Creative Cushions' monthly website hosting costs are the only expenses that the company has incurred in the implementation and maintenance of its website with the exception of some initial design and branding which totalled approximately \$4,000. Monthly website hosting charges totalled \$655 for the first five months of 2006. Monthly fees are based on a tiered fixed cost subscription plan plus bandwidth overage charges (see Table 10). For the months of January, February and March, Creative Cushions was subscribing to Volusion's Silver Plan and incurred no overage charges. In April, the number of products exceeded 250 and the company upgraded to the gold plan at \$97 per month. In addition, increasing web traffic resulted in bandwidth overage charges of \$30 at a rate of \$10 per gigabyte. Bandwidth overage charges will continue to increase as site traffic increases. Creative Cushions estimates that its monthly charges will increase to approximately \$250 per month for the remainder of 2006.

Table 10: Volusion Pricing Schedule⁶⁴

Plan	Bronze	Silver	Gold	Platinum
Pricing (USD)	\$57	\$77	\$97	\$197
Monthly Bandwidth Included (GB)	1	3	5	15
Number of Products Supported	100	250	1000	Unlimited

⁶⁴ Volusion Inc., ecommerce hosting-ecommerce web hosting, www.volusion.com: <http://www.volusion.com/ecommerce-web-hosting.asp> (accessed on June 12, 2006)

5.5.16 In-Store Merchandising Costs

To date, Creative Cushions has spent only \$854 on in-store merchandising display. However, an additional \$1,900 has been budgeted in 2006 for the installation of shelving and other improvements to product display.

5.6 Revenue Projections (2006-2008)

Table 11 provides three year revenue and expense projections. Since the business is directly financed by the two founders who are also the only managers within the forecast period, management salary expenses have been removed to reflect total income before management expenses or dividends. Inventory adjustments have also been excluded from the income statement. Inventory replacement value was \$71,974 on May 31, 2006 and is expected to fluctuate over the three year period as Creative Cushions works on supply management. However, elimination of slow moving product lines in favour of faster moving lines is expected to keep inventory costs down. Furthermore, increasing accuracy of re-order points and replenishment lead times are expected to lead to leaner inventory management practices over time. Income tax has been estimated at 18 percent.

Due to its start-up status, Creative Cushions anticipates a very steep increase in net income from 2006 to 2007. It is assumed that this increase will result from the awareness generated through initial marketing and promotion. However, as the company begins to move beyond the initial start-up phase, the annualized growth rate is expected to slow. In-store retail revenue will be limited by geographic market constraints leading to slowing growth rates. In addition, in 2008, Creative Cushions estimates a more gradual increase in online revenues following the initial rapid improvement in search engine rankings that are expected in 2007.

Table 11: Proforma Income Statement (2006-2008)

Revenue	2006	2007	2008
Online Retail	\$ 85,454	\$ 268,576	\$ 309,521
In-Store Retail	85,290	251,546	267,776
Custom Orders	2,947	13,000	44,000
Total Revenue	173,691	533,122	621,297
Cost of Sales	(56,136)	(165,855)	(192,172)
Gross Margin	117,555	367,266	429,124
	67.68%	68.89%	69.07%
Operational & Administrative			
Accounting fee	1,200	1,200	1,200
Alarm	335	335	335
Consultants	5,890	6,000	12,000
Insurance	1,584	1,584	1,584
Office Supplies	2,101	1,200	1,200
Telephone/ADSL	2,409	2,400	2,880
Rent	21,612	23,800	23,800
Bank Charges and Merchant Accounts	1,135	1,080	1,080
Admin Labour (Payroll)	6,562	12,000	12,000
Trade Show Buying Trips	2,114	10,000	10,000
Misc Expense	1,400	2,400	2,400
Total Ops and Admin	46,342	61,999	68,479
Online Expenses			
Credit Card Discount (2.5%)	2,279	7,181	8,276
Marketing	16,815	24,900	19,700
Packing Supplies	1,270	3,345	3,855
Website Design	1,680	5,500	5,500
Web site hosting	2,405	3,600	4,800
Pick/Pack/Ship Labour (payroll)	1,755	6,690	7,710
Total Online Expenses	26,204	51,216	49,841
In-Store Retail Expenses			
Marketing	17,276	23,700	23,700
In-Store Merchandising Display	2,754	4,000	4,000
Retail Labour (Payroll)	4,000	19,710	30,690
Credit Card Discount (2.5%)	2,180	6,417	6,831

<u>Revenue</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>
Total In-Store Retail Expenses	25,686	53,827	65,221
Total Expenses	98,232	167,043	183,541
EBIT	19,323	200,224	245,583
	11%	38%	40%
Interest Expense	-	-	-
Pre-tax Earnings	19,323	200,224	245,583
Income Tax	3,478	36,040	44,205
Net Income	\$ 15,845	\$ 164,184	\$ 201,378
Net Profit %	9.1%	30.8%	32.4%
Opening Retained Earnings	-	15,845	180,029
Closing Retained Earnings	\$ 13,776	\$ 180,029	\$ 381,407

5.6.1 Revenue Projections (2006-2008)

Table 12 shows total transaction and revenue projections for 2006 to 2008. Estimates have been made for increases in sales transactions based on a number of assumptions.

Table 12: Revenue Projections (2006 - 2008)

	Year 1		Year 2		Year 3	
	# Sales	Revenue	# Sales	Revenue	# Sales	Revenue
Online	704	\$85,454	2230	\$268,576	2570	\$309,521
In-Store	632	\$85,290	1860	\$251,546	1980	\$267,776
Custom	4	\$2,947	13	\$13,000	44	\$44,000
TOTAL	1340	\$173,691	4103	\$533,122	4594	\$621,297

For online sales, the company has estimated that it will take at least until the end of 2006 before it starts to achieve strong organic search engine positions. Therefore, monthly transactions are expected to increase relatively slowly from the actual 47 that occurred in May, 2006, up to 70 for the month of September, 2006. For the months of October, November and December, 90, 140, and 120 orders have been forecast to bring the total number of transactions in 2006 up to 706. Creative Cushions has limited its forecast to 350 orders for the last three months of the year as it

anticipates increased competition in its pay-per-click keyword campaigns. Creative Cushions' pre-Christmas sales are also based on the assumption that the company has sourced some additional holiday theme pillows. Survey results from the 2002/2003 National Family Opinion poll support this assumption. Of the 31,000 survey respondents, 78 percent bought decorative pillows with a holiday theme.⁶⁵

In-store sales are also expected to increase gradually and are forecast to spike during the three month pre-Christmas period. Sixty-three percent of annual in-store sales are expected to occur during this period. In-store average transaction values have been held constant at \$138 per transaction, although average sale value may increase during the pre-Christmas selling period.

Creative Cushions does not anticipate more than four custom orders for 2006. The company is considering setting its minimum order value at \$500 for custom orders but an average order value of \$1000 has been assumed in the revenue projections.

In year two, Creative Cushions has forecast rapid growth for both online and in-store sales. Revenue is estimated to increase 215 percent and 195 percent respectively. The increase in online sales will result from improved search engine rankings and further optimization of online marketing campaigns. In-store sales will be generated through increased spending on local advertising and market awareness as well as direct marketing to Vancouver designers and decorators. The company also anticipates that it will begin fulfilling more custom orders but only at a rate of a little more than one order per month in 2006, increasing to an average of 3.7 orders a month in 2008. Table 13 shows the projected average number of sales per month for 2006, 2007 and 2008.

⁶⁵ Dana French, "Pretty Pillows Plump Sales," *Home Accents Today*, October 2004, <http://www.highbeam.com/> (accessed May 12, 2006)

Table 13: Average Monthly Number of Sales Orders (2006-2008)

	2006	2007	2008
Online Retail	58.7	185.8	214.2
In-store Retail	52.7	155.0	165.0
Custom Orders	0.3	1.1	3.7

Year three will see more tapered growth. In 2008 a 15 percent increase over year two is forecast for online sales and a 7 percent increase is forecast for in-store sales. However, Creative Cushions anticipates more significant growth in its custom orders as it begins to provide more personalized service to its existing client base and to interior designers and decorators in particular. Toward the end of year three, Creative Cushions will also begin to explore new revenue streams including wholesale. Although some wholesale activities are anticipated in the first three years, they have been excluded from these projections as they are outside of the scope of this paper. Creative Cushions anticipates that wholesale activities will be conducted under a separate brand name.

Gross profit margin is expected to increase from 67 percent in 2006 to 69 percent in 2008. This is based on the assumption that the company will be able reduce the cost of goods sold by eliminating products bought from U.S. suppliers that have lower than average margins, while achieving better pricing from international suppliers. It is expected that larger order quantities will also reduce per unit shipping costs.

5.6.2 Expense Projections (2006-2008)

5.6.2.1 Consulting and Payroll Expenses

The most significant increase in expenses over the three year period is in consulting fees and payroll. No full-time employees are anticipated for 2006. Consulting fees will be paid to the company's designer, and by September 2006 two part-time employees will be on payroll. Their

time will be divided between administrative tasks, online order processing and retail sales. Order-processing labour costs have been calculated at \$12 per hour. Average order processing time, (includes transaction processing, pick, pack and ship activities) has been estimated at 15 minutes an order or four an hour. In addition, retail labour costs have been estimated at approximately \$14 per hour.

For 2007 and 2008 the company has estimated \$1000 a month for part-time administrative support. Part-time retail and online order processing and fulfilment support has been estimated at \$2,200 a month for 2007 and \$3,200 a month for 2008. At \$3,200 a month, the company has the option of hiring a well qualified store manager on a full-time basis.

Design consulting services are forecast to increase significantly between 2007 and 2008. This increase is tied to the growing number of custom orders in these same years.

Table 14 shows consulting and payroll expenses broken down by activity. The greater increase in retail labour costs relative to the other labour categories reflects the store retail start-up requirements. Beyond 2008, retail labour costs are not expected to increase significantly.

Table 14: Consulting, Payroll and Labour Expenses (2006-2008)

Expense	2006	2007	2008
Consulting	\$5,890	\$6,000	\$12,000
Admin Labour	\$6,562	\$12,000	\$24,000
Pick/Pack/Ship Labour	\$1,755	\$6,690	\$7,710
Retail Labour	\$4,000	\$19,710	\$30,690
TOTAL	\$18,207.09	\$44,400	\$74,400

5.6.2.2 Overhead Expenses

In the proforma income statement shown in Figure 11, expenses that are clearly traceable to either online retail or in-store retail have been separated out under the appropriate expense headings. Under operational and administrative expenses the expense items are primarily

overhead costs with the exception of consulting services and tradeshow expenses. With the basic infrastructure in place, Creative Cushions does not anticipate significant increases in overhead between 2006 and 2008.

5.6.2.3 Online Retail Direct Expenses

Marketing costs account for the greatest increase in online retail expenses from 2006 to 2007. This reflects an increase in pay-per-click advertising expenses to an average monthly cost of \$2,000. Online marketing expenses have been forecast to decrease slightly in 2008 to an average monthly cost of \$1,641 to bring online marketing costs to approximately 6 percent of revenue. This decrease is based on the assumption that an increase in organic website traffic will result in higher sales volume.

Website design expenses have been estimated at \$5,500 a year for 2007 and 2008. This budget has been set to allow for regular changes to the site in support of seasonal promotions. Website hosting expenses are expected to increase with site traffic.

Credit card discount expense and packing supplies are directly tied to sales volume and number of orders respectively as indicated in Table 15.

Table 15: Online Retail Direct Expenses (2006-2008)

Online Expenses	2006	2007	2008
Credit Card Discount (2.5% of sales)	\$2,279	\$7,181	\$8,276
Marketing	\$16,815	\$24,900	\$19,700
Packing Supplies (\$1.50 per order)	\$1,270	\$3,345	\$3,855
Website Design	\$1,680	\$5,500	\$5,500
Web site hosting	\$2,405	\$3,600	\$4,800

5.6.2.4 In-Store Retail Direct Expenses

As with online retail, marketing expenses make up the bulk of direct in-store retail expenses. The company has estimated an average monthly expense of \$1,875. This puts advertising

expense at approximately 9 percent of sales and allows for consistent exposure in local print media. In-store merchandising display costs are estimated at \$4,000 a year to allow for seasonal changes to store layout and display. Credit-card discount expense is 2.5 percent of in-store sales. Because the majority of custom orders are expected to come through the in-store retail channel, no separate expenses have been recorded. All costs associated with the production of custom orders have already been accounted for in cost of goods sold.

Table 16: In-Store Retail Direct Expenses (2006-2008)

In-Store Retail Expenses	2006	2007	2008
Marketing	\$17,276	\$23,700	\$23,700
In-Store Merchandising Display	\$2,754	\$4,000	\$4,000
Credit Card Discount (2.5% of sales)	\$2,180	\$6,417	\$6,831

5.6.3 Industry Benchmarks for Inventory Turnover, COGS and Gross Profit

Due to Creative Cushions' specialty retail focus, identifying an appropriate industry benchmark is difficult. Table 17 lists industry averages for select retail categories. Although these are not ideal comparisons, they provide at least a reference point for Creative Cushions.

Table 17: Industry Benchmarks - Inventory Turnover, COGS, Gross Profit⁶⁶

		Inventory Turnover Ratio (CGS/Avg. Inventory)	Days Sales in Ending Inventory	Cost of Goods Sold (% Sales)	Gross Profit (% Sales)
Furniture & Home Furnishings (sole proprietorships)		5.0	74	57.0%	43.0%
General Merchandise Stores		6.5	58	71.0%	29.0%
Apparel & Accessories		3.2	113	59.0%	41.0%
Gift, Novelty & Souvenir Shops		2.4	164	56.2%	43.8%
Creative Cushions	2006 (Assume Avg. Inventory \$72,000)	0.8	468	32.3%	67.7%
	2007 (Assume Avg. Inventory \$80,000)	2.1	176	31.1%	68.9%
	2008 (Assume Avg. Inventory \$90,000)	2.1	170	30.9%	69.1%

Increasing inventory turnover will be one of Creative Cushions' greatest challenges. Inventory turnover rate is expected to be low in the first three years of operation. However, over time, Creative Cushions hopes to increase turnover to near industry averages. Creative Cushions' inventory turnover ratio is expected to improve over time as the company identifies its higher velocity products and as sales volume allows for more frequent reordering of stock. Creative Cushions will strive to achieve an inventory turnover ratio of three to four. The company's cost of goods sold and gross profit margin are considerably better than these other retail group averages. In a recent survey conducted by Home Accents Today of over 500 small and medium size home accent/gift retailers in the U.S, average gross margin was found to be 51 percent.⁶⁷

⁶⁶ BizStats.com, "Inventory Turnover Ratios & Days Sales in Ending Inventory, US National Averages," 2003, BizStats.com: www.bizstats.com/inventory.htm (accessed online on July 4, 2006)

⁶⁷Kay Anderson, "Stores Optimistic for 2006: Expect Accents Role to Grow," *Home Accents Today*, June 2007, vol.21 no.7, pp S1-S19

5.7 Channel Profitability

The first five months of 2006 has provided a useful starting point from which Creative Cushions has been able to extrapolate revenues and expenses by channel. Actual numbers from the past five months for average order values and cost of goods sold provide for a fairly high degree of confidence in estimating gross margin. Assumptions regarding continued decreases in cost of goods sold are also supported by Creative Cushions' recent reordering experience. Suppliers have already shown willingness to lower prices upon evidence of Creative Cushions' professionalism, commitment to the relationship, and its ability to move product. Estimates of sales growth for both channels have been based on assumptions regarding the effectiveness of online marketing and search engine optimization for online retail, and on the effectiveness of local marketing and increasing awareness for in-store retail.

Expenses have also been estimated with a fair degree of confidence. Assumptions regarding marketing costs and human resources should be subject to ongoing scrutiny as the company progresses; however, Creative Cushions believes that its forecasts are reasonable and useful in an initial assessment of future channel profitability.

5.7.1 Allocation of Costs

Table 18 shows an allocation of indirect and direct costs across the two channels and lists operational overhead costs separately. For simplicity, because custom orders are expected to be generated primarily through local retail advertising, and because there are no additional direct or indirect costs associated with them other than cost of goods sold, they have been combined with in-store sales.

Table 18: Allocation of Costs by Channel (2006-2008)

		2006			2007			2008		
		Online	In-Store & Custom Orders	Total	Online	In-Store & Custom Orders	Total	Online	In-Store & Custom Orders	Total
Revenue		85,454	88,237	173,691	268,576	264,546	533,122	309,521	311,776	621,297
COGS		(25,411)	(30,725)	(56,136)	(74,684)	(91,171)	(165,855)	(86,071)	(106,102)	(192,172)
Gross Profit		60,043	57,512	117,555	193,892	173,375	367,266	223,450	205,674	429,124
Gross Margin %		70.3%	65.2%	67.7%	72.2%	65.5%	68.9%	72.2%	66.0%	69.1%
Expense										
Payroll	Direct	1,755	4,000	5,755	6,690	19,710	26,400	7,710	30,690	38,400
Payroll	Indirect	3,228	3,334	6,562	6,045	5,955	12,000	5,978	6,022	12,000
Consulting	Indirect	5,002	888	5,890	2,707	3,293	6,000	4,791	7,209	12,000
Manager 1 Salary	Indirect	56,000	14,000	70,000	49,000	21,000	70,000	49,000	21,000	70,000
Manager 2 Salary	Indirect	10,444	24,556	35,000	17,526	52,474	70,000	17,487	52,513	70,000
Marketing	Direct	16,815	17,276	34,091	24,900	23,700	48,600	19,700	23,700	43,400
Credit Card Discount	Direct	2,279	1,656	3,935	7,181	6,417	13,598	8,276	6,831	15,107
Packing Supplies	Direct	1,270		1,270	3,345		3,345	3,855		3,855
Web Design	Direct	1,680		1,680	5,500		5,500	5,500		5,500
Web Hosting	Direct	2,405		2,405	3,600		3,600	4,800		4,800
In-Store Merchandising	Direct		2,754	2,754		4,000	4,000		4,000	4,000
Rent	Indirect	7,132	14,480	21,612	7,854	15,946	23,800	7,854	15,946	23,800
Bank Charges &	Indirect	454	681	1,135	432	648	1,080	432	648	1,080

	2006			2007			2008		
Merchant Fees									
Trade Show Buying Trips	Indirect	1,057	1,057	2,114	5,000	5,000	10,000	5,000	10,000
Total Expenses		109,521	84,682	194,203	139,781	158,142	297,923	140,384	313,942
Contribution		(49,478)	(27,170)	(76,648)	54,111	15,232	69,343	83,066	115,182
% Sales Contribution		-57.9%	-30.8%	-44.1%	20.1%	5.8%	13.0%	26.8%	18.5%
Overhead Expenses									
Accounting Fees				1,200			1,200		1200
Insurance				1,584			1,584		1584
Telephone/ADSL				2,409			2,400		2880
Office Supplies				2,101			1,200		1200
Alarm				335			335		335.4
Misc.				1,400			2,400		2400
Total Overhead				9,029			9,119		9599.4
Net Income with Managers Salary				(85,677)			60,224		105,583
Net Income (w/o Managers Salaries)				19,323			200,224		245,583

5.7.1.1 Allocation of Indirect Costs

Human resource expenses are divided into consulting, payroll and management salaries. Creative Cushions' design consultant's time is divided between three primary activities: website content development, assisting in product sourcing and purchasing, and helping with showroom display. Table 19 shows the estimated distribution of her time for these activities over the next three years. Online support and in-store support are directly traceable to the two channels accordingly. Purchasing support, however, has been allocated to each channel by percentage of sales.

Table 19: Design Consultant Time Allocation

Activity	2006	2007	2008
Online Support	80%	30%	20%
Purchasing	10%	30%	40%
In-Store Support	10%	40%	40%

Payroll has also been divided into direct and indirect expenses. Online pick/pack/ship labour and part-time in-store retail labour costs have been allocated as direct costs to each channel accordingly. Indirect payroll expenses which cover general office management have been allocated by percentage of sales.

For the purpose of analyzing channel profitability it was necessary to value the two founders' time and to allocate it across the two channels. Salary estimates of \$70,000 have been used based on what is believed to be fair market value for two managers capable of performing the same tasks. Management expenses have been allocated across the two channels based on the estimated time each founder is expected to apply to each channel.

Rent expenses have been allocated at 67 percent in-store retail and 33 percent online retail based on usage and making some adjustment for the lower lease costs that could be

obtained for a facility that could support a pure online operation. Tradeshow and buying trip expenses have been allocated at 50 percent retail and 50 percent online.

5.7.2 Assessment of Channel Profitability

The expenses that have the most significant impact on channel profitability are those related to human resources and marketing. As is shown in Table 20, both channels post a net loss in 2006. Online sales account for the greatest loss due to heavy time investment in setting up and optimizing the website over the course of the year. However, based on the company's proforma income statement, breakeven will occur in July of 2006 at approximately \$11,500 in revenue with gross profit of about \$7,800.

In 2007, 20 percent of online sales and 5.8 percent of in-store sales are contributing to overhead and net income. This increases to 26.8 percent and 10.3 percent respectively in 2008. Over the three year period, online retail shows increasing profitability over in-store retail. This is primarily due to the increasing human resource requirements needed to support a busy retail store. By 2008, human resource expense as a percentage of sales is 37.7 percent for in-store retail compared to 27.5 percent for online retail.

Table 20: Percent of Sales Ratios

	2006		2007		2008	
	Online	In-Store	Online	In-Store	Online	In-Store
Gross Margin (% of sales)	70.3%	65.2%	72.2%	65.5%	72.2%	66.0%
Human Resources (% of sales)	89.4%	52.0%	30.5%	38.7%	27.5%	37.7%
Marketing (% of sales)	19.7%	19.6%	9.3%	9.0%	6.4%	7.6%
Contribution (% of sales)	-57.9%	-30.8%	20.1%	5.8%	26.8%	10.3%

Marketing expenses as a percentage of sales decline at a more or less equal rate for both channels. By 2008 online marketing is at 6.4 percent of sales and local retail marketing is at 7.6 percent of sales.

With gross margin expected to be slightly higher for online sales than in-store sales, the online channel appears to offer greater potential. However, uncertainty exists regarding the point at which online sales will begin to plateau. Failure to achieve strong search engine rankings may force the company to increase its spending on additional, and possibly more labour intensive, online marketing strategies. Lower than expected online sales may also prompt the company to offer deeper online discounts thus decreasing gross margin to below that of in-store sales.

However, it is also important to note that this analysis of channel profitability treats each channel independently and does not account for cross-channel activity. If (consistent with multi-channel retail trends) the website is effective in driving customers to the retail store, website costs should also be partially allocated to in-store retail. This would have the effect of increasing the relative profitability of the online channel.

5.8 Underperformance Scenarios

As shown in the company balance sheet of May 31, 2006, (see Table 21) the founders' total investment to date is \$160,000. With very low fixed costs, the company is confident that additional financing will not be required to achieve breakeven. Furthermore, given the size of its starting inventory, Creative Cushions believes that cash flow will turn positive very soon after achieving breakeven. Pre-Christmas buying of inventory may require some additional investment in September 2006, but cash flow is expected to be sufficient to cover new inventory after December 2006. As previously noted, breakeven is projected to occur in July of 2006 with approximately \$11,500 in sales and expenses of \$7,796. With just under \$11,000 in its cash accounts, the company will not require any additional financing if targets are met. However, if targets are not met, some additional financing may be necessary.

Table 21: Balance Sheet (May 31, 2006)

Balance Sheet - May 31, 06	
ASSETS	
Current Assets	
Cash in Bank	10,941.53
Cash in Transit	1,007.11
Accounts Receivable	495.36
Inventory	<u>72,179.68</u>
Total Current Assts	84,623.68
Property, Plant and Equipment	<u>12,449.44</u>
TOTAL ASSETS	<u>97,073.12</u>
LIABILITIES & EQUITY	
Liabilities	
Current Liabilities	
Accrued Revenue	530.00
Due to Government Agencies	-6,052.86
Loan From Shareholders	<u>160,000.00</u>
Total Liabilities	<u>154,477.14</u>
Equity	
Common Shares	200.00
Loss from prior years	-42,185.45
Net Loss	<u>-15,418.57</u>
Total Equity	-57,404.02
TOTAL LIABILITIES & EQUITY	<u>97,073.12</u>

Three underperformance scenarios are provided below along with the respective cash requirements to achieve breakeven.

Scenario 1: No increase in online sales from May sales level with in-store revenue growth as projected.

Assuming Creative Cushions sees no increase in online sales but in-store sales increase as projected, the company's breakeven point is pushed forward to early September, 2006, with total revenues at month end of \$16,480 and expenses of \$9,272. Only an additional \$1,556 investment would be required.

Scenario 2: No increase in in-store sales from May sales level with online revenue growth as projected.

Assuming Creative Cushions sees no increase in in-store sales but online sales increase as projected, the company's breakeven point is pushed forward to November, 2006, with total revenues at month end of \$20,701 and expenses of \$11,032. An additional \$7,494 investment would be required.

Scenario 3: The company achieves only a 5 percent month over month increase in sales through 2007.

Increasing total monthly sales by only 5 percent each month from May 2006 to December 2007 would have the result that Creative Cushions does not achieve breakeven for another 15 months. This would occur in August, 2007 with revenue of 16, 552. This assumes that marketing costs remain as were originally projected. To reach this point, the founders would have to make an additional investment of approximately \$35,000.

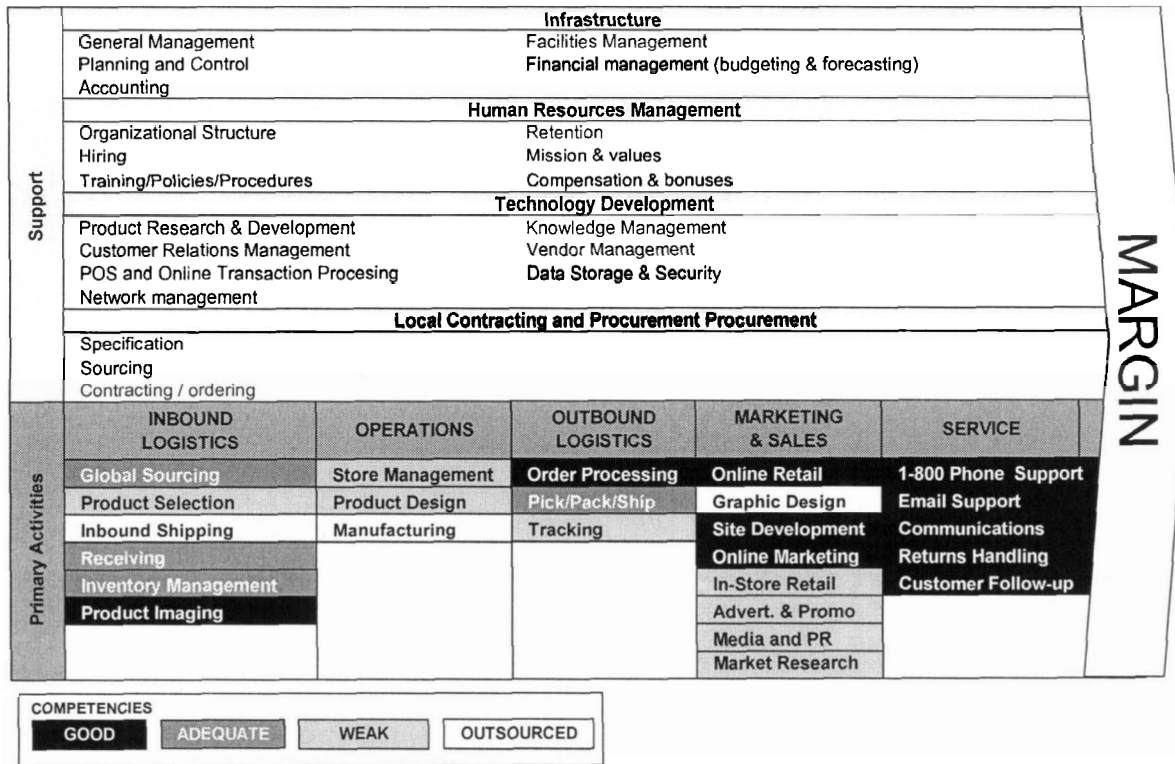
Given the company's early start-up stage, the founders would have to seriously doubt the viability of the business if it cannot meet a revenue target of \$16,000 by August of 2007. Creative Cushions does not anticipate the need for any external financing. However, should external financing be required this would most likely be sought through family and friends. Given the company's extremely lean cost structure, very little can be done to trim down costs to lower the breakeven point. However, the above scenarios suggest that a focus on increasing in-store revenue will help the company achieve break even at the earliest possible date.

5.9 Analysis of Internal Activities and Competencies

Creative Cushions is still in a start-phase and its internal activities are therefore increasing rapidly. The two company founders continue to perform over 80 percent of all activities personally. However, this must change as new activities are added in keeping with the scope of operations and as existing workloads increase. At this stage, however, the company still

has only minor experience in many areas. Identifying areas of weakness early on will therefore be critical to managing growth. Figure 13 outlines the firm’s primary and secondary activities at the present time.

Figure 13: Competencies in the Internal Value Chain



5.9.1 Primary Activities

5.9.1.1 Inbound Logistics (Adequate)

Creative Cushions’ inbound logistics activities centre on the sourcing, receiving, and processing of products that are shipped from manufacturers around the world.

Global Sourcing (Adequate)

Global sourcing activities are of great strategic importance to Creative Cushions and the company is striving to make product sourcing and management of supplier relationships a core competence. Through travel to regional tradeshows in India, China, Turkey and Western Europe,

the company has established direct relationships with a wide range of manufacturers. These manufacturers have been selected for their ability to offer well-designed products of good quality at low cost, and for their willingness to sell in relatively small order quantities. The company is presently working with over 20 manufacturers each of which offer Creative Cushions a unique product selection. Daily sourcing activities include correspondence with manufacturers regarding product availability, customization, pricing, and delivery times. Communication with manufacturers has been facilitated by the fact that among the two founders and two part-time employees, seven languages are spoken fluently including Mandarin, Cantonese, Indonesian, Spanish, Italian, French and German.

As sales volume increases, Creative Cushions must continue to negotiate for lower costs and better payment terms, and must build efficiencies into supply chain activities. Tracking seasonal sales velocity for top selling products and understanding lead-times for inventory replenishment will be critical to avoid inventory stock-outs.

Overall, Creative Cushions has done a good job of establishing a network of reliable suppliers. The company has gained credibility and trust by demonstrating good industry knowledge, design expertise, and a strong online brand. However, to the extent that Creative Cushions must carry some fashion-forward products, it must identify supply partners that have strong and leading design expertise.

Product Selection (Weak)

Despite having a part-time interior decorator involved in product selection, this is an area that Creative Cushions must improve upon in order to meet market demand. Products are currently selected based on research into popularity of various home décor styles and an awareness of current home fashion trends. Travel to the major industry trade shows has helped in this process.

Inbound Shipping (Outsourced)

Shipping and customs clearance are primarily outsourced. Manufacturers typically make arrangements for shipping upon approval by Creative Cushions of rate quotes. Thailand is the only country in which Creative Cushions has a shipping agent. Based in Bangkok, the shipping agent has been helpful in consolidating shipments from several Thai manufacturers and for securing the best possible shipping rates. Because of the fairly small order sizes, most shipments have been sent by airfreight which has resulted in high shipping costs. Creative Cushions uses a local Vancouver Customs Broker to assist with customs clearance procedures. As Creative Cushions' sales volume increases, it must work to keep inventory levels down by determining inventory velocity, re-order points and replenishment lead times.

Receiving and Inventory Management (Adequate-Good)

Upon receipt of a shipment at Creative Cushions' showroom and warehouse, boxes are opened and items are inspected, counted and compared against the original order form. Discrepancies are recorded and later communicated back to the manufacturer. If products are replenishing existing stock, they are simply counted, placed in stock bins in the storage room and the inventory levels are adjusted within the company's inventory management system which is an integrated module of the company e-commerce platform. However, if products are new stock items, a new inventory record form is completed. The person processing the shipment assigns a unique stock code to each product. This stock code is an eleven digit code that identifies the supplier, the model, the series and the dimension of the product. This level of detail in the product code can improve customer service as it enables an employee to quickly identify products when talking to customers on the phone or when the product is not physically present. The new inventory record also contains all relevant information including vendor product code, vendor price, landed costs, and starting inventory level. One item for each product is pulled and labelled for showroom display and the inventory count is adjusted accordingly. This showroom sample ensures that the company always has a physical reference for every stock item. At this point new

stockroom shelf space is assigned and labelled for each product and the new inventory record form is electronically and physically filed. At a later stage this information is combined with product images, product descriptions and other variables before it is uploaded into the company's online store.

Product Imaging (Good)

An important part of the inventory management process involves maintaining a comprehensive product image database. Before products can be displayed online, product photographs must be taken. Good product photography not only translates into increased online sales, but is also required for the production of print catalogues, print advertising and promotional pieces. Creative Cushions has built a small photo studio within its office space. This studio was put together with professional consultation and enables the company to generate its own product images. To outsource product photography would be very costly. Product images are taken using a professional digital camera. They are then downloaded, named according to product code and archived. These images are later optimized for the web using Photoshop and then batch processed in preparation for uploading to the website. Creative Cushions has found the quality of its product photos to be superior to most of its online competitors.

5.9.1.2 Operations (In-store-Weak /Online-Good)

Creative Cushions' daily operations primarily involve the management of its physical showroom, stockroom, and online store. Operations also include the handling of custom orders, including overseeing product design and manufacturing. Although custom manufacturing is currently a small portion of the company's overall business, it is expected to increase in the second year of operations.

Store Management (Retail Store – Weak / Online Store – Good)

Store management can be separated into online store management and physical store management. Physical store management is currently limited to basic merchandising activities,

including the creation of attractive product displays, and tagging products with pricing and in-store promotional details. Although the company has only been selling to the local market for a few months, the founders have not yet paid sufficient attention to the design and layout of its Vancouver store. Although they have plans to make store improvements, neither of them have experience in merchandising high-end home accent products for a predominantly female market. Despite assistance from their designer, more specific retail expertise is required to improve the Vancouver store.

The activity of managing the online store consumes a great deal of time. This includes adding new informational content, reviewing for errors, and changing graphic design elements. It also involves uploading products into the product database and configuring them under the appropriate product categories. It is at this stage that the information in the new inventory records are combined with detailed product information including descriptions, design features, sales options and accessories. For up-selling and cross-selling purposes, products must be associated with other complementary products, a process that also involves the company's designer.

Product Design (Weak)

Design and new product development are activities in which Creative Cushions is becoming increasingly involved. The company employs a part-time designer whose responsibilities include providing design specifications to manufacturers. These may be colour, fabric, dimension and detailing specifications. The company is also exploring the embroidery and photo stencilling market. An embroidery company is located directly across the street from Creative Cushions making collaboration even easier. Creative Cushions has also experimented with some custom manufacturing which has involved fabric selection and design. However, the company has much to learn in this area and is holding off on pursuing the custom pillow market.

Manufacturing (Outsourced)

Creative Cushions outsources almost all its manufacturing. In addition to its international manufacturers, Creative Cushions has worked with a local sewing factory in the production of custom pillows. This local manufacturer is also located within the same block as Creative Cushions and as the former manufacturer of Lululemon Athletica's clothing, provides very high quality service.

5.9.1.3 Outbound Logistics (Adequate)

Outbound logistics include the activities of order processing, packing, shipping and tracking. Online order processing is a very efficient process thanks to a well-integrated e-commerce system. For every incoming order, a single person handles the entire process from beginning to end (this is expected to change as the volume of orders increases). The first step involves physical confirmation that the product is in stock. This is done purely to eliminate any possibility of error prior to processing the customer's credit card payment. Upon processing the card transaction, which is done through the order interface, pillow covers are bagged and sealed. If the order includes pillow inserts, these are vacuum packed to within one fifth of their full-form size. Covers are shipped in Canada Post shipping bags which are provided at no cost while orders of inserts and covers are boxed for shipment. However, Creative Cushions must make considerable improvements to how it packages products for shipment to customers. Although orders are well packaged from the standpoint that they are protected from damage, the packaging consists of unbranded boxes and bags that do nothing to enhance customer perception of the product or of Creative Cushions.

The e-commerce system is integrated with Canada Post's Electronic Shipping Tool (CPOST EST) which, upon entering the parcel dimensions and weight, automatically generates shipping labels complete with U.S. Customs information. All outgoing packages are picked-up daily by Canada Post to be delivered by Small Parcel AirMail, Xpresspost USA (four day

guaranteed delivery time) or Expedited Parcel (12 day guaranteed delivery time). A Canada Post tracking number is automatically generated for Xpresspost and Expedited Parcel shipments. This number appears in the shipping confirmation email that the system sends to the customer upon completing the order, and is saved to the customers order file. Only shipments sent by Small Parcel AirMail are not given a tracking number. So far this has not presented any problems.

5.9.1.4 Marketing (In-store- Weak/Online-Good)

Creative Cushions' marketing efforts are divided between online marketing, to build its online business, and local retail marketing aimed at drawing customers into the Vancouver store. As a new firm, Creative Cushions has given priority to its web store as it is a low-cost means of generating immediate revenue and of measuring market response to the product mix and pricing. Creative Cushions believes that its level of expertise in online marketing gives it a significant advantage over a great number of competitors; particularly over smaller specialty retailers that are competing in the same market niche.

Local marketing activities designed to attract traffic to the Vancouver showroom have only just begun. A direct mail campaign targeting local interior designers and decorators has introduced a new set of activities involving the management of a designer discount program and the setup of designer accounts.

5.9.1.5 Service and Support (Good)

As a retailer, Creative Cushions' customer support activities are an important aspect of the business. Due to the nature of the products being sold, customer inquiries are common and Creative Cushions must respond to email and telephone inquiries on a daily basis. A toll-free phone number is provided on the website to encourage customers to call with questions. Toll-free service is very inexpensive to provide yet it can increase sales significantly. Offering toll-free

service further differentiates Creative Cushions as a professional organization and sets it apart from many smaller competitors.

Creative Cushions' e-commerce system includes a customer relationship management system that enables the company's owners and staff to raise customer inquiries or incident tickets for follow-up. This systems increases efficiency and provides the level of visibility necessary to ensure that efforts are not duplicated.

Service activities also include the handling of product returns. Notice of product returns are most commonly received by phone. The activities of issuing refunds or store credits only occur when the product has been received and inspected for damage. If the product is in its original condition, a refund is made to the customer's credit card and an email notification is sent to advise the customer.

With the current limited scale of its operations, Creative Cushions has not yet had its competencies in customer service tested. However, as sales volume increases the company will be faced with a greater number of customer inquiries, special requests and product returns. As this occurs, Creative Cushions will have to constantly re-evaluate its customer service levels.

5.9.2 Secondary Activities

5.9.2.1 Infrastructure

Creative Cushions is attempting to develop its infrastructure in pace with its growth. With all activities within the firm currently performed by only four people, tasks are frequently shared.

Creative Cushions' founders have strong skills in general management and their strengths are highly complementary. One of the founders has a long and successful entrepreneurial track record. He has been involved in four previous start-ups, all of which have been operating profitably for over ten years. His success as an entrepreneur stems largely from his consistent pursuit of the baby boom market and his ability to time new businesses to capitalize on growing

underserved markets. The other founder has extensive marketing and business development skills that have been developed in the logistics and technology industries. His experience in e-commerce and Internet marketing has enabled Creative Cushions to fast track the implementation of its online business.

The secondary activities relating to infrastructure and general management are handled exclusively by the two owners with the exception of accounting (one of Creative Cushions' employees is a certified general accountant and is involved in organizing the company's books and tax filings). As a start-up, strategic planning activities are intensive, with a focus on rapidly establishing systems and procedures to support the company's growth and on keeping the company focused on its business plan. Facilities management and financial management activities are equally important as the company develops its operations.

The founders' greatest weakness is in their lack of previous experience in the home textiles retail industry. Although one of the founders has extensive retail experience, new skills are required for home textiles retail. In particular, a better understanding of how to successfully market and sell to women will be needed. Although they are confident that the learning curve in this area will be steep and can be accelerated through hiring practices, they do present short term barriers to success.

5.9.2.2 Human Resources Management

Training in the use of the e-commerce system is the company's main human resources management activity. However, in general, human resources management activities remain relatively low at the present time. Procedures are being well documented to facilitate training and to reduce the impact of employee turnover. However, hiring and retaining part-time employees will present ongoing challenges. Although Creative Cushions has been fortunate so far in its

ability to find skilled but low-cost part-time help, if the present job market persists the company may face challenges in finding and keeping full-time employees.

5.9.2.3 Technology Development

From a technology standpoint, Creative Cushions is currently a small, low-maintenance office that is supported, when needed, by a local computer services company. Additional technology is used in the packaging process. Heat sealers and vacuum pumps are used to vacuum-pack pillows and pillow inserts. This serves to protect items during shipment and greatly reduces shipping costs. Thanks to a fully hosted e-commerce solution that includes technology upgrades, Creative Cushions is relieved of the additional burden of maintaining its own e-commerce servers, mail servers and data backup system.

Although the company's e-commerce solution includes customer relationship management tools, a more elaborate system will be needed to give the company greater ability to perform detailed customer analysis. In addition, the company has not yet implemented any internal collaboration tools. This will become necessary in the near future as the company grows.

A more efficient in-store retail point-of-sale system will also be required in the near future. Although the Volusion system can also be used as an in-store POS system, the online store is currently configured to process payments through the company's U.S. dollar merchant account. As a result, Creative Cushions must manually process in-store transactions through its Canadian dollar merchant account using the MONERIS web-based interface while the QuickBooks accounting system is used for generating sales receipts. This is a slow process that will hinder the company's ability to provide fast and efficient service to in-store customers. A Canadian version of the website that is configured to process transactions through the Canadian dollar merchant account would solve this problem. However, this introduces additional challenges in maintaining

a centralized inventory database. This later problem must be resolved before Creative Cushions can effectively provide cross-channel support to its Canadian customers.

5.9.2.4 Procurement

Creative Cushions' procurement activities are limited to the ordering of a few basic supplies required for daily operations and they are handled in an ad hoc manner. Packaging materials including boxes, barrier bags for vacuum packing and low density plastic retail bags are purchased infrequently in bulk from local suppliers. Creative Cushions has informal arrangements with a local embroidery shop and a local soft furnishings manufacturer. No formal arrangements exist with these suppliers and price quotes are given on a project-by-project basis.

6 ISSUES

Within a relatively short period of time, Creative Cushions has succeeded in getting its online business started and is now beginning to increase sales through its local Vancouver store. With breakeven well within reach, the greatest issue facing Creative Cushions is how to best apply its resources to maximize profitability and ensure a strong and sustainable growth rate. The temptation to pursue new opportunities is strong. On the one hand, Creative Cushions needs to be strategically opportunistic so as to gain the experience needed to identify new and promising long-term growth strategies. However, in the short-term it is critical that Creative Cushions remain focused on developing the online and in-store retail channels. The decisions that Creative Cushions makes must either ensure continued strategic fit within its current strategy of focused differentiation or they must be made with a commitment to developing the organizational capabilities and competencies required for a shift in strategy.

As Figure 14 illustrates, a focus strategy can serve to strengthen a company in a number of ways. A focus strategy involves focusing the business on a distinct buyer group or on a limited product line. "Focus can be central to the creation of an SCA [sustainable competitive advantage] and therefore the driving force, even if differentiation or low cost is also associated with the strategy."⁶⁸

The key success factors that Creative Cushions identified as being central to the success of firms within the home textiles niche retail strategic group are all in support of building sustainable competitive advantage through focus and differentiation. The issues that Creative Cushions faces can therefore be best described within a focus strategy framework. In discussing

⁶⁸ David A. Aaker, "Developing Business Strategies," (New York: John Wiley & Sons, Inc., 2001) p.7

issues within this context, it becomes clear how the firm's internal strengths and weaknesses can help or hinder the company in navigating in the external competitive environment.

Figure 14: A Focus Strategy⁶⁹



6.1 Avoiding Strategy Dilution or Distraction

A focus strategy can enhance competitive advantage when it succeeds in keeping all resources aligned toward a single goal. "The result will be assets, competencies, and functional strategies that match market needs."⁷⁰ One of the most important issues facing Creative Cushions centers on the need to stay focused and on avoiding distraction by the many opportunities that are surfacing as the company gains market awareness.

Over the past few months Creative Cushions has received numerous wholesale requests as well as requests for large custom orders. Both the wholesale and the custom order market appear to be directions worth pursuing but they present unique challenges, timing and investment issues. Most importantly, however, they introduce concerns regarding their potential to distract Creative Cushions from its current strategy.

There are several benefits to the integration of a wholesale operation. Not only would it lower supply costs for Creative Cushions' retail business thus increasing net profit as a percent of

69 Adapted from: David A. Aaker, "Developing Business Strategies," (New York: John Wiley & Sons, Inc.,2001) p.180

⁷⁰ David A. Aaker, "Developing Business Strategies," (New York: John Wiley & Sons, Inc.,2001) p.180

sales, but it would also offer the company greater long-term growth potential considering the current home textiles industry growth rate and the increasing demand from North American retailers for imports. However, wholesaling requires a very different set of competencies, a different strategy, involves greater risk exposure, and may potentially reduce the firm's strategic flexibility. With a focus on costs, wholesaling would place much greater emphasis on supply relationships and on maximizing the efficiencies in supply chain logistics. Not only would greater investment be needed for warehousing and logistics, but inventory carrying costs would most likely increase. Therefore, return on investment may not necessarily increase. Furthermore, it has been found that the most profitable companies are those that are either heavily integrated or not integrated at all.⁷¹

Although Creative Cushions does intend to pursue wholesale opportunities on a limited scale to gain experience, the company is not yet prepared to respond to wholesale requests in a professional manner, nor has it fully considered the strategic implications of this decision.

6.2 Reducing Competitive Pressures

One of the disadvantages in pursuing a niche market focus strategy is that the payoff can be much less than that of selling into a large, growing market. Hence the attractiveness of the wholesale market as discussed above. However, a major benefit is that within niches, competition is often much less intense.⁷² By not competing in the multi-category home accents or home décor retail market, Creative Cushions forgoes the opportunity to capture the demand for related products but is much better able to set itself apart in a crowded market.

With access to a range of complementary products such as curtains, bed throws, and table runners available from its current pillow suppliers, Creative Cushions is tempted to expand beyond decorative pillows. Curtains in particular are increasingly being sold as coordinates with

⁷¹ David A. Aaker, "Developing Business Strategies," (New York: John Wiley & Sons, Inc., 2001) p.180

⁷² Ibid. p.180

decorative pillows. Since they are commonly sold in two standard sizes that fit the windows in the majority of new homes, they are an easy item for Creative Cushions to source and sell. By carrying another product category that offers strong cross-selling potential, Creative Cushions believes it may be able to significantly boost revenue. However, in doing so, Creative Cushions would begin to cross over into more competitive territory and risks weakening its positioning as a specialty retailer of decorative pillows. Nonetheless, the temptation is strong as Creative Cushions eyes larger companies that are capturing this broader market.

6.2.1 Local Retail Competition

Although the growth in the home décor market will likely attract new market entrants, the greatest increase in competition with regards to decorative pillows will most likely come from existing retailers that add or increase the decorative pillow category within their stores. In promoting itself as a specialty store focused on providing consumers with a wide selection of decorative pillows, Creative Cushions is signalling to other local multi-category retailers that there is strong local competition committed to the decorative pillow category. For some, this may be incentive to limit the category within their stores.

Within the local Vancouver retail market, Creative Cushions believes that despite increasing competition and greater product selection, search costs will remain high as consumers are still forced to visit numerous stores to find a product they like. However, as a specialty retailer, Creative Cushions will have to work hard to find cost effective ways of building broad market awareness as the city's premier decorative pillow store. Creative Cushions hopes to have an advantage as the first specialty pillow store in Vancouver, but whether the local market is large enough to support a second store is something that cannot be determined until the existing store has been proven profitable. Nonetheless, in developing its store format, systems and processes, Creative Cushions must strive to develop an easily repeatable model. Easily repeatable systems

and procedures will help Creative Cushions reduce its dependency on its people should the company decide to expand by opening additional stores.

6.2.2 Online Competition

Increasing competition online presents Creative Cushions with a slightly different set of challenges. As is the case with the local retail market, more and more competitors will result in a wider product selection for online consumers. However, unlike traditional shopping, it is relatively easy for web surfers to browse for products across any number of web stores. Furthermore, with increasing numbers of online competitors, achieving online visibility through either organic search engine rankings or pay-per-click advertising campaigns becomes even more difficult and costly. A highly competitive online environment places even greater importance on Creative Cushions' competencies in Internet marketing. Increasing online traffic and maximizing conversion rates while tightly controlling online marketing costs will present an ongoing challenge for Creative Cushions.

6.3 Competing with Limited Resources

The founder's of Creative Cushions have taken a conservative approach to starting the business. A focus strategy has helped to limit investment to those activities and assets that will increase the company's competitive advantage within its niche. As the scope of Creative Cushions' operations grows, the company must continue to carefully estimate how the use of resources will impact its competitiveness. However, to accelerate growth, Creative Cushions must eventually begin to make larger financial commitments. These will most likely be in the form of larger marketing campaigns and the addition of full-time employees, but may also include technology and infrastructure investment. The misuse of resources toward activities or assets that are not clearly aligned with the company's strategy could severely impair the company's ability to compete as a niche retailer.

6.4 Providing Positioning Strategy

A focus strategy often helps strengthen a firm's positioning, however, despite being a specialty retailer of decorative pillows, Creative Cushions has a long way to go to hone its positioning strategy. Strong positioning is often a critical component of successful niche marketing. The better a firm can position itself as being able to satisfy the unique needs of its niche market, the greater the chance it will be able to develop a loyal customer base that is willing to pay a premium.⁷³

Creative Cushions is trying to position itself as a specialty retailer of decorative pillows – as an authority in its trade with in-depth product knowledge that extends to home textiles and home decorating. However, to do this effectively and to communicate it effectively to the market, Creative Cushions must develop its competencies in a number of areas. In particular, these include product design, home decorating and home fashion.⁷⁴ In strengthening its competencies in these areas, Creative Cushions will be better able to add value beyond the cost of the products it sells.

The need for these competencies is different for the online and in-store channels. For the online channel, Creative Cushions must provide rich content on its website that serves to inform and guide customers in the decision making process. However, this does not necessarily require that Creative Cushions have staff with these skills working in its office full-time. Although a quick response time to email inquiries is important, these too can be handled remotely by a part-time employee. In-store retail on the other hand does demand that knowledgeable consultative sales personnel be available to assist customers within the store. Creative Cushions needs to be able to promote the availability of this in-house expertise to the local market. However, finding

⁷³Philip Kotler, "Marketing Management," 11th rev. ed. (Upper Saddle River, New Jersey, U.S.A.: Prentice Hall, 2003)

⁷⁴Home fashion is used here to mean the latest fashion or fashion trends for the home. This should not be confused with home decorating which may involve working with any number of past or present home decor styles.

local retail staff with these skills is proving difficult. Until these in-house competencies are acquired or developed, Creative Cushions is hesitant to position its local business in a way that creates expectations that cannot be met within the store. This introduces additional challenges in trying to align the online positioning with that of the local retail business.

6.5 Other Issues

The growth of Chinese textiles exports and the increasing competitiveness among worldwide textile manufacturers, particularly between China and India, suggest that North American importers will continue to benefit from declining costs. These cost savings will likely be passed on to consumers, particularly by the discount department stores and large specialty store channels. However, the extent to which the more embellished mid and high-end decorative pillows find their way onto the shelves of these large retail category killers is questionable. If raw material, processing and manufacturing costs remain stable, then there will be limits to even China's ability to supply cheap products, particularly as China's manufacturing industries feel the pinch of rising labour, oil and energy costs. Nonetheless, Creative Cushions must assume that competition and technological innovation in the upstream processes will continue to lead to lower supply costs.

Although Creative Cushions will also benefit from lower cost of goods, it will not be able to compete with the buying power of the large retail groups. Furthermore, the trend toward smaller format and more localized discount and specialty retailers means that lower prices will be accompanied by a product mix more specifically targeted to local markets. Creative Cushions is clearly at a competitive disadvantage if the large retailers like Wal-Mart are successful in attracting and fulfilling the needs of a more upscale market. However the higher overhead costs that come with localization and managing a localized product mix (even despite clustering techniques) will place new limitations on these large retailers' ability to sell at rock-bottom prices.

The risk of declining market prices reinforces the need for Creative Cushions to stay true to a strategy of focused differentiation. Creative Cushions' ability to add value through highly differentiated products and services will be crucial to its success. Creative Cushions' competitive advantage will lie in its ability to know its customers and to offer them a range of products and a level of personalized service not offered by its larger competitors.

6.5.1 Product Selection

Creative Cushions has been sourcing products with very limited ability to predict market demand. A starting inventory has been established based partly on competitive research, partly on the recommendation of the company's designer and suppliers, and partly on industry news sources and trade shows.

This initial approach has worked well to the extent that the company has built up an inventory that covers a very wide range of styles, fabrics, and price points. This in itself is helping the company determine which products appear to have the greatest market appeal. However, this trial and error approach is costly, as every product requires photography and a description for the web. Furthermore, liquidation of slow moving products, whether it is done through the Vancouver store or through eBay, consumes even more resources. As product selection is one of the primary ways through which the company hopes to differentiate itself from the competition, product selection and optimizing the product mix are areas in which Creative Cushions must continue to improve.

6.5.2 Poor Cross-Channel Support in for the Local Market

Creative Cushions has priced its products online approximately 20 percent higher than in its Vancouver retail store. This decision was made so as to offset shipping costs and to give the company sufficient margin to adjust prices downwards to try to measure the effect on sales and determine an optimal price point. However, Creative Cushions is faced with the issue of trying to

support its local retail business with Canadian dollar web pricing that is consistent with its in-store pricing. This pricing issue is a major obstacle to implementing a successful and cost effective multi-channel strategy in the Vancouver market.

6.5.3 Overcoming the ‘Touch and Feel’ Barrier to Online Sales

Given Creative Cushions’ initial emphasis on online retail, it is critical that Creative Cushions find ways to overcome the need that many consumers have to touch and feel a product like decorative pillows before purchasing. If Creative Cushions is unsuccessful in doing this it may find that growth of its online business falls well short of its projections.

6.5.4 Establishing Credibility and Trust Online

A study conducted through the Center for eBusiness at MIT examined the drivers of online trust for various categories of websites.⁷⁵ Results from this study are shown in Table 22. Among the most important drivers of online trust for online retailers were navigation and presentation, advice and order fulfilment. Although security did not emerge as a dominant driver of trust for any category, the study suggests that “...it is so basic for all sites that it does not explain any variance in the presence of other drivers.”⁷⁶

⁷⁵Iakov Y. Bart, et al, “Are the drivers and Role of Online Trust the Same for all Web Sites and Consumers? A Large Scale Exploratory Empirical Study” April 2005, Paper 217, Sloan School of Management, <http://ebusiness.mit.edu/> (accessed on June 10)

⁷⁶Ibid. p. 10

Table 22: Categories with Dominant Effects of the Web Site Drivers of Online Trust⁷⁷

Driver	Category
Privacy	Travel
Security	None
Navigation and Presentation	E-tailer, Portal, Sports
Brand Strength	Auto, Financial Service, Computer, Community
Advice	Auto, E-tailer, Computer
Order Fulfilment	Travel, E-tailer
Community Features	Computers(-), Travel (-)
Absence of Errors	All

Web site navigation and presentation reflects on the expertise of the online retailer. For retailers that carry a range of products accompanied by detailed information, trust is increased by providing a fast, short and simple navigation path to the consumer's desired items.⁷⁸ Similarly, online retailers can increase consumer confidence and trust by providing advice in the form of the right suggestions and recommendations.

According to Gartner Inc., a dip in online consumer confidence due to security threats may slow the growth in business-to-consumer spending by as much as 0.3 percent to 1 percent per year over the next few years.⁷⁹ Creative Cushions must therefore continue to work on increasing trust and confidence among its online consumers.

⁷⁷ Iakov Y. Bart, et al, "Are the drivers and Role of Online Trust the Same for all Web Sites and Consumers? A Large Scale Exploratory Empirical Study" April 2005, Paper 217, Sloan School of Management, <http://ebusiness.mit.edu/> (accessed on June 10)

⁷⁸ Ibid.

⁷⁹ Juan Carlos Perez, "Gartner: Security concerns to stunt e-commerce growth," June 24, 2005, Computerworld.com: <http://tinyurl.com/oftyw> (accessed on June 10, 2006)

7 RECOMMENDATIONS

The following recommendations are made with two objectives in mind. First, they address the short-term need for the firm to remain focused on its niche retail strategy and on the external key success factors. Recommendations for short-term growth therefore place an emphasis on marketing and positioning, but they also focus on the need to improve internal competencies in areas such as product sourcing, design, inventory management and cross-channel support. Second, they address the issues of strategy dilution and of changing competitive pressures that would accompany a long-term growth strategy that involves a departure from the current focused niche retail strategy. Recommendations for long-term growth also give consideration to the new internal capabilities that would be required.

7.1 Recommendations for Short-Term Growth

With the online business established and growing steadily through search engine saturation and improvements in search engine rankings, Creative Cushions needs to begin focusing on building awareness within the Vancouver market. By shifting more attention to the in-store channel, Creative Cushions will achieve breakeven sooner and will begin generating positive cash flow. The following are recommended activities for increasing local retail revenue.

7.1.1 Media Coverage

Creative Cushions has not yet pursued local media coverage. This, however, may be Creative Cushions' most effective strategy for increasing awareness in the Vancouver market. Creative Cushions must develop potential media stories to pitch to local media. The majority of the city's local newspapers have sections dedicated to fashion, home, or lifestyle. Furthermore,

there are a large number of local magazines focused on home décor, interior design, and local business. The company has not yet had a formal opening or launch party. If possible this event should include print and television media representatives. Creative Cushions should begin preparing for a formal opening in September 2006.

At the same time that Creative Cushions is pursuing local media coverage, it should attempt to get media exposure more broadly in Canada and the U.S.. Media coverage will not only drive more traffic to the website, but it will also result in the creation of free inbound links which are important in improving positions in the major search engines.

7.1.2 Home Decorator/Designer Direct Marketing

The interior decorator market is an important channel through which Creative Cushions can reach the local consumer market. As important influencers and buyers, the interior decorator and designer market must be targeted directly. Although Creative Cushions has been gradually building a database of Vancouver decorators and interior design firms, it must begin to aggressively market to this group. Personalized direct mail and electronic direct mail should be used to introduce Creative Cushions. Designers need to be informed of available discounts and new products on a regular basis. Creative Cushions should therefore start a monthly direct mail and electronic direct mail newsletter to keep designers up to date on new stock and promotions. Creative Cushions should also consider a separate open house exclusively for the design community.

7.1.3 Advertising and Promotions

Although Creative Cushions has started to test print advertising in local magazines, it must take advantage of local newspapers to reach the broader Vancouver market. Although magazine advertisements can have a market life ranging from several weeks to several months, it is very difficult to measure response rates and return on investment over such extended periods.

The effectiveness of newspaper advertising can be much more quickly determined. The readership of the Vancouver Sun and the Vancouver Province are 895,000 and 881,400 respectively. This is compared, for example, to an audience of only 375,000 for Vancouver Magazine. Although less targeted, local newspaper advertising should be used to boost market awareness and measure response rates from various Vancouver areas. Home Accents Today's survey responses from over 500 small and medium home accent retailers in the U.S. revealed that these firms allocated the greatest portion (28 percent) of their advertising dollars to newspaper advertising. Newspaper advertising was followed closely by direct mail (24 percent).⁸⁰ Creative Cushions should also focus on these two methods for reaching the Vancouver market.

At the same time that Creative Cushions is increasing its emphasis on the in-store channel, it should continue to pursue online activities that will contribute to improved search engine rankings and online sales. These activities should include inbound link development, ongoing additions to the website content, and the pursuit of media coverage.

Content distribution, which involves providing other websites with free content, is an effective way of generating valuable inbound links. The value of content distribution is that it can be highly targeted, can position Creative Cushions as an authority, and can pre-sell readers on the value of the linked site. Content that is developed for external distribution can also be used on the Creative Cushions website to enhance search engine relevancy.

7.1.4 Positioning Strategy

Until Creative Cushions can develop its internal competencies in the areas of product design, home decorating and home fashion, it must find other ways of accessing these skills. This is important for positioning and for enhancing market credibility. As much as possible, Creative Cushions should align itself with well-known and respected professionals in the areas of interior

⁸⁰ Kay Anderson, "Stores Optimistic for 2006: Expect Accents Role to Grow," Home Accents Today, June 2007, vol.21 no.7, pp S1-S19

design and home decorating. This must be done for the online channel and the Vancouver retail channel.

For the online channel, Creative Cushions should pursue endorsement from recognized home decorators and designers. A recommended approach is to develop a new section for the website that profiles respected designers from major urban centres across the U.S. and Canada. In return for offering publicity on the Creative Cushions website, Creative Cushions should seek relevant or supporting content contributions in the form of short articles or testimonials. Creative Cushions should also seek to align itself with other complementary niche retailers whose own successful positioning might serve to elevate that of Creative Cushions. Bain & Company, a global consulting firm, notes that through alliances a firm can enhance its competitive positioning, gain entry into new markets and supplement critical skills.⁸¹

7.1.5 Product Selection

In order to improve its product mix Creative Cushions must do considerably more research into consumer tastes and should continue to solicit feedback from home decorators in various geographical markets. Creative Cushions should also continue to import and test new product designs providing suppliers' minimum order quantities are not too high. However, in the past, Creative Cushions has bought some items with very low inventory depth and as a result depletion of stock has occurred through only a few orders. This has not enabled Creative Cushions to reorder with any degree of confidence in future demand. It is therefore recommended that Creative Cushions increase its minimum order quantity per new product to at least 50 pieces. Using its top selling products as a benchmark for product turnover, Creative Cushions should then measure the profitability per item based on product gross margin and product turnover. Products with low gross margin and a low turnover coefficient should be systematically

⁸¹ Bain & Company, "Strategic Alliances," http://www.bain.com/management_tools/tools_alliances.asp?groupCode=2 (Accessed on July 15, 2006)

eliminated from stock. Other considerations such as seasonality should also be considered in making the decision to eliminate stock.

To help reduce inventory carrying costs while Creative Cushions continues to optimize its product mix, the company should consider drop-shipping arrangements with its U.S. suppliers. Although gross margin is considerably lower for products bought from U.S. manufacturers, drop shipping is an attractive option for unique, higher-end products that cannot be easily found in other markets.

7.1.6 Local Cross-Channel Support

Creative Cushions should continue to explore its options for providing better cross-channel support for its Vancouver retail customers. This will most likely require the creation of a Canadian version of the website under the company's '.ca' domain name. Further research is required to determine the most cost effective way of integrating a Canadian site. In the meantime, Creative Cushions must find a short term solution to this problem.

7.1.7 Overcoming the Touch and Feel Barrier

Creative Cushions must continue to enhance its site features to overcome the need that many consumers have to touch and feel Creative Cushions' products. There are several ways that Creative Cushions can achieve this goal. First, product descriptions should be improved where possible to include more detail on fabrics and fabric texture. Second, Creative Cushions should pursue product reviews from satisfied customers. A website feature is already available that enables customers to upload reviews on individual product pages. However, Creative Cushions must follow-up with customers to request these reviews. Third, Creative Cushions should increase the emphasis on its 30 day returns policy. Finally, Creative Cushions should encourage customers to call its toll-free number if they have any questions regarding the quality of any of Creative Cushions' products.

7.2 Strategies for Long-Term Growth

There are several long-term growth strategies that Creative Cushions should explore. These include opening additional retail stores, developing wholesale operations and increasing custom services. Each of these should be pursued cautiously, remaining cognizant of the different competencies that each demands and of overall strategic and competitive implications.

7.2.1 Retail Expansion

Retail expansion would be the best fit based on Creative Cushions' current strategy and the competencies that it is developing. Creative Cushions must continue to develop its business as though it is planning for the launch of additional stores. As previously mentioned, this requires a focus on repeatable systems and procedures. However, further market research is required. Creative Cushions should speak with other local niche retailers to improve its ability to estimate the potential for single store sales. Assuming that Creative Cushions' current store is successful, the company should also consider the following options:

- Move from its current location into a high-traffic retail location.
- Look for a second location within the Greater Vancouver Regional District to access a larger local market.
- Open a second store in another Canadian city such as Calgary.
- Open a store in a U.S. city such as Seattle or San Francisco.

The benefits of a U.S. retail store should be carefully examined as this option has the potential to significantly reduce the cost of serving the U.S. online market.

7.2.2 Wholesale

Although the wholesale market requires different competencies, it offers the greatest growth potential. However, Creative Cushions must develop a wholesale business plan before it commits significant resources to pursuing this opportunity. Further research is required to understand the home textile wholesale distribution channel, competitive environment and key success factors. Nonetheless, short-term opportunities should be pursued providing that the

demand on resources and the distraction from retail operations can be minimized. The following are recommended steps for a low-cost, low-impact approach to pursuing wholesale opportunities.

1) Create an electronic catalog for wholesale:

To reduce the amount of correspondence required with retail customers, Creative Cushions must create an electronic catalog displaying all products available for wholesale and identifying those that are in stock and those that can be ordered or booked in advance for either the Spring or Fall seasons. Seasonal bookings would enable Creative Cushions to assemble orders that are large enough to meet suppliers' minimum order quantities thus reducing inventory carrying costs.

2) Hire a commission sales representative:

Hiring a 100 percent commission sales representative within the Vancouver market would help to introduce Creative Cushions to local gift stores, furniture stores and smaller home accent and home décor retailers. The commission sales representative would be primarily focused on securing advance bookings to ensure that suppliers' minimum order quantities are met with sufficient lead time for manufacturing and delivery.

3) Develop a wholesale website:

As an extension of the digital catalog, Creative Cushions should introduce a wholesale website. This site would be inexpensive to develop and could reside at one of Creative Cushions' related domains. The site would provide the advantage of eliminating the need to distribute updated catalogs to retail customers, could provide a secure registration and login feature to track new prospects and existing customers, and could provide a standardized online order form to eliminate errors and increase order processing efficiency.

Creative Cushions must carefully monitor the performance and profitability of its wholesale activities. Furthermore, at the point at which Creative Cushions begins ordering products from suppliers specifically for wholesale (rather than simply selling from existing

stock), the company should begin treating its wholesale operations as a separate division or profit centre. Assuming Creative Cushions sees continued growth through wholesale, it may be advisable to make an important strategic decision; either spin off the wholesale operations into a separate entity enabling the retail division to continue to develop as a focused differentiator, or wind down the retail division to focus solely on wholesale and on developing the competencies required to pursue a cost-based strategy.

7.2.3 Custom Services

Just as Creative Cushions must carefully manage the costs and risk of distraction in pursuing the wholesale market, it must also take care in its approach to introducing custom services. In the short term, Creative Cushions must identify ways of offering value added services that do not involve significant increases in costs or require additional staff. Although Creative Cushions has already found that there is high demand for custom sewn pillows, order values are too small to justify these kinds of projects. Creative Cushions should instead identify two or three independent seamstresses to whom it can refer small custom orders for a percentage.

Creative Cushions has also been receiving numerous requests from advertising and promotional agencies for custom embroidered pillows. These requests have ranged in size from 200 pillows to 4000 pillows. Although Creative Cushions has aligned itself with a local sewing factory and embroidery shop, the company has not been able to fulfill these orders due to insufficient lead time for production. To develop this opportunity, Creative Cushions should proactively market the service and provide prospective customers with detailed requirements and options. By specifying minimum order quantity, lead time, color and fabric choices, Creative Cushions can easily coordinate production. As the volume of these orders increases, Creative Cushions may also be able to request that its supplier maintain an inventory of ready made product for shipping on demand.

7.3 Strategies for Increasing Competitiveness

As a specialty retailer, Creative Cushions can develop competitive advantages through product focus as well as through distribution channel focus. However, Creative Cushions must ensure that it continues to build competitive advantage in at least one of these areas of focus if not both. As previously noted, Creative Cushions is tempted to expand its product mix to include complementary products such as curtains. At the same time, the company is looking at wholesale and custom services as part of its long-term growth strategy. Attempting both of these would greatly increase the risk that Creative Cushions is unable to develop any sustainable competitive advantage as its strategy would become overly diluted and unfocused.

Given the highly competitive retail industry, it would be a much greater challenge for Creative Cushions to attempt to develop competitive advantage through retail distribution strategy alone. Creative Cushions should therefore maintain its focus on the decorative pillow product category and focus on building competitive advantage through superior product knowledge and through expertise in marketing and distribution of this single product category. Creative Cushions should continue to identify opportunities for growth through wholesale and other channel strategies. In addition to developing its competencies in sourcing and supply, product design and distribution, Creative Cushions should concentrate on building an innovative and flexible organization that can continue to be strategically opportunistic.

7.4 Review for Strategic Fit

As a focused differentiator, Creative Cushions must continually strive to add value and to enhance customer service. Value for the customer can be increased through all processes in the firm value chain. Creative Cushions must therefore look closely at all its activities to try to identify ways that it can enhance the customer experience as cost effectively as possible. For example, by extracting more value from its suppliers beyond the cost of the product, Creative

Cushions can in turn provide more value to its customers. This may be through product photography, textile and manufacturing information, or detailed product descriptions. As Creative Cushions approaches the end of its first year of operation, it should plan to review all its activities and the degree to which it is staying true to its strategy. Where necessary, adjustments should be made to ensure continued strategic fit.

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