

## **Losing the grip on Sears Holdings**

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### **Abstract**

This case is set in 2015 as a junior partner in an investment firm is trying to convince his partners to mount a takeover of Sears Holdings Corporation. In developing the presentation to the partners, the case addresses the steps in strategic analysis and highlights the need for an integrative financial and marketing strategy. The case also illustrates how any industry evolves, but particularly how the retail store industry has brutalized those competitors who have not been willing to change. By putting the student in the shoes of the junior partner in an investment firm, the case also has the reader take responsibility for coming up with a range of potential ways of developing a strategy for repositioning Sears Holdings.

The Sears Holdings case can be used in a course in strategic management, in marketing, or in strategic marketing. It could also serve as a foundation for further development in a finance course.

**Keywords:** Retail industry, department store industry, marketing strategy, turnaround

## INTRODUCTION

Since Edward Lampert merged Kmart with Sears in 2004, the retail performance of Sears has plummeted. Lampert has a history of investing in struggling companies, and Sears Holdings was created through this merger. He believed this merger would help his struggling company compete with the more powerful companies in his industry, which includes Amazon, Target, and Walmart. Over the past few years, Sears has fallen behind its competitors because of a number of reasons, including no improvement on brand strategies, outdated retail stores, online sales being more profitable than the retail locations, and tools and appliance profits are falling. Lampert has not invested in improvements of the company, and as a hedge fund manager, Lampert has spent little to invest into the retail stores. In 2014, Sears Holdings sold off 200 Kmart and Sears stores.

A group of investors have been following the retail sector and Lampert's actions since 2004, and are interested to see what he will do with the struggling stores. John, a fairly new partner in the investor group, is preparing to make his pitch to buy Sears to his fellow business partners. This is the first presentation John has made as a new member of the investor group. Last week, a few of the senior partners asked John what his first acquisition proposal might cover. John told the two investors "Sears," and the two senior partners both laughed and said there is no chance to save a company in a situation like Sears. John requested help on the presentation from his partners, however each partner declined. In the end, John had to prepare his own presentation on Sears, including information on the company's management, industry, competition, and external environment. His presentation includes the findings below.

## HISTORY

Sears is a company with a rich and extensive history, dating back to 1886. Richard Sears, the founder of Sears began selling watches to supplement his income as a station agent in North Redwood, Minn. In 1887, the first Sears location opened in Chicago. In addition to opening the company's first location, Richard hired a watchmaker named Alvah C. Roebuck. In the early stages of operation, Sears initially sold their products through catalogs.

After being in operation for 41 years, the company founded by Richard Sears officially took on the corporate name Sears, Roebuck and Co. A staple of Sears is selling and offering repairs on their tools. Their Craftsman tools line has been largely a success, and dates back to 1927. Sears is more than just a company focused on retail. In 1931 Sears, Roebuck and Co. established the Allstate Insurance Company, and these two companies operated together until 1995. Sears rapidly grew after its initial launch, and by 1945 the company had exceeded one billion dollars in sales.

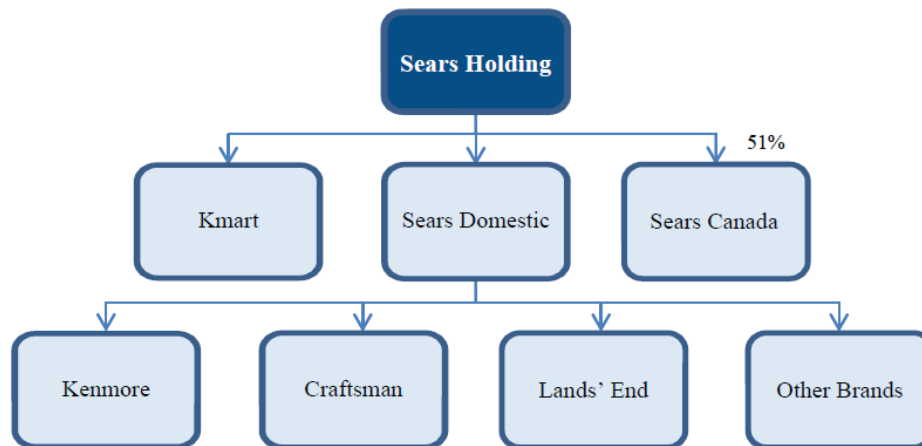
After many years of success, the company had begun to struggle. With revenues and overall performance declining, it was time for a change. This change came in 2004, when the company was sold to an investor with a history of turning around struggling companies by the name of Edward Lampert. The next year Sears and Kmart merged, forming Sears Holdings. Lampert believed that this merger would allow the company to regain its past successes. The goal of the merger was to allow Sears to compete with companies such as Amazon, Target, and Walmart. The company's major problems of outdated stores, faded brand strategies, limited online presence, and failing tool and appliance lines, have not been addressed. With the company still struggling, Lampert has begun selling the stores to his investment firm for short term relief. Currently the company is in a failing market, and has had to close 200 stores. The one time retail giant is failing quickly, and it remains to be seen whether or not the company can recover.

## CURRENT MANAGEMENT AND STRUCTURE

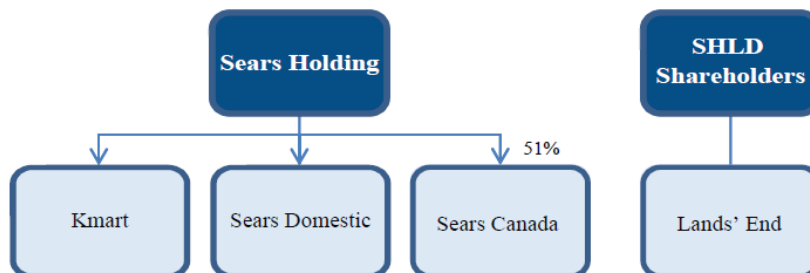
John started his presentation with the management structure of Sears. Sears has eight members on The Board of Directors. The ages of these members range from 42 to 67. Sears has twenty eight Executives, and Edward Scott Lampert is the Chairman and CEO. Sears Holdings structure can be found in the chart below, however in March 2014, the company was restructured and moved the Lands' End clothing line to its own, almost independent company.

### Organization Structure

#### Pre Spin-Off Structure



#### Post Spin-Off Structure



Source: Company data

Source: Cornel, J. (2014). Sears Holdings to Spin-Off Lands' End. Retrieved from Forbes website: <http://www.forbes.com/sites/joecornell/2014/03/14/sears-holdings-to-spin-off-lands-end/2/>

## INDUSTRY

The retail industry was the next area John addressed. In recent years, the use of technology has grown tremendously in the retail industry. Many companies have partnered with Apple and Visa to create a mobile wallet. Instead of having to carry a wallet, a purse, and a phone around the mall people can now resort to just one item, their phone. Without the hassle of getting your credit card or cash out of your wallet, you can now just show the cashier your phone

for payment. Because of technology many shoppers avoid the crowd at shopping malls, which have led to low markings.

For the last couple of years, Sears' competitors have been heading in the right direction by expanding and investing in their companies. For example, Target and Walmart are expanding and created a base for a dominant market in Canada. Another competitor, Macy's, has invested in inventory localization technology to meet consumer demands. Holding back on these investments has put Sears' behind, trailing online competitors and with the stores that are not up-to-date.

In his presentation John states that there are many factors that must be met to be successful in the retail industry. One key factor is the ability to control inventory. The status of the economy affects sales, and the retail industry must be able to adjust to the changes to maintain inventory levels, especially during the months of higher demand. Between the higher demanded months of October and December, the retail industry has annual sales of 32.1%. Retail stores must be able to control stock in order to maximize sales. Sears' under investment along with poor inventory planning systems has led to seasonal inventory excess. A significant amount of seasonal inventory raises risk to the gross profit margins reported. Because of poor inventory planning, Sears has been continuously overstocked in departments that are considered slow-moving, such as fitness equipment. Apparel is also seasonal which can lead to excess inventory. It is crucial to control inventory levels. Right now, Sears does not have the tools to complete with the abilities of leaders in the retail industry.

## COMPETITION

John believed the competition of Sears would be a good way for the investor group to see what they are up against in the industry. Sears' direct competitors are Amazon, Target, and Walmart.

Looking at the advertising expenses of each of Sears' competitors, Sears' is not fully competing on the same level. In 2009, Walmart spent \$2.04 Billion on advertising and in 2013 Walmart spent \$1.83 Billion on advertising. In 2009, Target spent \$1.35 Billion and by 2013 Target spent \$1.70 Billion on advertising. Amazon spends on average around \$150 Million on advertising, but most of this is done on google share. In 2013, Sears' spent around \$560 Million in media advertising, but only \$350 Million went towards Sears the other \$210 Million went towards Kmart's advertising.

The discounting and sales tactics of Sears' are also a problem, according to John. Walmart buys in bulk and runs very low priced sales on hot items without hurting their net sales. There are a lot more Target locations, and the company is doing well with their Cartwheel App, which gives the customers coupons on their mobile device. The Cartwheel App just has to be shown to the cashier at checkout, no more clipping coupons or remembering to take them with you shopping. Target also has a huge clearance section that is constantly added to. Amazon is known for finding products cheaper and is the most convenient way to buy the product, if you don't need the product same day. Amazon also has a section on their website dedicated to Sales & Deals, and most of the time they have free and quick delivery. It is hard to get the customers to come into Sears' stores, when it is very convenient to buy the item online and have the product delivered at the same or lower price. Sears' website does have a bargain section and Sears' does not run promotional coupons.

<b>Direct Competitor Comparison</b>					
	<b>SHLD</b>	<b>AMZN</b>	<b>TGT</b>	<b>WMT</b>	<b>Industry</b>
<b>Market Cap:</b>	4.62B	178.98B	53.32B	259.05B	6.32B
<b>Employees:</b>	196,000	154,100	347,000	2,200,000	13.79K
<b>Qtrly Rev Growth (yoy):</b>	-0.24	0.15	N/A	0.01	0
<b>Revenue (ttm):</b>	31.20B	88.99B	72.62B	485.65B	1.76B
<b>Gross Margin (ttm):</b>	0.23	0.29	0.29	0.25	0.36
<b>EBITDA (ttm):</b>	-858.00M	4.36B	6.73B	36.32B	103.90M
<b>Operating Margin (ttm):</b>	-0.05	0	0.06	0.06	0.06
<b>Net Income (ttm):</b>	-1.68B	-241.00M	2.45B	16.08B	N/A
<b>EPS (ttm):</b>	-15.82	-0.52	-2.55	5.05	0.11
<b>P/E (ttm):</b>	N/A	N/A	N/A	15.9	24.91
<b>PEG (5 yr expected):</b>	0.03	38.24	1.52	3.51	1.39
<b>P/S (ttm):</b>	0.15	2	0.73	0.53	5.68
SHLD = Sears Hoildings					
AMZN = Amazon.com Inc.					
TGT = Target Corp.					
WMT = Wal-Mart Stores Inc.					
Industry = Department Stores					

Source: Yahoo Finance. (2015). Sears Holdings Corporation (SHLD). Competitors. Retrieved from the Yahoo Finance website: <http://finance.yahoo.com/q/co?s=SHLD+Competitors>

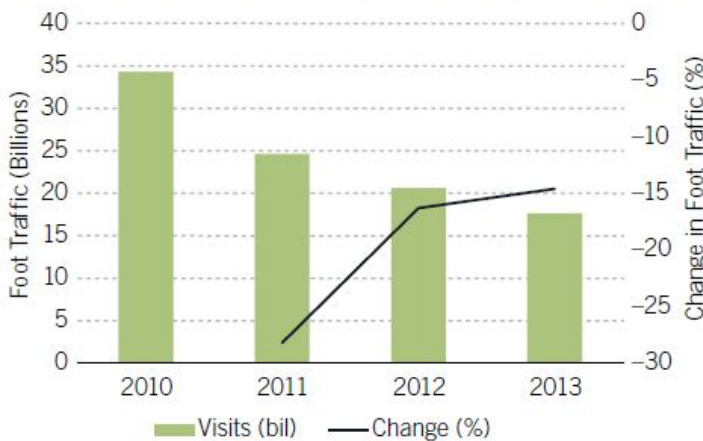
## EXTERNAL ENVIRONMENT

The outside environment of Sears has become very influential in the retail industry, and John gave an update of a few things that were going on. Over the years the environment in the retail world has changed, and it has had a big effect on the performance of Sears. The U.S. economy and Canadian economy have also fluctuated over the years. Technology has greatly changed, and has surpassed Sears' technology. There is also a growing move on the decrease of retail stores environmental impact. Consumers have changed their ways of shopping, and even have negative thoughts on Sears' stores. Sears was only successful when the economy was prospering. When the economy in the U.S. and Canada is prospering, customers shop and spend money in retail stores. During hard times, however, these consumers have less money available to spend on items that are not essential to living. For example, items such as tools, household appliances, and clothes. Consumers focus on things that are essential to living including food and paying utility or household bills. Sears store technology is outdated, however, this is a common occurrence for many retail stores. It is very hard for a retail store to keep up with changing technology. If Sears and other retail stores tried to keep up with current technology, profits would be lost. With the constant changing of technology, it is very difficult for retail companies to keep up because of their large amounts of stores and presence across the country.

Corporate Citizenship is a big area that many retailers are beginning to strive for. Many are trying to eliminate the environmental impact of their operations. The idea for a decrease in environmental impact includes the issues of product packaging, energy efficiency, recycling, and light bulbs/plastic bags/paper usage. Retail stores want to decrease their impact on the environment and human health. The shift to greener products has now begun with the belief that

the reputation of the retail store would look better with the elimination of their environmental impact. Another of the biggest problems today is the belief that retail stores are outdated with the same old boring store appearance. There are less in-store transactions and there is no interaction between the customer and products offered in the store. For example, Sears' stores have not been updated and there has been no investment in their retail stores. The location of Sears and many other department stores is often in a mall or mall complex.

TOTAL RETAIL FOOT TRAFFIC IN U.S. SHOPPING MALLS



Source: Dixon, P. (2014). Have You Been To The Mall Lately? Foot Traffic Is Declining. Consider Retail Companies Finding Ways To Attract Shoppers. Retrieved from Fidelity website: <https://www.fidelity.com/viewpoints/investing-ideas/mall-shopping>, ShopperTrak, The Wall Street Journal (Jan. 16, 2014).

The internet has become a widely used shopping experience, and for many companies it has cut down on physical stores and sales have become solely fulfilled out of a warehouse. Online sales are becoming more prominent for consumers, and it is a lot less expensive to run a company with just a warehouse and employees verse having a retail presence, employees, a warehouse, and a distribution method. Some believe malls will begin to be phased out, and there will be a shift to mostly online shopping. Online shopping will continue to have an impact on retailers.

## INVESTOR MEETING

John summarized his presentation on Sears with what he believed the investment company could do with Sears. He believes Sears can go through a transformation, but does not want the few stores that are outdated to represent our 2,000 store base. John believes the turnaround plan for the company includes investing in the brand by renovating stores, improving customer service, and providing quality management. Through John's research he believes Sears is not fully utilizing its advertising abilities, and must change its ways to beat out competitors. He believes the company can reduce cost and improve gross margin.

After John finished his presentation, many of the investors were against the idea believing the company was too far gone. Two of the partners said don't understand why the company has many upper management levels, and believe the management structure must be

overhauled. They believe Sears must continue to adapt to the ever-changing external environment. The two said the company needs to expand their internet sales operations and reduce their retail presence. Sears must update and maintain their technology capabilities to adapt to the tech savvy consumer. Finally, Sears would have to be responsive to environmental impact issues to be known and perceived as good stewards to the environment. Such adaptability is necessary to prevent Sears from becoming a retail store of the past like Clover, Caldor, Korvettes, Gimbal's, or Two Guys. They believed that was the starting point to turn the company around, but just a start the two investors said. The two investors believe that there are too many things wrong, and it is a risk for the investor company to take on that much of a risk.

After the meeting, John sat in the conference room. He was trying to figure out if there was anything he could do to get his fellow investors interested in acquiring the struggling company. John believes that Sears would be a good acquisition, and he feels like he can show his fellow investors that he knew what he was doing as a fairly new partner in the investor group.

On John's drive home from work, he thought to himself is there anything else he could inform his fellow investors to make them want to buy Sears or if it was a good business decision to buy Sears or not. Perhaps he needs to develop a marketing strategy that leverages the physical stores with a new online strategy? Maybe he should propose a merger of Sears with a strong online retailer? Or perhaps this is just a financial play?

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