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¹ <http://www.hottopic.com/store/product.asp?LS=0&ITEM=230230&RN=292>

Hot Topic, Inc. has had unprecedented growth since its humble beginnings back in 1989, when Orv Madden, inspired by MTV, decided to exploit the connection between music and fashion. The company derives its strength from a small but loyal customer base, strong relationships with suppliers, and a unique sense of style not found anywhere else in the mall. As with any profitable enterprise, Hot Topic must guard against potential competitors while still maintaining its place in the market. This paper is intended to establish how the company can accomplish this goal.

STRATEGIC POSITIONING

In order for a company to stay ahead of its competitors it must develop a strategy that cannot be imitated. This is done by incorporating a set of activities that work together to further this strategy. For another company to enter successfully, it must copy all elements of the strategy which can be complicated if the activities as a set cannot be duplicated. Hot Topic's strategy is a complete effort to really listen to its customers. Everything it does to improve is based on consumer input.

Activities that Strengthen Operational Fitness

The most obvious example of this is the fact that the CEO reads extensive customer "report cards" from the stores. In addition, Hot Topic's website offers a "community" link which allows for feedback on all kinds of issues as well as discussion forums. A close customer-employee-management relationship is also emphasized to speed up the chain of communication. Its business strategy includes hiring managers and employees who know this niche well and allowing them the freedom to create the business. Hot Topic allows them to bring in small, quality, unique retailers that are trying to sell somewhere without sufficient retail space and offer them a better distribution

channel and in return many of them offer exclusiveness to Hot Topic¹. This allows Hot Topic to continuously find and bring in undiscovered products that fit in with the store's culture.

Another way they listen to customers is by testing their reaction to the product line. Being in the teen fashion industry, Hot Topic is well aware how fast trends come and go as well as the necessity of staying ahead of them. The company does this in several ways. Employees, whose average age is 17, are encouraged to attend concerts and clubs and are reimbursed for their expenses when they write a report on what they see people wearing². They especially watch to see what bands wear at concerts and on music videos because 50% of their apparel is inspired by artists' fashion³. Ideas are also taken from customer input and suggestions. To prove the extent to which Hot Topic takes the input seriously, the company opened a new concept store called Torrid for overweight girls just 18 months after it started offering larger sizes in a limited number of styles, and was told by customers that they would like their own store⁴. By serving this niche, Hot Topic obtains another advantage over competitors, who routinely overlook this growing and underserved market. While watching for trends, Hot Topic also keeps track of how customers respond to the products. Over 75% of new merchandise is tested before expanding the line completely which reduces markdowns and raises profit margins. In addition, there is a quick test and reorder system of six weeks compared to

¹ Information provided by the manager at Hot Topic at Barton Creek Mall, Austin, TX

² Pfaff, Kimberly. Edgy Hot Topic on a Hot Streak. *International Council of Shopping Centers Industry News*. April 2001. Retrieved 30 October 2002 from <http://www.icsc.org/srch/sct/current/st0401/page1c.html>.

³ Hot Topic, Inc. Retrieved 11 October 2002 from www.corporatewindow.com/fl/hott/frame.html.

⁴ Takacik, Maureen. "Hey Dude, This Sure Isn't the Gap". *The Wall Street Journal*. Friday February 12, 2002: pp. B1, B4.

industry average of nine months¹. Every day Hot Topic's stores receive a merchandise shipment. This, along with 30 to 60 day lead times, helps Hot Topic to keep its stores current on a consistent basis². Even the look of the stores has gone through two transformations since the company started operations just over ten years ago². All of these efforts have surely contributed to the fact that no store has ever lost money in any year of operation³.

DIFFERENTIATION FROM REST OF TEEN RETAIL MARKET

To keep their emphasis on the connection between music and fashion, Hot Topic stays involved in the music scene. It has sponsored Ozzfest, a summer hard rock and metal music festival in the tradition of Ozzy Osbourne, for the past two years². In addition, the other 50% of Hot Topic's merchandise is music-licensed and often ordered at customer requests to see their favorite bands on t-shirts³. The company gladly obliges their requests and obtains customer loyalty in return. The type of merchandise sold, mostly t-shirts and accessories, help to support the company with its accompanying low fashion risk.

In the company's own intention not to be mainstream⁴, their offering is much different than traditional retail stores The Limited or The Gap. This helps Hot Topic to differentiate itself to aim at self-described "alternative" teens, which has been estimated

¹ Hot Topic, Inc. Annual Report 2000.

² Hot Topic, Inc. Retrieved 11 October 2002 from <www.corporatewindow.com/fl/hott/frame.html>.

³ Hot Topic, Inc. Annual Report 2001.

⁴ Betsy Laughlin, CEO of Hot Topic, Inc. Edgy Hot Topic on a Hot Streak. *International Council of Shopping Centers Industry News*. April 2001. Retrieved 30 October 2002 from <<http://www.icsc.org/srch/sct/current/st0401/page1c.html>>.

at about 17% of American high school students¹. And as an analyst at Wells Fargo Van Kaspar says, "Hot Topic has virtually no competition" in the arena of alternative fashion available at the mall². Clearly, Hot Topic has a distinct and loyal following among its target market.

RIVALRY

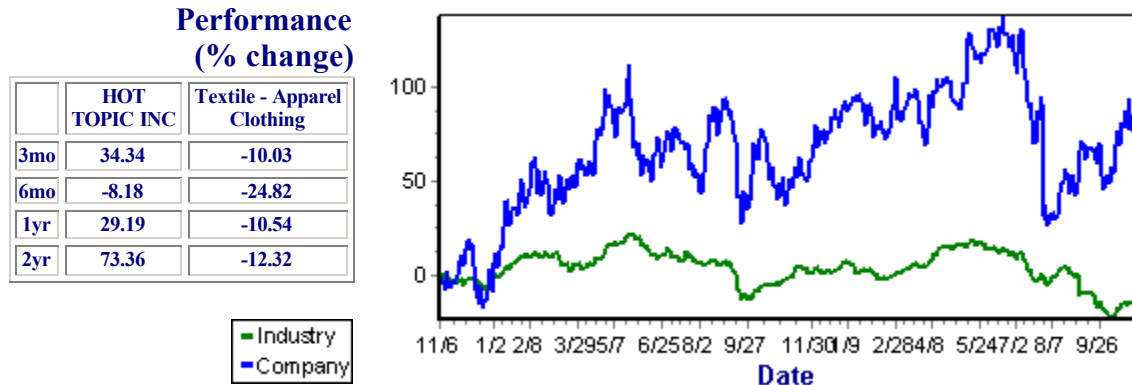
Mainstream large market shareholders in the clothing industry resisted from rivalrous competition when Hot Topic entered the market. Hot Topic managed to enter without rivalry attacks by supplying to a specific segment of the "teen market", which dislikes conformity of society and prefers to differentiate themselves from the mainstream³. The only one that comes anywhere close is Gadzooks, who noticeably tries to copy some styles from Hot Topic¹. Yet, they remain far too mainstream to compete. One Hot Topic manager exclaimed, "There is no way anyone can touch us or even come close to us¹." They seem to be without any substantial rivals because their large diversity of products differentiates them to an extent that is inimitable. As the figure below shows, Hot Topic's growth is far above the rest of the industry.

¹ "Alternative Teens are Hip to Hot Topic's mall stores". Retailyatra.com. February 13, 2002. Retrieved on 30 October 2002 from <<http://202.140.133.23:8080/powerTnet/current/cur16.htm>>.

² Jennifer Black. "Alternative Teens are Hip to Hot Topic's mall stores". Retailyatra.com. February 13, 2002. Retrieved on 30 October 2002 from <<http://202.140.133.23:8080/powerTnet/current/cur16.htm>>.

³ Information provided by the manager at Hot Topic at Barton Creek Mall, Austin, TX

Figure 1



Source: <<http://www.sectorwatch.com/kiprprt.asp?SYM=HOTT>>.

BARRIERS TO ENTRY

Hot Topic has established itself well within the teen market, which is growing nearly twice as fast as the general population and spends an amount equivalent to half of the U.S. defense budget¹. It has done this mainly through music. Music based retailing lets the musicians themselves do the marketing. For a store to take advantage of this concept, it must buy licenses. Any company could buy a license from a particular group or record label. But Hot Topic was the first to have a close relationship with several independent suppliers of licensed rock merchandise and now is the lead customer of most rock licensing companies².

One thing that gives Hot Topic an advantage is its information sources. Customers are hired as employees and then sent to clubs, concerts, and other hang outs to

¹ Hot Topic, Inc. Annual Report 2000

² "Alternative Teens are Hip to Hot Topic's mall stores". Retailyatra.com. February 13, 2002. Retrieved on 30 October 2002 from <<http://202.140.133.23:8080/powerTnet/current/cur16.htm>>.

see what the latest trends are and what kids are listening to. Therefore, always being on top of the latest trends gives it a huge advantage. Why don't other companies do the same and grab huge sales from this particular niche? Well, to even get the types of people that Hot Topic deploys to the music scene would take knowing who they are. It would be hard for a company such as the Gap, for example, to even find a person who is "cool" enough to understand what's going on. This is where the first mover advantage is exploited and Hot Topic has established its reputation with this segment. They earned a free reputation when they entered the market as the first company to serve the niche. The learning they have acquired revolves around gaining additional knowledge of their customers. Hot Topic's friendliness with its customers has produced a type of circular process where kids buy and then are used as a source for information, each element reinforcing the other.

Why don't music stores begin to focus more on clothing and accessories and grab sales? The main answer to this question is that it would take a complete repositioning. Music stores that we see in the malls are not particular to any one segment of the population. CD Warehouse would need to sell Beatles apparel and T-shirts with classical composers' faces on them in addition to the latest Linkin Park design, in order not to alienate or lose some of the largest components of its sales. This is just not feasible for these companies. Why doesn't a store open up and position itself within the teen music genre like Hot Topic did? It would take an immense amount of capital, careful choice of suppliers and time to build loyalty to be able to have a chain similar to Hot Topic's.

Hot Topic has also built very strong relationships with its suppliers. These relationships would likely be hard to break. Upward integration here becomes a key

barrier to entry. It takes a lot of hard work and time to build relationships with input suppliers such as those that Hot Topic has accomplished. The mutual benefits, in terms of profits, for the store itself and its suppliers are strong enough to discourage them from switching their business to other companies. And, it is proven, the teenage niche has disposable income in the form of allowances and wages that are set aside JUST for buying these brand names so that they can look cool and fit in.

SUPPLIERS

The ability to maintain profits in some industries revolves around the viability of firms to vertically integrate or capture exclusive deals with manufacturers. The reason it is so attractive to set up exclusive deals is that it will allow the firm to hold a monopolistic rule over the industry. Hot Topic is already highly differentiated and with few competing firms there are also few competing manufacturers. Hot Topic has given these manufacturers a place to sell and in return the manufacturer will only sell to Hot Topic.

Competition Upstream

If there are two upstream firms selling the same product, competition will result in the two firms earning zero profit. If these two firms are selling to too many retailers in the same area, the result is every retailer earning zero profit also. In order to make a profit each of these firms must agree on one retail outlet to sell to exclusively. In each region, the same dealer will carry the same version of each manufacturer's good. This creates a local monopoly selling both the brands in each region and creates extra profit.

The upstream manufacturers can extract payments from the retailer for creating the monopoly effect¹.

Hot Topic must maintain their position through relationships with the manufacturers and keep the competitive advantage by monopolizing the inputs of the successful manufacturers. Hot Topic has already confirmed that they maintain an exclusive deal with at least one of their manufacturers, Morbid. If a vendor is late on shipping an order, Hot Topic will always forgive and forget any problems in ordering or communication. This vertical restraint also gives Hot Topic and the manufacturer a higher price on the merchandise. The monopolistic effect created by having the downstream firm as the only seller of the merchandise, provides Morbid and Hot Topic with a relationship that is profitable to maintain. If an entrant wanted to pose a threat to the market, the entrant would have to open their own means of manufacturing clothes or exclusive dealing. This would require marketing the merchandise and promoting the clothing to counter Hot Topic's position. They could enter at the grass-roots level, as Hot Topic did, and slowly move their way up in the market. They could also advertise on MTV or other music networks and offer the more "trendy crowds" the same type of clothing that is becoming popular with the Hot Topic crowd.

PRODUCT LIFE CYCLE – PROBLEMS WITH GROWTH

Hot Topic is in a position where they must remain serving the music scene. If they attempt to grow with their customers, they will lose the roots of what they are trying to do. The older kids do not watch as much MTV and the popularity and vitality of the music scene lies in the teenage crowd. The problem that Hot Topic does face is if they

¹ Pepall, Richards Norman. Industrial Organization: Contemporary Theory and Practice. p.510

grow too large. The appeal of Hot Topic lies in their off-trend labels and alternative look. If they become too popular they will no longer be alternative, but mainstream. The question is how high does Hot Topic want to fly; too high and they will get burned. They must remain a grassroots organization without mainstream advertising or appeal. Hot Topic cannot support both crowds; the alternative crowd will quickly jump ship.

WAYS TO STRENGTHEN THEIR POSITION

Hot Topic has a strong place in its market, but what should the company do to ensure its position in the future? There are several options that can be considered carefully.

- **To further exploit complementary products**-This can be explored through selling song sheets from CDs they sell and more bedroom accessories, for teens wanting to start their own bands or those who just want another outlet to express themselves. Another way may be to open clubs, skateboard parks, or X-games which many of their customers are interested in. The downside to this is that Hot Topic may not know enough about this line of business to manage it effectively.
 - **More promotion**-The company does not advertise because it wants to lure potential customers into the store without preconceived notions of what they might find. But an alternative means of promotion besides the traditional would be to have annual or monthly design contests and also to ask up and coming bands to wear Hot Topic clothes.
 - **Expansion**-It has also been suggested that Hot Topic expand into a more mainstream punk rock music culture to gain more customers. But repositioning
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has the negative effect of losing their grassroots crowd and losing customer loyalty.

- **Use manufacturing efficiencies**-Hot Topic could also find ways to lower their prices. But this may have the effect of losing the image of quality and distinctiveness. On Hot Topic's website, the reason for high prices is that "Many of the items we bring you are unique and hard to find. Small companies and entrepreneurs make most of these items and have to charge us more because their product is not mass-produced¹". So it does not seem that Hot Topic has much control over this area. But the company does have a strong relationship with its suppliers, to the point that the suppliers will refuse to produce for anyone else. This is perhaps their strongest barrier to any effective competition and the key to continuing to be the leader in its market segment.

CONCLUDING REMARKS

It is clear that the key to keeping competitors out of this market is through Hot Topic's relationship with its suppliers and its customers. The key to good business in general, it seems, is to maintain a sense of community, with each part helping and reinforcing the others, giving the kind of support that is not found elsewhere. If Hot Topic can continue this, it will remain popular and keep a strong advantage over potential competitors without sacrificing its core constituency.

¹ <http://www.hottopic.com/services/FAQ.asp?LS=0&>