

Running Head: HEAD, N.V.

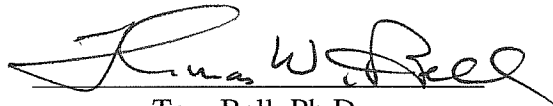
An Analysis of the Sports Equipment Industry and One of Its Leading Companies, Head,  
N.V.

Priit Pihl

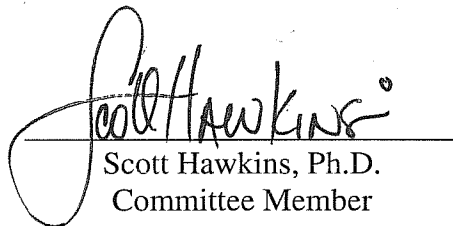
A Senior Thesis submitted in partial fulfillment  
of the requirements for graduation  
in the Honors Program  
Liberty University  
Spring 2006

Acceptance of Senior Honors Thesis

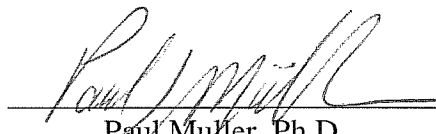
This Senior Honors Thesis is accepted in partial fulfillment of the requirements for graduation from the Honors Program of Liberty University.



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April 24, 2006  
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## Abstract

Sports equipment manufacturing is an estimated \$13.5 billion industry that is continually growing worldwide. Head, N.V. (N.V. stands for Naamloze Vennootschap which is the Dutch terminology for a public limited liability corporation) is one of the leading manufacturers and marketers in the sports equipment industry focused on developing and producing innovative, high quality and technologically advanced Alpine skiing and snowboarding equipment, racquet sports equipment and diving equipment.

The following thesis will provide an analysis of the sports equipment industry, including a competition analysis, and a discussion of the driving economic forces and key success factors in the industry. This is followed by a company analysis on Head, N.V. (from here on Head) including an evaluation of its current business strategies and a SWOT (strengths, weaknesses, opportunities, threats) analysis. In the final section, some strategic and managerial recommendations will be offered for Head's future success.

An Analysis of the Sports Equipment Industry and One of Its Leading Companies, Head,  
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*Sports Equipment Industry Situation Analysis*

This section analyzes the current situation in the sports equipment industry including areas such as dominant economic characteristics of the industry environment, competition analysis, driving forces and key success factors in the industry, and overall attractiveness/unattractiveness of the industry.

*Dominant economic characteristics of the industry environment.* The demand for sporting and athletic equipment in the United States has increased at a rate significantly higher than inflation. In 2002, the US market size of the sports equipment industry was \$11.86 billion, and it was estimated to reach \$13.5 billion in 2004 which marked a 13.8% market growth rate (Economic Census, 2002; U.S. Industry & Trade Outlook, 2000).

The scope of competition in the sports equipment industry is global; and global competitiveness, especially in the manufacturing process, is something that the US sports equipment industry has focused upon (U.S. Industry & Trade Outlook, 2000). The top ten producers in the sports equipment industry are Brunswick Corp.; K2, Inc.; Callaway Golf Co.; Oakley, Inc.; Nautilus, Inc.; Head, N.V.; Johnson Outdoors, Inc.; Escalade, Inc.; Cybex International Inc.; and Aldila Inc. (Yahoo! Finance, 2005). It should be noted that according to the U.S. Industry & Trade Outlook (2000), the sports equipment industry includes manufacturers of “equipment for golf, fishing, tennis, physical fitness, gymnastics, archery, bowling, billiards, winter sports, and team sports; [however, this industry does not include manufacturers of] camping equipment, athletic apparel and footwear, hunting equipment, or most leisure-related vehicles, such as boats, bicycles,

motorcycles, and snowmobiles” (p. 39-4). That is why giant athletic apparel and footwear producers such as Nike, Inc., Adidas-Salomon AG, and Reebok International Ltd. are neither considered sports equipment manufacturers, nor rivals in the sports equipment industry. It should also be noted that there are organizations that manufacture athletic apparel, footwear, and sports equipment which are not classified in the sports equipment industry because the companies’ primary revenue is generated via other product lines.

As consumers look for opportunities to buy quality products at cheaper prices, manufacturers look for ways to satisfy those needs where innovation plays an important role in their. The two most efficient ways that sports equipment manufacturers use to reduce costs, maximize profits and reach a larger target audience are through e-commerce and forming partnerships with retailers (U.S. Industry & Trade Outlook, 2000).

Innovative ideas help companies differentiate their products to gain a competitive advantage over other companies in a market where products tend to be similar. In the sports equipment market, these differences are most evident in new technologies used to manufacture cutting edge products. For example, in 2004, Head launched innovative concepts in most of its manufacturing divisions. Their skis now have “an integrated all-round ski binding system;” skiboats now feature a *full custom system* which is “an internal wedge that enables the internal shape of the boot to be adapted to the individual foot;” racquets now contain “the first-ever Electronic Dampening System” which specifically addresses players with tennis elbow; and they came out with the most sophisticated diver’s watch in the world (Head Annual Report, 2004, p. 4).

The sports equipment industry has been characterized by mixed marketing

integration. The internet has been used to sell and advertise products, and create retail stores by forming partnerships with professional retailers. Backward integration also occurs when companies have acquired key suppliers and service providers.

*Competition analysis.* Competition between the sports equipment manufacturers is moderate to high. Competition among sellers to gain market share exists in the areas such as new technologies, product performance, price and service, design, and strategic alliances, etc.; however there are untapped markets making it worthwhile for current and potential new companies to enter the sports equipment business.

The percentage of overall expenses that sports equipment manufacturers spend on research and development is generally smaller than in some other industries. For example, in 2004 Head reported \$457.7 million in operating expenses and only \$15.5 million (3.8%) on research and development (R & D). In the same year, Electronic Arts, Inc., a leading producer of interactive software games, reported \$518.9 million expenditure on R & D which was almost half (48%) of its \$1.08 billion operating expenses (Head Annual Report, 2004; EA Annual Report, 2004).

Purchase price is a significant factor which affects the consumers, thereby creating a natural competition between manufacturers. Similar to most of the US products, sports equipment produced in the US is well known and respected for its quality and service throughout the world. Because of higher labor costs in the US, and the high dollar value, it is more expensive to produce sports equipment here than in Asia or Latin America. Many US manufacturers have taken advantage of the lower international wage rates in Asia and Latin America by opening production facilities in these foreign lands. This practice has helped manufacturers maximize their

competitiveness in a difficult US market. In addition, in most countries outside Europe, US companies have had to fight against unfavorable currency exchange rates by trying to sell most of their products outside the US in foreign markets (U.S. Industry & Trade Outlook, 2000).

As previously mentioned, there have been two popular ways to reduce production costs and stay price competitive: through e-commerce and through the formation of partnerships with retailers. The internet has become an integral part of the distribution process in sports equipment manufacturing. This is true not only in terms of business-to-consumer transactions, but also in business-to-business operations. Sports equipment manufacturers have partnered-up with specialized retailers to reduce the dominance of large chain stores over smaller sports equipment manufacturers in terms of price and product offerings (U.S. Industry & Trade Outlook, 2000).

The threat or power of potential entrants in the sports equipment industry is weak to moderate. Competitive barriers to companies trying to enter the market include economic, technological, and regulatory obstacles; even though they are not as rigid as in other industries. Perhaps one of the most difficult obstacles to overcome when entering sports equipment market is the consumers' loyalty for existing brands. New companies to the market have the daunting task to change consumers' current buying habits and break their commitment to existing brands.

Finding the right balance between quality and price is a key to success for companies trying to introduce new products to the market. If new products are priced too low with a goal of quickly gaining a large market share, consumers might get the perception that the products are of low quality; and when they are priced too high, people

will most likely retain their currently preferred products.

Companies trying to enter the sports equipment market have to spend more on research and development and marketing than existing companies in order to survive and be successful in the competition for the market share and consumer base. Many companies in the industry remain profitable, especially the larger ones, but there are many others chasing a revenue pool that is not expanding quickly enough to support them all (Hoover's Inc., 2001).

There are at least three challenges for sports equipment manufacturers in terms of competition from substitutes. Firstly, companies face direct competition from other companies producing the same type of products. For example, Head has to compete with other tennis racquet manufacturers on the market such as Prince Sports, Inc.; Wilson Sporting Goods Co.; and Babolat, Inc. Secondly, companies have to deal with competition from producers of other sports equipment within the industry. For example, Head tennis racquets have to compete with Callaway golf clubs, Easton baseball bats, and Nautilus fitness equipment for consumers trying to decide which sport to choose. Thirdly, the sports equipment industry also faces indirect competition from other industries. For example, consumers who are trying to decide whether to use their free time to play tennis, watch a movie, go to a concert, play video games, or be involved in other types of entertainment bring along a whole different set of competitors for a sports equipment manufacturer such as Head (Shank, 2004).

The power of suppliers in the sports equipment industry is weak to moderate. A supplier's leverage in the market increases when a specific product offers a unique feature or technology. In this industry most sports equipment suppliers have weak to



moderate influence because of supplier-seller collaboration that discourages any single retailer's distribution of a product (Armstrong & Kotler, 2005).

However, the power of buyers in the sports equipment industry is strong. In the current competitive environment, customer satisfaction has become a crucial factor in shaping companies' business strategies. Companies have to build and maintain long lasting and effective relationships with consumers in order to remain competitive in the market. If a company wants to be successful, customers have to be on the top of its priority list (Armstrong & Kotler, 2005).

*Driving forces.* Being globally competitive is one of the driving forces in the sports equipment industry today. Being able to distribute products globally is the vehicle of growth in the industry. As previously mentioned, global competitiveness is what drives the US sports equipment industry; especially in the manufacturing component of the business (U.S. Industry & Trade Outlook, 2000). Companies try to take the manufacturing process of their products to the parts of world where wages and other production costs are lower. For example, according to U.S. Industry & Trade Outlook (2000), many US sports equipment manufacturers have production facilities in Asia and/or South America where wage rates are considerably lower than in the US.

Innovation through R & D is another important driving force in the sports equipment industry. Without sufficient research and development it is impossible for a company to remain competitive. The amount of money spent on R & D is closely connected to a company's ability to remain innovative and bring new products into the market. Innovative products are the way a company can differentiate itself and win clientele from its competitors. Even though much lower than some other industries, sums

spent on R & D in the sports equipment industry have been constantly rising. For example, R & D expenses for Head for the years 2002, 2003, and 2003 were \$11.0 million, \$13.6 million, and \$15.5 million, respectively (Head Annual Report, 2004).

Electronic commerce has become a driving force in the sports equipment industry. As previously mentioned, the internet has become critical in the distribution of sports equipment, but its importance is also evident in several other aspects of the business. Most, if not all, sporting equipment companies have comprehensive web sites where users can access a plethora of information about a company, and purchase its products. For example, visitors of the Head company web site can read the latest company related news, learn about the history of Head, access the company's financial information, get to know Head's management team, locate Head dealers and offices around the world, see a list of job openings and apply for them, and, of course, access thorough information about all of Head's products including warranty information. If the consumers wish, they can buy these products online, at their convenience. Having an effective website is crucial for reaching a quickly growing number of internet users. According to the latest statistics, 1.02 billion or 15% of the world's population have regular internet access (Internet World Stats, 2005). In the United States, where the internet usage is the highest in the world, currently already 68.1% (204 million people) of the whole population of 300 million people use internet on a regular basis (Internet World Stats, 2005). In addition to increasing internet usage, more and more people like to buy merchandise such as sports equipment online, where they can easily compare different products and prices, and shop at their leisure in the comfort of their home or office.

Business-to-business e-commerce is another area that has become increasingly

important for sports equipment manufacturers. Many transactions between suppliers, manufacturers, distributors, and dealers are now completed online. Doing business through the internet is much less time consuming and more efficient than traditional ways because companies are able to complete more transactions in a shorter time period. Business-to-business e-commerce also significantly reduces administrative costs and processing, which benefit both parties in a transaction (U.S. Industry & Trade Outlook, 2000).

*Key success factors.* There are several important factors for companies trying to be successful in the sports equipment industry. One of most important is in the area of personnel. Like any other industry, skill and experience in the field of producing sports equipment, with a strong strategic business plan, can be highly beneficial. Skilled and experienced workers and management usually guarantee that a company uses its resources wisely and is run efficiently. Therefore, it is important for companies to be built on intelligent and dependable people in order to stay competitive in this business (Hess & Siciliano, 1996).

Having an effective management team is another factor that has proven to be critical for successful sports equipment manufacturers. These teams have proven to keep a company's costs down. Having a well-balanced budget, controlled expenditures, and running low cost operations are extremely important for a company in maximizing its profits. As previously discussed, moving a manufacturer's operations to areas of the world where labor rates are the low and political conditions most supportive, choosing the most efficient distribution network by working together with retailers, and using the internet in its operations to keep administrative costs down, are three of the most basic

ways to lower operational costs for a sports equipment manufacturer. For example, Head has production facilities and regional offices in Austria, Canada, Switzerland, Denmark, Germany, Spain, France, Great Britain, Italy, Czech Republic, Japan, China, and the United States, sells its products directly to retailers eliminating intermediate distributors in order to maximize its profits, and runs an effective web site to support its business (Head Corporate, 2005; Head Annual Report, 2004).

It should be mentioned that while in some of those countries listed above wage rates are not considered low, other factors such as workers expertise, political and economic conditions and regulations in a country, as well as distribution expenses, have to be carefully calculated in order to decide where to place a company's manufacturing plants. Overall, it is probably more useful for Head to produce its winter sports equipment in Austria, than, for example, in China. In contrast, in April, 2005, mainly because of lower wage rates and more easily transferable production know-how, Head decided to move 90% of its tennis racquet production from its European sites in Austria and Czech Republic to China (Head Corporate, 2005).

Having sufficient expertise in a company also leads to technological and product innovation, which is another key success factor in the sports equipment industry. Manufacturers of sports equipment have to be able to constantly come up with new technology and improve their products in order to continually satisfy consumer's demand, keep up with the competition, and differentiate itself in a market with similar products. Again, in order to innovate, companies have to be willing to budget enough money in research and development, which should be an important calculated expense for every sports manufacturer who wants to be successful.

Building an effective distribution network is another key factor in the success of sports equipment manufacturers. Companies have to decide whether to sell their products to distributors and wholesalers who then forward them to retailers, sell them straight to retailers, or run their own specialty stores. Which ever way a company chooses, the decision should be based on what benefits the company and consumers most. A company should evaluate each market it operates separately, and choose the best distribution network for that market. Selling to distributors might not seem like the best option because distributor mark-ups drive up the price of products to the consumers. However, in a market where there are no large and powerful retailers, rather there are many different medium to small sized retailers, dealing with fewer distributors instead of several independent retailers can potentially save a lot of time and money for a manufacturer. Selling directly to retailers may be the best option for most sports equipment companies in markets where large chain stores have acquired smaller retailers and have gained substantial influence over manufacturers in terms of distribution price and which products are distributed (US Trade Outlook, 2000).

In order to further improve this type of distribution networking, many manufacturers have formed close relationships with retailers through special partnerships (US Trade Outlook, 2000). Leaving retailers out of the equation, and selling products directly to consumers might seem like an attractive option for a manufacturer because it allows the company to use retailer' mark-ups as leverage to get more cash out of its products; but it also poses some difficulties. First, a company would have to build specialty stores, hire and train professional sales force, etc., all of which create extra expenses. In addition, it would have to compete with retailers for consumers, which is

difficult to do in the markets controlled by large chain stores. Usually there is no one single distribution pipeline that a company uses. Most sports equipment manufacturers use a combination of two or more different ways to get their products to consumers. For example, Head sells most of its products directly to retailers, but also, to a lesser extent, uses distributors to get its products to “pro shops, specialty sporting goods stores, and mass merchants in over 80 countries around the world” (Head Annual Report, 2004, p. 5)

The ability to analyze and predict demographic and macroeconomical trends, and consumer preferences are yet other factors contributing to the success of sports equipment manufacturers. Companies need to be aware of changes within society in order to adjust their operations, product lines, and pricing accordingly. The demographic trends which currently effect the US sports equipment market include the aging of the baby boomers generation and their offspring, the growing importance of female spending power and increasing female sports participation, growing ethnic populations, and an increasing number of different leisure activities for youth (U.S. Industry & Trade Outlook, 2000). US companies also have to consider macroeconomic trends such as availability of disposable income and changes in consumers’ preferences that shape sports equipment consumption in the country (U.S. Industry & Trade Outlook, 2000).

Finally, building a good reputation and brand loyalty through excellent customer relations is extremely important for success in the sports equipment industry. A good reputation is important in order to be recognized and develop a sense of respect in the market place. This, in return, will increase a company’s customer base resulting in more income. In the sports equipment market where there are many competitors, providing excellent customer satisfaction is one way a company can differentiate itself from the

competition, getting an edge for continued success. Providing customer satisfaction means, in general, taking good care of one's customers. One way a sports equipment manufacturer can do that, is through providing warranties for defective products. For example, Head has a special Customer Service/Warranty section on its webpage, which includes information about defective products, warranty procedures, and warranty periods, which for Head products is two years (Head Corporate, 2005).

*Overall attractiveness/unattractiveness of the industry.* Factors that make the sports equipment industry attractive include a large profit potential, industry growth potential, increasing global demand, relatively low entry cost, and low risk of failure experienced by the established companies that dominate the market. There is a significant profit potential for companies in the sports equipment industry. In order to realize that potential, companies have to fulfill most if not all of the key success factors discussed previously. There is also a huge growth potential within the whole industry. The economic strengthening of the huge Asian market makes the industry more attractive and poses a serious potential for its further expansion. The latter is supported by increasing global demand. Although the sports equipment industry has faced some challenges recently, the demand for sports equipment in terms of value has been on a slow but steady rise, which adds to the overall attractiveness of the industry (Economy.com, 2004).

Relatively low cost of entry is another factor making the sports equipment industry attractive to entrepreneurs. Because of the low research and development costs the initial investment for start-ups are much more affordable than in some other industries. Finally, contributing to the attractiveness of the sports equipment industry is

its relatively low risk of failure. It is normal that, like in any other industry, sports equipment manufacturers face their share of challenges and difficulties; but overall, as long as people play sports, there will be a market for sports equipment; and that is not likely to change any time soon.

Factors that deter investors in the sports equipment industry include customer brand loyalty, potential lawsuits, and the seasonal nature of the industry. The sports equipment industry is characterized by high brand recognition and loyalty. Buyers of sports equipment often choose a product by brand instead of price or performance. In addition, consumers tend to develop their brand preferences and stick with them for extended periods of time. It is not easy for new brand names to change those preferences and win over consumers. Most sports equipment categories on the market have a very limited number of brand names that control the market share, which dissuades investors (Economy.com, 2000).

Manufacturers of sports equipment cannot forget about the safety of their products to the consumers. Companies can face serious lawsuits from injuries caused by defective sports equipment. This is especially true in the United States, where lawsuits are a common recourse for consumers. Due to potential litigation many who would aspire to produce and sell sports equipment might withdraw and invest elsewhere.

Another factor contributing to the overall unattractiveness of the sports equipment industry is its seasonal nature. Few sports are played year round. Most are played during specific seasons, during which sales of equipment are naturally higher than the off-season. R & D becomes a priority during times of low sales volume. Other activities that flourish during the off-season include re-evaluating a company's financial situation,



business strategies, etc. The fluxuating seasonal income generation is another factor that causes many to seek other areas to invest their money (compared to evenly distributed revenue accrual).

### *Company Situation Analysis*

This section focuses on one of the leading companies in the sports equipment industry, Head, N.V. It provides an evaluation of Head's current business strategies and an analysis of the company's strengths and resource capabilities, weaknesses and resource deficiencies, market opportunities, and threats to future profitability.

*Evaluation of the current strategy.* Head's business strategy, according to its website, is:

To expand sales through global sales, marketing and distribution network, rapidly develop and launch new and exciting products; continue to focus on keeping our cost base optimized, develop licensing opportunities for our brand in non core areas like sports apparel, and to pursue a focused acquisition program.

(Head.com, 2005, ¶ 6)

In order to fulfill that strategy Head manufactures and sells "highly innovative and technology driven [products positioned at] "middle to high price points" (Head Annual Report, 2004, pp. 1 & 7) that serve a motto "Superior Performance Through Superior Technology" (Head Corporate, 2005, ¶ 1). Head's managers believe this strategy will be financially successful and helps the company gain market share (Head Corporate, 2005). With its products ranging from winter sports equipment to racquet sports and diving equipment, Head targets an audience of "sports enthusiasts of varying levels of ability

and interest ranging from the novice to the professional athlete” (Head Annual Report, 2004, p. 5).

In order to grow and remain competitive in the market, Head has used brand creation, strategic acquisitions, and licensing transactions. Founded in 1950, the company concentrates its efforts on producing tennis, squash and racquetball racquets, alpine skis, bindings and ski boots, snowboarding boards, bindings and boots, and accessories and apparel. The company’s first acquisition was Tyrolia, the world’s number one producer of alpine ski bindings. In 1997, Head acquired Mares, one of the leading producers of diving equipment. In 1998, Dacor, an US based producer of scuba diving equipment, was purchased. Head’s latest acquisition was in 1999 when Penn, the top producer of tennis balls in the United States, and the number one selling racquetball ball in the world became an acquisition (Head Corporate, 2005; Head Annual Report, 2004).

Licensing out its brand name has become an important part of Head’s business strategy. Through its licensees, Head has brought to the market a wide range of product lines such as ski, snowboard, tennis, golf, and outdoor apparel, and casual wear as well as swim- and beachwear, underwear, socks, footwear including a wide range of sport and lifestyle shoes, a wide assortment of ski, casual, dress, and sport gloves for men, ladies, and children, headwear and accessories including caps, hats, and accessories like wallets, wristbands, etc., eyewear, watches including a unique range of 10 ATM / 20 ATM water-resistant watches, toiletries including soaps, perfumes, creams, shampoos, etc., bags including backpacks, monopacks, gymbags, holdalls, wheeled luggage and travel luggage, bicycles including off road bikes, road bikes, city bikes and bikes for fun and

extreme, golf equipment, including golf clubs, balls, bags, and covers, gloves, and accessories, skates including ice, inline, and roller skates, and balls including footballs, golf balls, and tennis balls (Head Corporate, 2005).

Table 1 highlights some of the key financial performance figures for Head over the last five reported fiscal years, retrieved from Head Annual Report (2004, pp. 2 & 9). Quantitatively, even though the total revenue for Head has been increasing, the company has experienced a total net loss in the last three reported fiscal years. The total revenue from sales and licensing for the last reported fiscal year, 2004, was \$477.8 up from \$431.2 million in 2003 and \$387.5 million in 2002. The increase is partially the result of continued strength of the euro and other currencies against the US dollar (Head Annual Report, 2004). However, the primary reason for net losses have been the high net interest and income tax expenses after operating income, which the corporation has had to pay. Head accounted a net loss of \$36.9 million in 2004, which is a dramatic increase from the net loss of \$14.7 million in 2003 and \$2.6 million in 2002. The last year Head realized a positive net income, was 2001 with \$9.4 million. According to John Eliasch, Chairman and Chief Executive Officer of Head, the reasons for this downturn have been the ongoing challenging conditions on the sports equipment market, such as the constrained demand for sports equipment in many categories and geographic regions, increasing raw material prices, and continuing pricing pressures (Head Annual Report, 2004). However, other companies with multiple product lines similar to Head, such as Amer Sports Corp., Volkl, and Fischer, have managed to deal with those conditions more efficiently than Head as they have been able to realize a positive net income in the recent years (Yahoo! Finance, 2005).

Table 1

*Financial Highlights*

US\$ millions (except margin data)	2004	2003	2002	2001	2000
Total revenues	477.8	431.2	387.5	392.0	398.6
Total net revenues	467.0	422.3	380.0	384.8	390.7
Cost of sales	294.3	266.0	233.5	234.0	227.4
Gross profit	172.7	156.3	146.5	150.8	163.3
Margin	37.0%	37.0%	38.6%	39.2%	41.8%
Selling & marketing expense	118.5	108.2	95.1	94.9	89.8
General & administration expense	42.4	39.5	34.2	36.9	36.1
Gain on sale of property	-5.7	-	-0.4	-0.9	-1.2
Restructuring costs	2.3	8.4	-	0.8	-
Operating income	15.0	0.2	17.8	19.1	38.6
Margin	3.2%	0.1%	4.7%	5.0%	9.9%
Net interest expense	-23.6	-12.9	-10.7	-10.4	-17.5
Foreign exchange gain/loss	-0.6	-1.1	-7.4	5.8	7.5
Income tax expense	-27.7	-0.8	-2.6	-4.0	1.9
Extraordinary gain	-	-	-	-	2.1
Net income/loss	-36.9	-14.7	-2.6	9.4	27.8

Europe continued to be Head's biggest market in 2004 with \$292.2 million sales and licensing revenue, which was 62% of its total revenues. It was followed by North America at \$124.2 million (26%), and the rest of the world at \$57.3 million (12%).

By division, winter sports equipment sales have been the most successful for Head with \$223.2 million sales revenue (47% of total revenues). The second greatest area of revenue generation was the racquet sports division with \$168.0 million (35%). Revenues from Head's diving division were \$75.5 million (16%). And finally, Head's licensing agreements brought in \$11.1 million in 2004, accounting for 2% of the total revenue.

*Strengths, Weaknesses, Opportunities, Threats (SWOT) analysis.* Head's strengths and resource capabilities include its strong brand name, high quality and technologically advanced products, successful acquisition program, and excellent innovations. These have all been historically among Head's top priorities and objectives, and the company has done a good job in maintaining those qualities.

Company's weaknesses and resource deficiencies are obviously rooted in its recent inability to produce income. Understandably, some of the reasons behind this slump have not been under the control of Head. However, the company needs to do a better job in keeping its costs down and face the challenges imposed by the current market situation. Fortunately, as do all sports equipment manufacturers, Head implemented strategic plans to enhance profits when they stated:

In order to expand market share and maximize profitability, we have increased our emphasis on marketing and new product development, leveraging further our brands, global distribution network and traditional strength in manufacturing, and

we have initiated a program to reduce our fixed costs and streamline our organizational structure. (Head Annual Report, 2004, p. 5)

Head's market opportunities include continuing globalization, and further improvements in its product innovations, acquisition and licensing programs. Although, according to its corporate website, Head products are currently sold "through over 31,000 accounts in over 80 countries around the world" (Head Annual Report, 2005, p. 1), in 2004, only 12% of the company's total revenues came from sales outside Europe and North America. Yet Head believes that the untapped market in Asia, with its 3.67 billion people provides a huge opportunity in the sports equipment market. Winter sports have not been popular recreational outlets; however, Head's other products, i.e. tennis racquets, etc. may prove to be viable alternatives that could catapult Head as the world leader in sports equipment manufacturing and dramatically improve its profits.

Keeping up and further improving the current pace of technological innovations is also an opportunity for Head to continue to differentiate and distance itself from competitors, gain market share, and increase profitability. In recent years Head has continually launched innovative concepts in almost all of its manufacturing divisions, which is a trend they need to carry into the future.

Continuing to successfully acquire and license products also present another marketing opportunity for Head. Both of those strategies allow the company to expand into new areas in the sports equipment manufacturing and also to venture into other areas not normally associated with the industry; which means reaching a different and larger audience, resulting in larger revenue generation.

The threats to Head's future profitability, besides competitors, include the continuing challenges faced by the sports equipment industry, i.e., constrained demand in many categories and geographic regions, increasing raw material prices, and continued pricing pressures (Head Annual Report, 2004). According to Head's management discussion in its 2004 Annual Report, operating globally in a multi-currency environment always poses a risk for the company in terms of currency translation, and to some extent, currency transaction, mainly between the US dollar and euro. Currency translation risk originates in the difference between the actual currency used in the transaction and the financial reporting currency. For example, Head's functional currency in its European operations is the euro, but its reporting currency is the US dollar, which means that all of the financial information of Head and its subsidiaries' European operations need to be translated into US dollars. The fluctuations between these two currencies have a significant impact on the company's financial condition and results of operations (Head Annual Report, 2004). Currency transaction risk occurs whenever a company does business using a different currency from its functional currency. However, by matching its revenues and costs, as well as assets and liabilities in each currency, Head has been able to significantly reduce this risk (Head Annual Report, 2004).

Unfavorable macroeconomic and demographic trends and even weather conditions also pose a threat to Head as a sports equipment manufacturer. An example of an unfavorable macroeconomic trend would be changes in consumer preferences, which has led to a surplus of unwanted products (U.S. Industry and Trade Outlook, 2000). Unfavorable demographic trends to Head include the aging of the baby boomers

generation in the United States, and the growing number of alternative recreational opportunities among teenagers.

According to the U.S. Industry and Trade Outlook (2000), baby boomers, who now have reached their fifties, lack the energy they once had, and as a result have moved from equipment-intensive sports and activities to non-equipment intensive. Baby boomers are a large purchasing force and the aforementioned trend has had a negative effect on sports equipment manufacturers, such as Head (U.S. Industry & Trade Outlook, 2000).

A growing number of activities among today's youth also poses a challenge to a sporting good company like Head. The emergence of internet and computer age has kept many children away from playing sports; and as the US Industry Outlook (2000) pointedly mentioned, sports equipment companies "face the challenge of getting children off the sofa and away from the internet and persuading them to participate in sport activities" (p. 39-5).

Unfavorable weather conditions can also become a threat to Head's market success. If people cannot play sports due to bad weather, they are not going to buy as much equipment. For example, in 2004, Head experienced some setbacks in the snowboard market due to the late snow and start of the winter sports season; and in the European tennis market, due to the bad weather conditions during the summer months tennis equipment sales dropped (Head Annual Report, 2004).

### *Recommendations*

This section briefly discusses some key business strategic and internal managerial recommendations that could help Head overcome its recent hold back in profits as well as



benefit the company in the future in successfully operating in the sports equipment market.

*Strategic recommendations.* It will be critical for Head to maintain its successful acquisition and licensing operations and product innovation process. Expanding into new areas of manufacturing and maintaining a reputation of being “a technology driven company” [and] “a leading global manufacturer and marketer of premium sports equipment” (Head Corporate, 2005, ¶ 1), demands that Head continually looks for acquisition options, re-visit its licensing contracts, and invest in the research and development process.

Continuing global expansion is another area that can greatly support Head’s growth in the market. The company’s restructuring process in which different parts of Head’s operations are moved to locations where they can be run most efficiently is definitely a step in the right direction. Increasing its sales outside Europe and North America can also prove highly beneficial for Head. This can be done by mainly taking an advantage of the huge potential of the Asian market.

An important improvement that can help Head cut down its losses is taking further measures to lower its operational cost. The company has been working with a net loss for the past three reported fiscal years: even though sales revenue has gone up, so have the operational expenses. Maximizing profits alone is not effective without minimizing expenses. Even though the industry conditions have not been supportive for Head over the last couple of years, it will be critical for the company to keep looking for ways to lower its expenditures without losing its production capacity. As previously mentioned, Head has started a restructuring process to reduce their fixed costs and

streamline their organizational structure, which is a step in the right direction.

Continually improving customer relations is another strategic recommendation for Head. Customer satisfaction should be high on the priority list for any company. Having an effective warranty program is one way to maintain strong customer relations. For example, one of Head's top competitors in the area of racquet sports equipment production, Prince Sports, Inc., guarantees that its "racquet frames are free from defects in materials and workmanship under normal use, for a period of one year from the date of purchase" (Prince Tennis, 2006, ¶ 1). However, if any frame is found defective, "Prince will repair or replace at its discretion, provided it is returned through an authorized dealer (with proof of purchase) at the purchaser's cost to the Prince Service Center within the warranty period" (Prince Tennis, 2006, ¶ 1).

*Managerial recommendations.* Like in any other business, in order to be able to compete successfully in the sports equipment industry it is crucial for Head to put together and maintain a talented and capable management team. Attracting successful managers from outside the company is critical for bringing new ideas and strategies to the table. However, it is also essential for Head to find people who already work within the company with the skills and abilities to fill key strategic jobs and give their current employees incentives to work hard. As a result, it would be valuable for Head to always be searching for individuals, inside and outside the organization, with the proper background, experiences, management styles, and personalities that will lead the company successfully into the future.

This is true not only for the management team, but also for all of the Head's employees. Employees are a company's most important asset. Thus, the hiring process

demands much effort and attention. A way of doing this is to put applicants through an extensive screening and evaluation process and then selecting those applicants with the proper attitudes, skills, personality, and initiative to work well in Head's work environment and culture (Nelson, 2003). Once the employees have been selected and hired, the company can get the most out of them by investing in their workers. This can be done by putting them through an extensive training program, similar to the program at Amer Sports Corp., another top rival of Head, through which its employees are trained and encouraged to become "strong both as individuals and as team members; strive to create a good working atmosphere characterized by passion, determination to win and quality work; and discuss matters openly and to develop their working practices continuously" (Amer Sports, 2006). Head can also benefit from keeping its employees motivated by giving them challenging and exciting assignments. It can be useful for the company to encourage its employees to be innovative and creative, thus finding better ways to do their job and create better products. This can be accomplished by holding regular sessions with managers and selected employees for idea generation and sharing. To further motivate the employees an attractive incentive package could be offered for worthy employees (Hess & Siciliano, 1996).

Finally, it is strongly recommended that Head would keep up with the high ethical standards within the company's internal culture, and in their business transactions. For that purpose, Head has set up a Code of Conduct for its employees, a document that all of the company's employees must adhere to.

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