The rise and fall of Circuit City

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Abstract

Circuit City paved its way in the consumer electronics retail market by committing to its Five S's operating philosophy – selection, savings, service, satisfaction, and speed. However, the company fell victim to several poor business decisions in the early 2000's that eventually led to the filing of Chapter 11 bankruptcy in 2008 and its closing in 2009. This case highlights the importance of identifying appropriate product differentiation strategies, building a distinctive competence, monitoring the competitive landscape, and making sound business decisions. It will also aid the student's understanding of the role and impact of management and explain the importance of employee engagement, satisfaction, and retention.

Keywords: Circuit City, Five S's, customer service, product differentiation, competitive landscape, employee retention, Alan McCollough, Philip Schoonover, layoff, Chapter 11 bankruptcy

INTRODUCTION

This case covers the time period in Circuit City's history between the decision of CEO Alan McCollough to halt the sale of appliances in 2000 and the decision of CEO Philip Schoonover to lay off 3,400 employees in 2007. The case also highlights the importance of sound strategic business decisions, target marketing, and customer input. Moreover, the case points to the need for a retailer in such a competitive marketplace, with both brick-and-mortar and online competitors, to find its competitive advantage and adhere to it. Differentiation and customer value are keys to success.

This case is suitable for both undergraduate and graduate courses in Marketing and/or Business Administration or Management, in areas where the students are studying Marketing or Business Strategy or Marketing Planning.

BRIEF HISTORY

Circuit City opened its doors to the public in 1949 under the name of Wards Company. This date marked the beginning of the electronics superstore concept in the United States (BCRC, 2009). Within 10 years, Wards became a four store chain with total sales of $1 million per year (BCRC, 2009). In 1965, the company began its expansion through the acquisition of several television and home appliance stores in the United States (BCRC, 2009). In 1970, Wards came under new management and the focus shifted to consolidating the business. Wards closed all unprofitable stores and invested the revenues generated in a $2 million electronics superstore (BCRC, 2009). The store shifted Ward's focus from home appliances to the growing consumer electronics market. It offered more than 2,000 products, including video and audio equipment and major appliances. Due to the company's high volume sales, it was able to offer lower prices than its smaller competitors. In addition, the stores offered service incentives, such as home delivery and in-store repairs (BCRC, 2009).

Based on the success of its superstore model, Wards began to streamline its operations and transformed many of its small stores into full-service electronics specialty stores. With this new concept, Wards opened six new stores in the Washington, D.C. area. Each store was 6,000 to 7,000 square feet, featured brand name video and audio equipment, and consistently offered in-store service capabilities. This new business strategy allowed the company to end 1979 with $120 million in sales (BCRC, 2009).

In 1984, Wards changed its corporate name to Circuit City Stores, Inc. and became publicly traded on the New York Stock Exchange (BCRC, 2009). At this time, Circuit City operated 113 stores and had become the leading specialty retailer of brand name consumer electronics (BCRC, 2009). The company's growth continued and its profits were increased by the launch of innovative electronics products. The company was expanding rapidly and opening a large number of superstores in new markets, which were heavily advertised at once.

In February 1987, Circuit City's annual sales reached $1 billion for the first time, driven mainly by the demand for VCRs, which also pushed up demand for complementary items, such as new televisions and other audio equipment (BCRC, 2009). However, as the demand for this core product decreased and competition from other electronics superstores such as Best Buy heated up, the company faced a difficult future. Despite these threats, the company did reach $69.5 million in profits by 1989 (BCRC, 2009). Many observers attributed the success of the Circuit City concept to its strong management, customer service focus, and a good

merchandising formula which capitalized on innovative electronic consumer products. Based on this success, the company continued to follow the concept of the superstore, which led to overall sales of $2 billion by 1990 (BCRC, 2009).

SCENARIO

As newly elected Circuit City CEO Alan McCollough sat on his back porch on a summer evening in early August 2000, drinking a fresh glass of iced tea and wearing his favorite Saluki t-shirt, he pondered the tough decision ahead regarding his company's involvement in the appliance business. He knew that Circuit City had been selling appliances nearly since its inception in 1959, but Lowe's and The Home Depot were hot on the company's trail, threatening to take its place in the appliance retail market. McCollough knew that despite Circuit City's standing as the second largest appliance retailer next to Sears just the year prior, the company could realize big savings in warehouse storage and delivery costs by exiting the appliance business. He had an important decision to make, and soon. So, he weighed the pros and cons.

Appliances, McCollough believed, didn't have the same growth potential as the consumer electronics category and the sales cycle was cyclical. Eliminating the appliances line would also provide more open space on the selling floor, allowing for more product categories. However, appliances had accounted for $1.6 billion in Circuit City sales revenue in 1999 (Wells, 2005).

McCollough had accumulated 13 years of experience in merchandising and store management, joining Circuit City in 1987 as a general manager of corporate operations, moving up to president and COO in 1997, and eventually taking over leadership of the company in June 2000. As his first strategic move since being named CEO, the decision to eliminate the appliance line had serious implications for his future with the national retailer. As the sun set and McCollough took his last sip of watered-down tea, his decision was made. He jotted down the statement he would deliver to his Board of Directors and investors the next day.

STRATEGIC DECISIONS

Selection, savings, service, satisfaction, and speed – the Five S's – was Circuit City's operating philosophy in 1984 when the name Circuit City was born. This was a time when customers could choose from a wide variety of merchandise; receive 110 percent back if they found a better deal; enjoyed the peace of mind of a 30-day money back guarantee; received expert advice from a commissioned sales force; and had the convenience of service and repairs in the store. The company's point-of-sale systems facilitated quick transactions and kept management apprised of inventory needs. During this time, Circuit City also utilized customer satisfaction surveys to track progress in all areas (Wells, 2005).

Exits Appliance Market in 2000

The decision by Alan McCollough in 2000 to eliminate major appliances from main locations resulted in the closing of six distribution centers and the elimination of 1,000 jobs. The decision was made as a result of increased competition in the appliance segment and the potential savings in warehouse storage and delivery costs (Wells, 2005). Prior to withdrawing from the appliance market, appliances accounted for 14 percent of Circuit City's total sales and

took up 20 percent of its selling space (Johnson, 2001). To make up for appliances being shifted out, Circuit City began to expand the number of its imaging and entertainment products (Wells, 2005).

Store Restructuring in 2000

The exit in appliances was accompanied by the announcement of an ambitious store remodeling program and new real estate investments. By 2004, Best Buy had aggressively pursued "A" quality locations and strategic lease negotiations that resulted in the chain having better real estate than Circuit City (Reingold, 2005). On the contrary, Circuit City failed to secure prime real estate and instead opted for low cost leases in inferior "B" and "C" locations that were sometimes inconvenient for consumers (Eames, 2009). To identify and secure better store locations, the company began testing "strategically differentiated" pilot stores by working with new master brokers under the direction of the recently named real estate vice president, Steven Jackson (Twice, 2005). Part of the restructuring program consisted of closing underperforming locations and focusing on the better executed expansions. Circuit City planned to build 20,000 and 30,000 square foot stores as opposed to continuing with its wide array of store sizes, which at the time, ranged from 2,000 to 50,000 square feet (Shalfi, 2006). The stores that were not scheduled for relocation were instead scheduled for remodeling.

In response to the store's restructuring initiative, many observers commented that Circuit City's new format looked more like a Best Buy store (Wells, 2005). The new stores reflected an open warehouse-style floor plan with an overall brighter look and colorful signage. More products were stocked on the store floors and registers were placed near the entrances, allowing customers to help themselves and navigate the store in a more efficient manner (Wells, 2005). However, in January 2001, McCollough announced that instead of the 140 stores that were originally planned for remodeling in 2001, only 20 to 25 stores would be remodeled. The reasoning was said to be based on costs, the amount of time the remodeling effort took, and disruption to the stores. Scaling back the remodeling efforts would reduce costs by $1 million per store and the rollout would be completed over a longer time period (Wells, 2005).

Commissioned Sales End in 2003

Circuit City's largest competitor, Best Buy, had operated without a commissioned sales force since 1989. By fiscal year 2003, Best Buy's market capitalization was 10 times that of Circuit City. Circuit City's commissioned sales force was clearly a major differentiator and was said to be a competitive advantage, not only by Circuit City, but by competitors alike (Wells, 2005).

Despite such an advantage, in February 2003, due to falling sales and reduced profitability, Circuit City announced that 3,900 commissioned sales staff would be laid off and replaced with hourly employees. Before the layoffs, approximately 60 percent of Circuit City's sales associates were paid on commission; the rest on hourly pay. The desired outcome of the decision was to simplify store operations, create a united customer service objective, and reduce operating costs. Circuit City estimated there would be no sales and margin disruption beyond one month (Wells, 2005).

Firedog Launched in 2006

Best Buy's Geek Squad launched in 2002 and quickly grew into the number one national electronics service organization. To challenge the Geek Squad, Circuit City launched Firedog in August 2006 to provide in-store, in-home, and online computer and home theater technical support, as well as installation services (Eames, 2009). In September 2006, the Firedog workforce was approximately 4,000 strong and growing, and staffed by a mix of in-house and outsourced tech crews (Wolf, 2006). Firedog in-store and in-home PC support was available through all 632 Circuit City stores and home theater installations were available within 25 miles of Circuit City locations (Wolf, 2006). It was estimated in the company's 2007 Annual Report that Firedog generated above average margins and had annual revenues of $200 million in 2007. This number was expected to double in 2008 to more than $400 million (Circuit City, 2007).

Firing of 3,400 Employees in 2007

In 2004, Philip Schoonover, a former executive vice president of Best Buy, was appointed executive vice president and chief merchandising officer of Circuit City. In 2005, Schoonover replaced McCollough as president and CEO. Other senior management talent was also upgraded and repositioned at this time. In 2007, Schoonover, facing declining sales and profits, decided to reduce labor costs by firing 3,400 employees that the retailer determined were paid too much. Schoonover said the cuts were necessary to save money; however, several months later, the company awarded retention bonuses to top executives (Mui, 2008). Among those laid off were the most tenured, knowledgeable, and highly compensated employees. Circuit City replaced the laid off employees with less experienced people that could be hired at the lowest wage possible (Eames, 2009).

Circuit City Closes Its Doors

On November 3, 2008, Circuit City announced that it would close 155 stores and lay off 17 percent of its workforce by year-end as a result of its ongoing struggle for profitability (Popken, 2008). Days later, 700 corporate employees were laid off from headquarters in Richmond, Virginia. The 1,000 remaining corporate employees were merged into a single building in an effort to further cut costs and improve profitability (Llovio, 2008).

On November 10, 2008, Circuit City filed for Chapter 11 bankruptcy protection. Bruce H. Besanko, Circuit City's chief financial officer, wrote in the court filing, "Without immediate relief, the Company is concerned that it will not receive goods for Black Friday and the upcoming holiday season, which could cause irreparable harm to the Company and its stakeholders" (Sorkin, 2008). The company asked the court for a loan of $1.1 billion to buy new inventory and pay wages (Hamilton, 2008). Together with the $400 million from a previous credit line, Circuit City believed it would have enough financing to push through the busy holiday season.

Court filings showed the company had $3.4 billion in assets, $2.3 billion in debts, and more than 100,000 creditors (Sorkin, 2008). The company's goal was to emerge from bankruptcy protection by mid-year 2009. However, Wall Street analysts believed that the prospects of long-term survival for the chain were bleak.

The court set a January 16, 2009 deadline for Circuit City to find a buyer. Otherwise, the company would have to shut its doors. It was rumored that two unnamed buyers were interested; however, an agreement between the creditors and lenders was not reached in time. On January 16, 2009, Circuit City announced its plans to liquidate. CEO and acting president, James A. Marcum, stated, "We are extremely disappointed by this outcome," calling the liquidation "the only possible path" for this 60-year-old company (Rosenbloom, 2009).

LEARNING OBJECTIVES

The purpose of this case is to identify various areas of strategic marketing planning and decision-making, including:

1. Identifying appropriate product differentiation strategies
2. Understanding the importance of building a distinctive competence
3. Understanding the importance of monitoring the competitive landscape
4. Understanding the importance of implementing:
    a. Creative growth strategies
    b. Short-term and long-term objectives
5. Being able to perform a SWOT analysis
6. Defining a clear positioning statement
7. Understanding the role and impact of management
8. Explaining the importance of employee engagement, satisfaction, and retention

DISCUSSION QUESTIONS

1. Evaluate the influence of Circuit City's organizational management beginning in 2000.
2. Who was Circuit City's target market? Did that change after the decision in 2000 to remove appliances from its product offering?
3. How would the store remodeling effort play into customer satisfaction levels? What impact did the remodeling have on the company's financial strength and profit levels? What about the role of Circuit City's real estate decisions?
4. How did the end of commission-based sales affect Circuit City's once main competitive advantage in customer service?
5. In 2007, Circuit City participated in two actions of controversy: the laying off of 3,400 employees and the awarding of bonuses to top executives amid declining sales and profits. How did this controversy impact the public perception of the brand? Did it contribute to its eventual demise?

TEACHING SUGGESTIONS

1. Ask students if they have been a customer of Circuit City, of Best Buy, of Wal-Mart, of online retailers, for their consumer electronics purchases. Why did each student prefer each retailer? What influenced their choice of retailers?
2. Of those students who had been a customer of Circuit City, do any remember when Circuit City offered appliances? Did their parents purchase appliances? What did they/their parents think of Circuit City? What was Circuit City "known for?"

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3. Would students' purchases be affected if they found a retailer was taking customer service shortcuts and firing low- and mid-level employees, while rewarding management? What is considered important in a retailer?
4. Do students believe there is enough of a market for consumer electronics to support a Best Buy and Circuit City (given the other competitors in the marketplace)? What if Circuit City had stuck to its original product offerings with appliances in the mix?

DECISION-MAKING QUESTIONS

1. If you were Alan McCollough, would you have exited the appliance business? Why or why not?
2. From a customer perspective, did Circuit City provide a product or service offering that differed from competitors? What was its strongest Point of Differentiation?
3. How would you have evaluated the option to exit the commission-based pay schedule? Do you believe Circuit City made the right decision, given that Best Buy operated under this structure and held market leadership?
4. Considering Circuit City's financial crisis, do you believe Schoonover should have laid off 3,400 employees in 2007?
5. Do you believe, after filing for Chapter 11 bankruptcy protection in 2008, that Circuit City could have successfully reorganized its business? How?

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