CIRCUIT CITY SIX

Six Fatal Mistakes of a Once “Good to Great” Company

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TABLE OF CONTENTS

THE WORLD ASKS THE QUESTION

How Could This Happen?

As I was enjoying my cup of Masala Chai tea with the CEO of a new start-up electronics retailer in New Delhi, India, I was asked a question: “What happened to Circuit City?” It is really amazing to most people that a company like Circuit City could go from solvency to bankruptcy and liquidation so quickly. Wherever I go in America, Russia, Middle East, India or elsewhere, leaders of large retail organizations want to know the story.

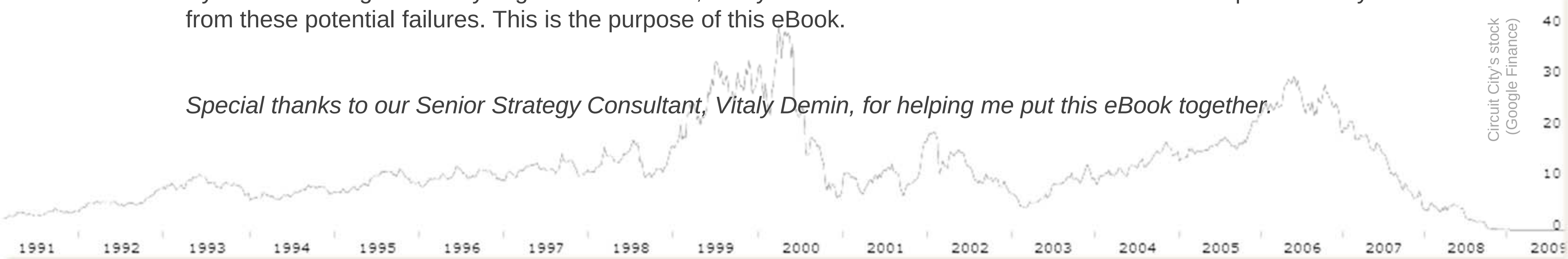
In Jim Collins’ 2001 book “Good to Great”, Circuit City is featured as a company that made a leap from a good performer to a great performer. Jim wrote: “Circuit City became to the consumer electronics retailing what McDonald’s became to the restaurants – not the most exquisite experience, but an enormously consistent one.” In the early 1980’s the company had built a culture of discipline that produced superior execution of the “4-S” model (service, selection, savings, satisfaction). “It was because of this consistency that Circuit City took off in the early 1980’s and beat the general stock market by more than 18 times during the next 15 years.”

The problems that Circuit City faced started years before but the severity was compounded by the current economic climate. External threats included weakening consumer demand, growing unemployment, tight credit and collapsing housing markets. Internally the organization suffered from several years of declining sales, a weak balance sheet, skeptical vendors worried about getting paid and increasing competition from Best Buy and low service/no service retailers.

Aside from these current realities, in my opinion, Circuit City made six fatal mistakes which resulted in one of the most significant business failures in retail history. These mistakes undermined their own progress and ultimately killed them.

By understanding and analyzing these mistakes, today’s leaders must learn how to steer their companies away from these potential failures. This is the purpose of this eBook.

Special thanks to our Senior Strategy Consultant, Vitaly Demin, for helping me put this eBook together.



1. ARROGANCE

How It All Started

The Genesis

In the early 90’s, Circuit City was the leading electronics retailer in the United States with about 400 stores nationwide. At that time their competitor Best Buy was a small struggling company with about 70 stores. They were focused on survival, growth and conquering the 400 store giant. Led by the founder Dick Schulze, the company was driven to take the game to Circuit.

Best Buy aggressively entered existing Circuit City markets where the latter had been doing business for 5-10 years. In those markets, the strategy was to go into newer retail developments which outpositioned Circuit City’s existing locations. This proved to be a game changer. Best Buy mandated best locations in these trade areas and often paid a premium price rather than saving money and picking less costly and inferior sites.

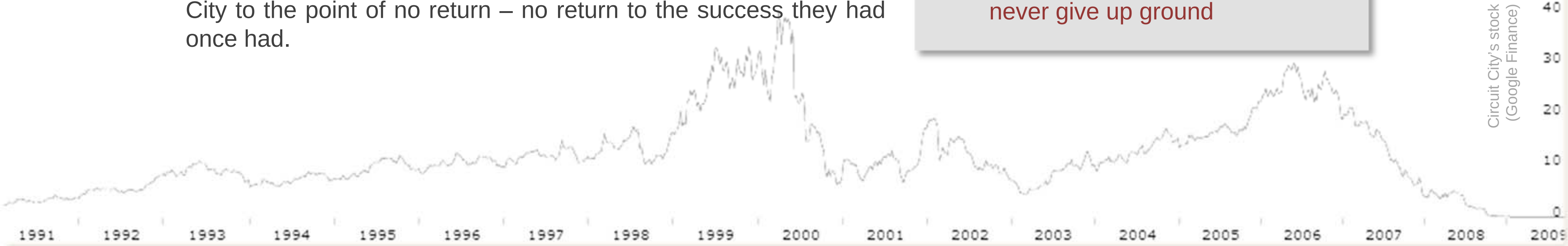
Losing the Edge

The Circuit City reaction to this Best Buy offense was to do nothing, stick to their existing real estate strategy and stay in their older store locations. The results are well known. By 1996, Best Buy had surpassed Circuit City in size and was sweeping up market share.

The arrogance of the top leadership of Circuit City allowed Best Buy to successfully implement their strategy. A refusal to admit that they could be challenged by a smaller company took Circuit City to the point of no return – no return to the success they had once had.

HAVE EDGE, NOT ARROGANCE

- ✓ Humility is always better than arrogance
- ✓ Never be satisfied, always keep moving the ball
- ✓ Stay ahead of the competition – never give up ground



2. REAL ESTATE

Prioritizing “B” Site Locations Is Never a Good Strategy

Real Estate Strategy Aiming Low

Over the years, Circuit City struggled to produce maximum return on their real estate strategy. They prioritized cheap leases which resulted in inferior or “B” locations. Because they were not aggressive in locking up new great real estate, they were almost always second to Best Buy. They did not realistically evaluate the ROI of existing stores, keeping unproductive stores open after the shopping node had shifted and stores turned unprofitable. They also followed a very weak remodel and refresh program resulting in old tired stores that did not allow for the newest technologies to be presented in a compelling way. Circuit City never achieved the customer traffic needed to produce profitable results and the customer experience continued to decline.

BE STRATEGIC

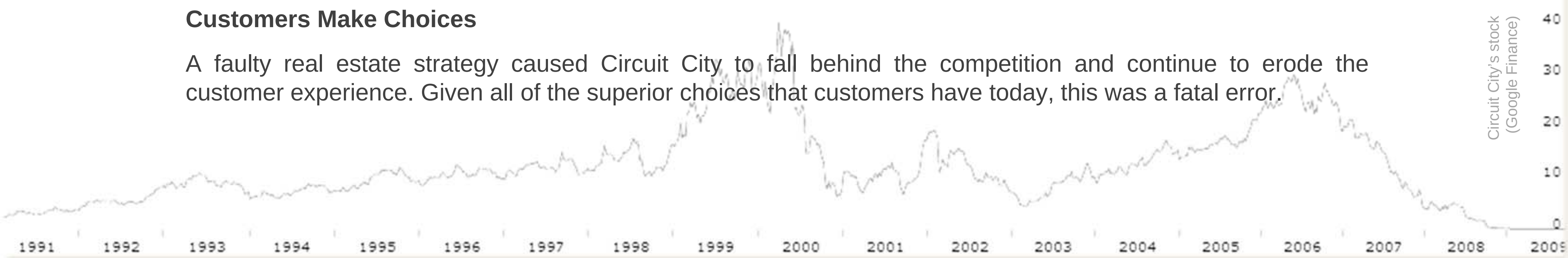
- ✓ Always go for “A” locations as long as NPV is positive and IRR is within your acceptable range
- ✓ Be faster than your competition
- ✓ Hire the best real estate experts in the industry

On the Other Side

In contrast to Circuit City, there are many reasons for the success of Best Buy. Their overall real estate strategy, site selection competency, aggressive pursuit of new “A” quality locations, store design and lease negotiations along with a proactive remodel/refresh strategy are world class. Circuit City, however, believed in their own strategy and was unwilling to change.

Customers Make Choices

A faulty real estate strategy caused Circuit City to fall behind the competition and continue to erode the customer experience. Given all of the superior choices that customers have today, this was a fatal error.



3. HOME APPLIANCES

From White Goods to Red Ink

Not Taking It Slow

In June of 2000, Circuit City's CEO Alan McCollough announced that they would stop selling appliances. It appears to have been an overnight decision. The combination of increasing competition from Lowe's and Home Depot, high fixed costs, inventory investment and declining sales spurred the decision to move quickly. In fact, their White Goods vendors were not even notified of the change prior to the announcement.

THINK BIG

- ✓ Always test your assumptions before you act, look for unintended consequences
- ✓ Many financial decisions have another side to them which may often hurt other aspects of the company's business
- ✓ Focusing on short term can lead to trouble – think long term

Side Effects

Circuit City's strategy to replace the appliance business was to expand the consumer electronics section of the store and bring the box product out of the back room onto the selling floor. This meant a major retrofit of the selling space from a commission set up to non-commission format while reducing warehouse space. Obviously, this was easier said than done. It required a substantial capital investment which strained the profitability of the company and it also took three years to complete these updates.

The Reality

By exiting the White Goods business Circuit City lost the appliances customer and traffic. The leadership of the retailer lacked an understanding of the metrics of the business. The home appliances category may have operated at a loss but the margin dollars it generated were applied to the company's fixed overhead. These dollars were not replaced. Also, as my business associate Vitaly Demin commented, eliminating this category created a significant disruption for the retailer's brand because their customers had associated Circuit City's name with home appliances as well as other consumer electronics product categories.

4. COMMISSION MODEL

Listen to Your Customers, They Don’t Like This Experience

It Only Took 14 Years

For years Circuit City considered their commissioned selling staff to be a major differentiator from Best Buy who eliminated commissioned sales compensation in 1989. It was Circuit City’s belief that by training and compensating knowledgeable and professional sales people they could provide a superior shopping experience. However, by 2003, faced with falling sales and profitability, the company felt compelled to move their sales employee compensation model from commissioned to hourly rate.

CHANGE MANAGEMENT

- ✓ When changing strategies, understand the impact on your business, customers and employees and manage the risk accordingly
- ✓ In order to make a successful change in your operating model, ensure organizational alignment (process, structure, systems, compensation, training, culture, etc)

Losing Their Best

The results of this change were devastating. 3,900 highly trained but expensive commissioned sales people were terminated. Sales in profitable categories declined. Circuit City was left with an ineffective under-trained selling staff and continued to lose market share. Terry Smith, a former Change Management executive at Best Buy commented on this: “When decisions are made without a systemic understanding of the impact on employees, customers and business results, the overall outcomes are not maximized.”

Back to Arrogance

Circuit City, having been one of the most successful retail companies in the world, never learned to embrace change. Their leaders, as great and smart as they were, held on to old models well beyond their usefulness. They did not realize how important it was to change and do things differently in this very dynamic world. This critical mistake was not about the fact that they made the decision to move to a non-commission selling model, it was about the fact that it took them almost one and a half decades to figure that out.

5. FIREDOG

“Better Late Than Never” Doesn’t Always Work

Geek Squad? Hmmm… Yeah, Whatever

In 2002, Best Buy bought Geek Squad and grew it into the number one national service organization with revenues projected to reach over $1 billion in 2009.

Circuit City did not see the value in providing their customers with comprehensive services solutions. It took them four years to realize that they had to do something about it. To challenge Geek Squad, in 2006, Circuit City launched Firedog. This move required a huge financial investment which put strain both on the company’s financial and people resources. Building a brand is difficult, very expensive and takes time. The rollout lacked consistency, local ownership, and customer acceptance. Also, by that time Geek Squad had already developed into a very strong brand with a large base of loyal customers.

The introduction of the Firedog project became another money drain for the company. The Circuit City’s services organization never got close to what Best Buy had accomplished.

STAY TUNED

- ✓ Be the leader
- ✓ If you are not the leader, at least be a fast follower
- ✓ Invest in profit opportunities
- ✓ Listen to your customers, know what they want

Put Your Money Where Your Margins Are

Considering the narrow margins in electronics retailing, baskets must be built to improve the profitability of each transaction. For years baskets were filled with warranties and accessories. While these are profitable they do not necessarily enhance the overall customer experience and satisfy the true needs and desires of customers. Unlike Best Buy, Circuit City refused to recognize this customer service and profit opportunity. They should have been first, not second four years later.

Circuit City’s stock (Google Finance)

6. TALENT

Your Best Employees Are Your Greatest Asset. Keep Them

They Let Them Go

In 2007, faced with falling sales and profits, Circuit City had to find a way to improve their overall profitability. A decision was made to reduce their labor costs, the largest contributor to SG&A. In one day 3,400 sales associate jobs were eliminated. People holding these jobs were their most tenured, knowledgeable, successful and highly compensated employees. They were replaced by new, much less experienced sales people that were unproven and under-trained. The results proved disastrous. “Firing 3,400 of arguably the most successful sales people in the company could prove terrible for morale,” wrote Colin McGranahan, an analyst with Sanford Bernstein & Co.

ANY ORGANIZATION IS ALL ABOUT PEOPLE

- ✓ Make retention of your best people one of the top priorities
- ✓ Create a great culture inside your organization where your employees would love to belong
- ✓ Invest in training. Untrained or under-trained employees are usually dissatisfied with their jobs which negatively affects themselves , other employees and customers

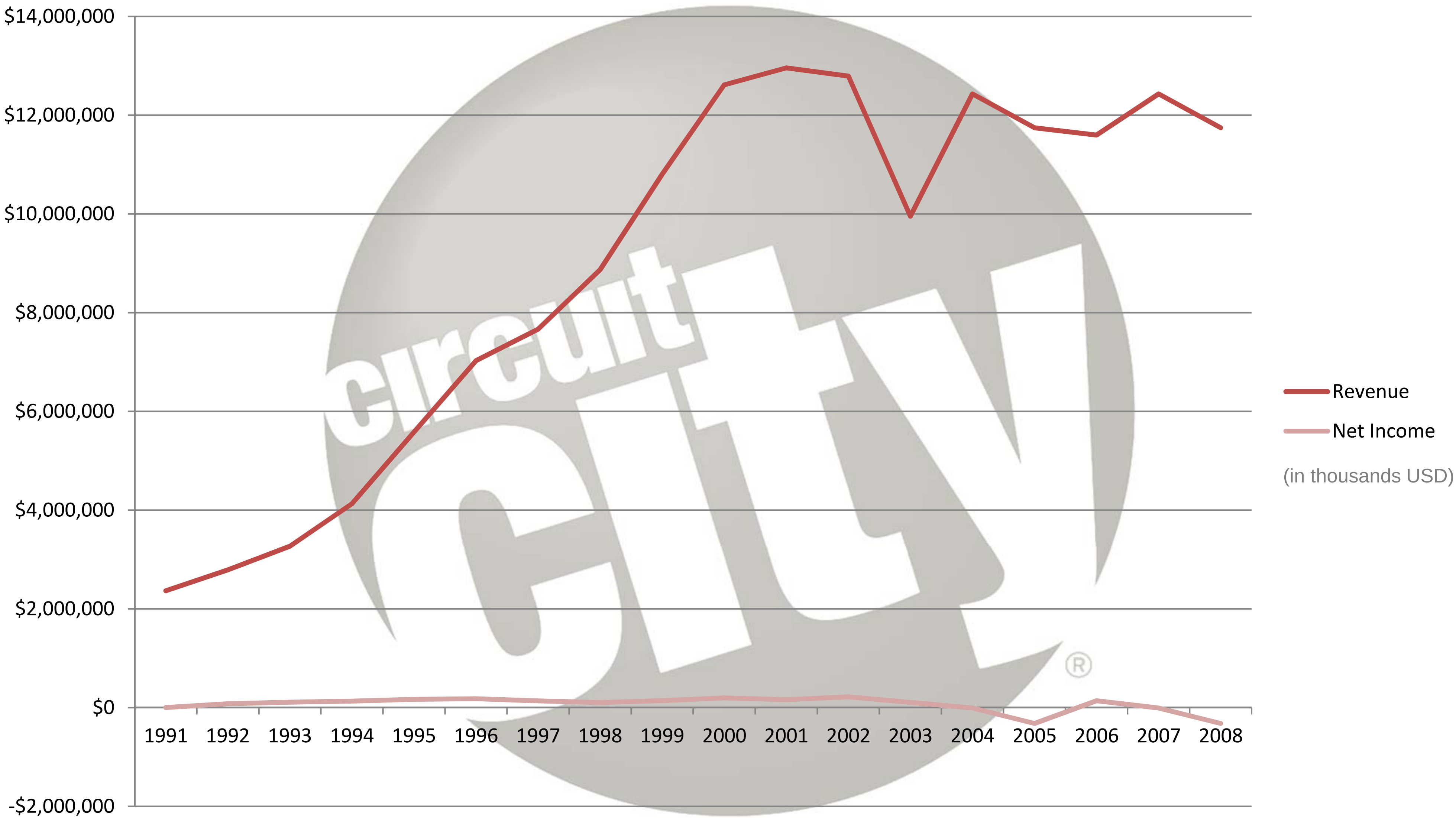
Hurting the Core

The morale of the remaining employees plummeted resulting in even more turnover. With the loss of their best employees, the Circuit City customer experience deteriorated and much like in the restaurant business, when customers have just one bad experience they almost never come back. There are just too many choices.

This fatal mistake resulted in an unrest inside the organization, lost customers, lost productivity, lost revenue and lost profits from which they never recovered.

REVENUE AND NET INCOME SNAPSHOT

1991-2008



LEARN FROM OTHERS’ MISTAKES

Hopefully, This eBook Helps

Unfortunately…

Throughout my consulting work all over the world, I see executives and top managers of major companies making the same mistakes described above. Some are arrogant, some refuse to recognize the necessity of change, some fail to invest in talent, etc. It takes a lot of work to convince people to do things differently, especially if they have operated the business their own way for a very long time.

The challenge for business leaders is to seek innovative ways of developing their businesses while learning from mistakes of the past.

Hopefully, this eBook provides insight into these mistakes as they illustrate the demise of one of the greatest retail organizations ever built. It is very hard to ignore the facts that proved this management behavior wrong.

Follow Don on Twitter at
twitter.com/DonEames

About Don Eames

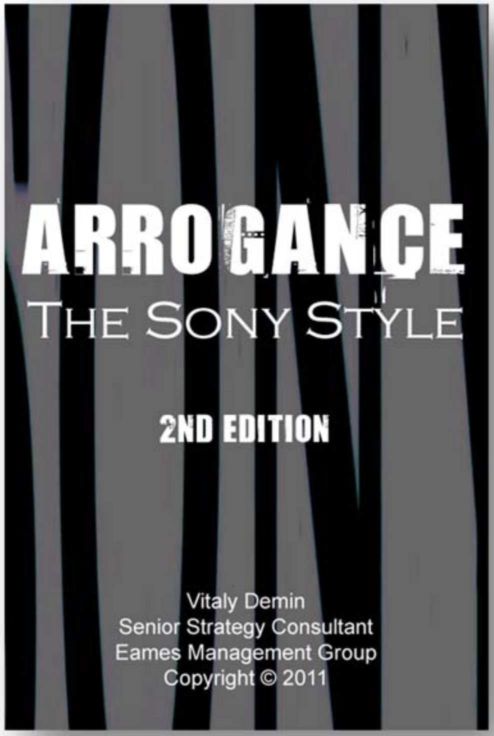
Don worked for Best Buy in senior leadership positions for 17 years including Senior Vice President of Retail Stores and Senior Vice President of Operations, Training and People Development and Growth Strategies. During his time at Best Buy, the company’s total annual revenue grew from about $400 million to over $35 billion.

After leaving Best Buy in 2006, Don founded his own management consulting company, Eames Management Group, and has since been working on projects in the US and abroad for over three years now. The work includes large retailers in the US, Russia, Europe, Kuwait and India.

The core competencies of the EMG company are development of comprehensive growth strategies, implementation of changes inside an organization, improvement of retail performance, effective retail real estate strategies, services integration and talent optimization.

Don Eames and the EMG team can be contacted for consulting services at www.eamesmgmt.com.

MORE EBOOKS FROM EAMES MANAGEMENT GROUP



Arrogance The Sony Style

Vitaly Demin, Senior Strategy Consultant

This eBook is a brief insight into the core of the executive management of Sony Corporation, the core that is unfortunately filled with one of the most perilous human qualities – arrogance. The 2nd edition includes financial updates from 2010 as well as other recent events associated with the Sony organization.

More information about the eBook and download links at eamesmgmt.com/sony.