



## J.C. Penney: The Turnaround?

In September 2000, when a group of J.C. Penney retirees extended an invitation to the company's new CEO to attend their Florida convention, they did not expect to see Allen Questrom. He had been on the job only two weeks while Penney had been mired in trouble for nearly a decade. The company's stock, which many of the former employees relied on for retirement savings, had been falling over the last few years (Exhibit 1, "J.C. Penney Stock Performance"). But Questrom made it to the convention and gave a passionate speech about rejuvenating Penney, the nation's largest department store chain, which left many of the angry retirees feeling confident that a turnaround was underway<sup>1</sup>.

Allen Questrom had a track record in turning around prestigious retail stores that included bringing Federated Department Stores out of bankruptcy in the mid-90s and reviving luxury chains Neiman Marcus and Barneys New York. But even for a veteran like Questrom, J.C. Penney posed a huge challenge. Penney, once the department store of choice for Middle America, was struggling to hold its place after being squeezed by discounters such as Wal-Mart and Target on one side and moderately priced chains like Macy's and Kohl's on the other. Revenues for fiscal 2000 were \$31.1 billion, a 6% drop from 1999, and net income was a loss of \$568 million (Exhibit 2, "Financial Results of J.C. Penney"). More disturbing was the fact that the disappointing 2000 results were an extension of a trend of the last few years.

Questrom and his management team thought that they had identified the central issue that could comprise the cause of Penney's woes. Penney was a completely decentralized organization, subscribing to the philosophy that those closest to the customer best understood their demands. This philosophy dated back to the very beginnings of the company. Even Cash Penney himself believed that those who knew the customer – the store personnel – were best able to determine their needs and desires. Now Questrom had to decide if this best served the company in the current retailing environment. Consequently, processes such as buying, product development, technology and, most importantly, assortment and merchandise selection, were done at the store level. On the other hand, getting input from the stores could be vital in making Penney's assortments the best. On the one hand, changing this system could create major culture shocks throughout the entire organization, which could cause more harm to the company than it was worth.

As a man who once modeled in a Neiman Marcus catalog and acted like a mannequin in a Bloomingdale's window, Questrom certainly added color to the stodgy Penney organization. But the question in the minds of most analysts was whether he, as the first outsider to run the company in its 99-year history, could institute much needed changes and revive this 1140<sup>2</sup> store chain. Indeed, bringing in outsiders in any position throughout the Penney Company was a rarity.

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*This case was prepared by Chandran R. Chary, under the supervision of Professor Alan Kane, as the basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation. This case is for internal use within the Columbia Business School only. It was based on a case written in 1996 by the Harvard Business School and parts of that case were reproduced in this version.*

<sup>1</sup> Business Week: February 12, 2001, "Can an Outsider Fix J.C. Penney?"

<sup>2</sup> In 2001, Penney had 1140 department stores and 2600 Eckerd drugstores.

## History

When James Cash Penney opened his first store in Kemmerer, Wyoming, in 1902, many courtesies that today's customers expect from a retail store such as money-back returns, standardized pricing, high quality merchandise, and friendly customer service were not widely practiced<sup>3</sup>. In naming his first store the Golden Rule, Mr. Penney boldly proclaimed the idea of superior customer service, which set his store apart from his competitors.

In 1909, Penney established a headquarters office in Salt Lake City to coordinate the chain's buying and accounting operations. By 1912, there were 34 Golden Rule stores with sales exceeding \$1 million. By 1914, the chain incorporated as the J.C. Penney Company, Inc., and moved its headquarters from Salt Lake City to New York City to be closer to its major sources of merchandise. As the structure of the place, the growth of J.C. Penney soared. By 1920, 197 J.C. Penney stores were in operation nationwide, with total sales of nearly \$43 million. Between 1920 and 1930, J.C. Penney opened more than 1,750 new stores, mostly in small towns. Although the Great Depression of the 1930s devastated many American businesses, it was a time of opportunity for J.C. Penney. With cash in short supply, value-conscious shoppers patronized the chain and by 1940, Penney had grown to 1,586 stores with sales exceeding \$300 million.

With America's entry into World War II, J.C. Penney shifted to meet the country's wartime needs and produced uniforms for the Cadet Army Nurses Corps and other service units. Following the war, J.C. Penney responded to the rapid growth of suburbs by remodeling its stores, offering a wider selection of merchandise. In 1949, J.C. Penney opened its first store designed as a new "in-shopping center," which was a forerunner of modern-day shopping malls. In 1951, sales for the first time surpassed \$1 billion. Penney was in a strong position nationwide in the retailing of apparel and some soft home furnishings. By 1960, J.C. Penney adjusted its merchandise mix to include hardlines -- appliances, sporting goods, and home furnishings, and offered its customers credit for the first time after decades of cash-only sales.

During the 1960s, J.C. Penney stores expanded their offerings to include styling salons, restaurants, and automotive and garden centers. To provide shoppers with an even greater selection of merchandise and shopping convenience, the first J.C. Penney Catalog was introduced in 1963. By 1970, Catalog sales surpassed \$200 million and the company made its first foray into pharmacies with the acquisition of the Thrift Drug Company. During the 1970s, J.C. Penney's nationwide name recognition, customer loyalty, wide selection of merchandise, and reputation for quality merchandise and customer service, positioned it as a mall anchor. This was reflected by sales increasing from \$1 billion to \$11 billion.

During the 1980s, J.C. Penney undertook a dramatic restructuring program that included modernizing stores and emphasizing high-merchandise offerings more in line with consumer buying patterns. The mix shifted to new mix, auto service, major appliances, paint and hardware, lawn and garden merchandise and suburbs were re-scanned. In 1988, J.C. Penney moved the Home Office, located in New York City since 1914, to Dallas, Texas, bringing the Home Office buyers closer to the selling organization in the stores and speeding up communications within the Company.

By the beginning of the 1990s, J.C. Penney made the transformation from mass marketer to a national department store. For the 1994 fiscal year, J.C. Penney's total corporate sales were \$21.1 billion with catalog and department store sales of \$18.8 billion. Net income exceeded \$1 billion for the first time in the company's history. In 1995, J.C. Penney acquired Eckerd Corporation, a strategic step toward creating one of the nation's premier drug store businesses. The acquisition built upon its Thrift Drug operation with the prior acquisitions of Kerr Drug Stores in 1995 and of Fay's in 1996. As a result, J.C. Penney became the nation's fourth-largest drug store chain.

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<sup>3</sup> J.C. Penney web site

## The Retail Climate

Competition in retailing had intensified in the late 1980s and through the 1990s. The development of numerous regional malls had left most major metropolitan areas with more retail space than their markets could support. In addition, new retail formats evolved; increased competition arose in hardware from power retailers such as Best Buy (major appliances and home electronics), Ikea (knock down, contemporary home furnishings), and Toys 'R' Us, which typically were located in freestanding locations, but not in regional malls. Fiercely competitive discount chains such as Wal-Mart and Target now served the more price-sensitive end of the market. Popular chains of specialty stores such as The Limited, Abercrombie & Fitch, and The Gap competed for apparel market share within the malls. Off price retailers, located in malls, such as T.J. Maxx, Marshalls, Loehmann's, Ross Stores and others were also focused primarily on the apparel market. An explosion in factory outlets and factory outlet malls had increased further the intensity of retail competition. In essence, J.C. Penney was getting squeezed from all directions.<sup>4</sup>

The apparel preferences of the American public were also in transition during this time frame. Apparel sales lost momentum from the strong growth they enjoyed in mid 1980s. The impact of women entering the workforce and investing in professional wardrobes had passed. "Casual dress" had been introduced in the workplace, and more Americans were working at home. In the late 1980s, the "dot-com" culture encouraged a further departure from formal clothes and renewed emphasis on dressing down. The customer became "value-oriented," not necessarily preferring lower price points, but having a heightened interest in quality, service, and convenience with a greater interest in latest fashions than in traditional styles.

In response to these changes, J.C. Penney's strategy was to focus on high margin businesses as a value-oriented, national department store with more emphasis on fashion than in its original positioning. Adopting the decision to reposition J.C. Penney was not easy for the company's senior management, since the company had been very successful in retailing basic and staple items. Executing this strategy was even more challenging. The central buying organization had to learn to purchase more fashionable merchandise for which demand was less predictable. The store operations managers, in turn, had to accept some of the sales uncertainty that came with trendier merchandise. Penney also faced the challenge of establishing relationships with more fashion oriented national brand vendors. To do so, they had to overcome their existing image as a conservative seller of basic and mainly private label merchandise, and the pressure these vendors faced from some existing accounts which did not want to be selling the same merchandise as Penney's. Furthermore, Penney would have to design vendors' own private brand lines with more fashion in mind to attain customer credibility as a seller of more fashion oriented apparel.

While J.C. Penney's chief competitors faced many of the same challenges, they were able to better adapt to the changing retail market due to their organizational structure, which was much more centralized. Penney on the other hand faced a much greater challenge in changing its strategy since a significantly larger group of employees had to subscribe and adjust to the new strategy. Penney's competitors had also managed to establish a better reputation for fashion and high-end merchandise. This meant that they did not face the same level of competition from discounters like Target and Walmart and from the start, differentiated themselves as catering to the market's tastes. As a result, J.C. Penney's efforts to move higher along the fashion hierarchy were expected to be a rocky road. (Exhibit 3, "Fashion Hierarchy in Apparel Market").

## The J.C. Penney Organization in 2000

By 2000, J.C. Penney, Inc., had three main businesses – J.C. Penney Stores, Eckerd Drugstores, and J.C. Penney Direct Marketing Services, and operated more than 1,140 department stores in all 50 states, Puerto Rico, and Mexico. The chain as a whole had more store space, with 118 million square feet, than any

<sup>4</sup> Salmon, W.J., J. Blasberg, D. Wylie, "J.C. Penney", Harvard Business School, April 5, 1996

U.S. department store. The majority of the space was in premier shopping malls. Virtually all store locations had catalog desks. J.C. Penney catalog, including e-commerce, was the nation's largest catalog merchant of general merchandise. In addition, the company operated 35 Renner department stores in Brazil. Merchandise offerings for department stores and catalog consisted of family apparel, jewelry, shoes, accessories, and home furnishings.

Eckerd Drugstores was comprised of approximately 2,600 drugstores located in the Southeast, Sunbelt, and Northeast regions of the United States. Eckerd sold pharmaceuticals, related products, as well as general merchandise.

J.C. Penney Direct Marketing Services was a direct marketing organization that marketed life, health, accident, disability, and credit insurance, as well as membership services products. It marketed to various credit card files by direct-response solicitation primarily in the United States, Canada, Australia, and the United Kingdom.

Women accounted for more than 80% of the apparel purchases in J.C. Penney stores. This was reflected by the amount of store space devoted to women. In a typical J.C. Penney store, the Women's selling area had increased to over 52,000 square feet, nearly 41% of the total. Men's accounted for 31,000 square feet, nearly 27%, while 16% was devoted to Children's, and 1% to Home and Leisure.

The stores and merchandising organizations at J.C. Penney were, in some respects, similar to those at other large retail chains in the United States. Allen Questrom was Chairman of the Board and Chief Executive Officer. Vanessa Castagna, the chief operating officer who reported to Questrom was responsible for the J.C. Penney stores, catalog and internet. Reporting to Castagna was an Executive Vice President (EVP) of Stores, and an Executive Vice President of Merchandising.

Reporting to EVP Stores were Regional Senior Vice Presidents (RSVP) and through them, the entire store organization. Store Managers reported to District Managers and the District Managers reported to the RSVPs. Each Store Manager supervised 2 Assistant Store Managers (ASM), an HR Manager, an Operations Manager, and the Visual Merchandising Manager (VMM). Department Managers and Assistant Department Managers reported to Assistant Store Managers (Exhibit 4, "Organizational Chart"). The sales associates at J.C. Penney, who were known as the exceptional club, reported to Department Managers. Some of the ongoing management of the store staff however, was handled by selling supervisors (reporting to the HR Manager). They established hiring policies for all personnel and were responsible for training. (Exhibit 5, "Tenure and Remuneration of Members of the J.C. Penney Store Organization") One of the well-known facts about Penney was its long tenure on its store organization.

In the home office buying organization reporting to the EVP of Merchandising either directly or indirectly were General Merchandising Managers (GMMs), Vice Presidents (VP) of Merchandise Development and Directors of Merchandising (DMMs). Reporting to the VP of Merchandise Development were Fashion Directors and Brand Managers. The DMM on the other hand oversaw the merchandising operation and supervised Merchandising Managers (MM), Buyers, Assistant Buyers and Marketing Program Managers (MPM). While overall in the merchandising organization was focused on assortment selection and purchasing, the responsibilities varied in terms of the product entities and groups (Exhibit 6, "Job Roles at J.C. Penney").

The primary difference between the organizational structure of Penney and its competitors was the split responsibility for merchandise selection and ordering. Consistent with the philosophy of store autonomy, Penney store personnel played an important role in choosing the merchandise assortment that suited their particular customers. Penney's management believed deeply that those closest to the customer could best assess the unique aspects of local consumer preferences. Although encouraged to purchase inventory through headquarters, department managers sometimes purchased directly from other approved sources.

J.C. Penney executives knew that the dollars of expense for the merchandising organization both centrally and at the stores was higher than at most of their competitors. They believed, however, that the benefits derived from maintaining a strong central merchandising organization with significant product development capabilities and talented merchandising personnel in individual stores far outweighed the added financial burden.

### **Merchandising Responsibilities**

As mentioned above, responsibility for merchandising was split between the central merchandising organization and the individual stores. Within the merchandising organization, Buyers and Brand Managers were the individuals most directly responsible for implementing the fashion strategy. While Buyers were charged with the negotiation and purchase of merchandise from vendors around the world, Brand Managers were involved with the design and sourcing of high quality, private brand merchandise. Buyers and Brand Managers worked closely to ensure that the private brand merchandise complemented the nationally branded assortments. In addition, the Buyers were charged with conveying information about the available merchandise to the Assistant Store Managers and Department Managers who determined the merchandise that would be purchased for their individual stores.

Buyers had either entered J.C. Penney as an Assistant Buyer or had gained experience in buying positions at other companies. Very few had any direct experience within J.C. Penney stores until the late 1980's when Department Managers were recruited from the stores to be Assistant Buyers. Buyers were paid a salary and a bonus based on their sales and gross margin performance. Buyer's salaries, bonuses, and total remuneration were competitive with that of buyers in other large department store chains.

Historically, Buyers had been responsible for all phases of developing private brand merchandise. As the company strove to become more fashion forward, however, development of private brand became more complex. To differentiate itself from competitors, J.C. Penney created the Merchandise Development Organization in 1990 to create coordinated collections of private brand merchandise. The position of Brand Manager was created to focus on developing high quality, value driven, fashion merchandise. Brand Managers were almost all experienced buyers, and were paid a salary and bonus comparable to and based on the same targets as Buyers. The Brand Manager level of the private brand development role, could concentrate on buying merchandise and controlling inventory.

Marketing Program Managers (MPMs) were communication links between Divisional Merchandise Managers, Buyers and Brand Managers and store personnel. MPMs were promising Assistant Store Managers who rotated for seasonal assignments through headquarters before pursuing careers in either the store or central buying organizations. There was one MPM for each merchandise classification. In women's sportswear, for example, there were MPMs for casual sportswear, career sportswear, and special sizes. They acted as the "stores' representative to the buyers and the buyers' representative to the stores," and coordinated such efforts as product marketing programs, facturing, and national advertising. They facilitated communication to the stores (particularly through the satellite broadcasting presentations and seasonal merchandising CD's described below), developed visual presentation guides, developed (with the Buyers) the content and timing of advertising programs, and made sure the stores were aware of upcoming sale events.

### **The Store's Role in Determining Assortments**

In addition to ordering merchandise for their stores, Department Managers also had departmental responsibility for training the sales staff on merchandising matters, selling, handling customer problems, making sure that new merchandise was presented properly on the selling floor, setting up sale events, taking markdowns on slow-selling inventory and taking seasonal physical inventory. They also had to determine their sales targets for future seasons. Department Managers were typically recent college graduates who had

successfully completed a one-year training program, which consisted in part of gaining practical store experience under the tutelage of seasoned Department Managers.

Typically, an individual had been a Department Manager for less than one year, and had been assigned their current merchandise entity for 18 months. The average remuneration for Department Managers was about \$35,000, 15 - 30% of which was a bonus related to sales increases. Department Managers generally were interested in pursuing careers either within the store or central buying organization.

Department Managers gained valuable assistance in buying from their veteran counterparts. They also counseled with regional and district personnel in choosing inventory. Because of their limited experience, however, Department Managers relied most heavily on the Business Planning Manager (BPM), the Assistant Store Manager, and the Store Manager for direction and advice.

Every week each Store Manager gathered his/her staff together to discuss upcoming events such as special promotions or special broadcasts on the satellite network from headquarters. In addition, CD's were periodically sent from the buying organization to the Department Managers, Assistant Store Managers and Store Managers, which showed the new merchandise selections for them to choose from for their store. Store managers reviewed all pre-season sales estimates and promotional plans to make sure the Department Managers and Assistant Store Managers were doing their job properly.

Department Managers were encouraged to order all merchandise from the headquarters but, with the consent of the Store Manager, were authorized to purchase directly from non-headquarter-approved suppliers to meet unique store needs. Because the introduction of the satellite broadcasting system and later the distribution of CD's had enhanced Department Managers' confidence in the central Buyer's selections, they now relied more on headquarters for the majority of their orders.

Another important source of guidance for Department Managers was the Business Planning Teams. Each district had five or six Business Planning Teams organized by merchandise division. A designated Store Manager called an "entity manager" provided general guidance for each Business Planning Team. An experienced Assistant Store Manager chosen from within a district store was designated Business Planning Manager (BPM) and the other members of the team were experienced Department Managers from within the district. The District Manager with the approval of the Regional Manager selected the BPM and other team members.

Being named BPM was recognition of a Assistant Store Manager's abilities. The BPM's job was to gather suggestions from the team and to suggest buying strategies for all district personnel to follow when ordering merchandise for their departments. They were also always available to respond to questions. Department Managers often gathered at the BPM's store to view and discuss the broadcast from headquarters or a new CD's recommendation from their Buyer before placing orders.

Under the direction of the BPM, the team's mission was to build sales and profits within the district. Typically, the team recommended appropriate purchase quantities and the emphasis to be given to major items. In addition, the teams would identify sales opportunities, communicate to MPM's at corporate, encourage all stores within the district to participate in major events, recommend newspaper advertising, and coordinate merchandising matters such as price point emphasis, clearances, overstock and markdown activities, and resolution of delivery problems.

## **Technology and Communication with the Stores**

In 1914, when a central buying office was originally set up in New York City, Mr. Penney had concerns about diminished store autonomy, but strongly felt that merchandise buyers needed to be close to

their suppliers to understand trends. Store managers also recognized the contribution of the central buying office, but maintained that ultimately they knew best how to stock their stores. Indeed, one of the major challenges J.C. Penney executives continued to face was how to maintain the benefits of decentralization while offering more assortments which included difficult to purchase, fashion forward merchandise. To surmount this challenge, J.C. Penney made extensive use of market research, and information technology. This included the use of a system of satellite direct broadcasting and later, a system of communicating via compact diskette with the ultimate goal being online interactivity between headquarters, nearly 4,000 suppliers, and Department Managers at 1,140 stores. These technologies enriched and expedited the flow of merchandise information between headquarters and store personnel to help them participate in making more timely and accurate buying and merchandising decisions.

The satellite system included three central broadcast studios at the Dallas headquarters and large screen monitors in most stores. A major and continuing consumer research program and direct, instantaneous communication between Buyers at headquarters and the Department Managers in the stores were its primary uses. The consumer research program had been introduced to help Buyers make better decisions. When Buyers or Brand Managers needed feedback on a particular item or item, they could broadcast directly to focus groups at sixteen geographically and demographically diverse stores. At each store, consumers representative of J.C. Penney's customers were chosen and paid to attend an evening meeting in a specially designed facility. There, the fashions to be tested were broadcast through the satellite system on large screen monitors. Buyers and Brand Managers used the results of feedback to achieve a better feel for fashion direction.

The satellite system was also used to broadcast "fashion shows" to store personnel four months before each season. Since the stores had final say on what merchandise to stock, it was crucial in the hectic fashion world to have an accurate and rapid communication system between Buyers and stores. Within two weeks of the fashion shows, orders were sent electronically through PCs back to the Buyers, usually in time to adjust final production orders and shipping schedules for private brand merchandise and final orders for national brand merchandise. For the early spring line, for example, the broadcast was done in September, allowing the Buyers to make final adjustments to their orders for production in October and November.

In addition to the seasonal "fashion shows," there were numerous informational broadcasts per year to the stores for each merchandise category. The purpose was to explain to store personnel both fashion ideas and other selling features of new merchandise. Store merchandising personnel also received periodic up-to-date information briefings on fashion developments since J.C. Penney executives believed in keeping store leadership in the "fashion decision loop." During the broadcast, questions could be phoned into the Buyers. Questions about a particular request for details on a particular item, clarification of fashion trends, or coordination among merchandise divisions could be broadcast to the entire audience.

The broadcasts were later partially replaced by CD's, where diskettes produced at headquarters were distributed to all relevant store personnel for viewing on personal computer. The diskette provided the same level of information, but allowed the personnel the freedom to view offerings at their convenience. The CD system broke the total store assortment down into approximately 150 merchandise divisions with further distinctions within each division, resulting in 600 to 700 merchandise categories per store. Stores were also classified into nine groups depending on sales volume with purchase recommendations varying by store size. Appropriate diskettes were sent to each store. As a result, viewing time by store merchandising personnel was shortened because, unlike the broadcast, it was only necessary to view the segments pertaining to one's volume class within a merchandise division.

Before each broadcast and along with each diskette, the stores received a rather complete supplementary package for the forthcoming broadcast. This package included supplementary information when the broadcast could not adequately convey subtleties of color, texture, or pattern of particular items. Worksheets and selling and display suggestions were also a part of the supplementary package.

## Private Brand Merchandise

J.C. Penney's core customer, the middle-income consumer, preferred high-quality, attractive merchandise, but wanted it at a reasonable price. The private brand strategy was an effective way to address both the price and quality concerns of the customer. National name brands were perceived as status symbols, which lacked uniqueness, while private brands represented value and fair price. For instance, Stafford and Worthington, two of Penney's private brands, were considered to be good values by customers.

In the stores, Penney's brands were displayed adjacent to national brands. Consumers could compare their look, feel, and price, and make their own choices. By the late nineties, some of Penney's private label lines such as Worthington were close behind national brands such as Lee, Claiborne, and Jones Apparel Group.

J.C. Penney's successful private brand program had a very positive effect on profitability since gross profit dollars per item were much higher than on national brands. To further enhance its private brand businesses, J.C. Penney supported it with a major TV advertising campaign.

Private brands were particularly important to J.C. Penney since the chain was struggling to establish a fashion-forward image and faced very stiff competition on some of the national brands from discounters like Target and Wal-Mart and moderate priced chains like Kohl's.

## The Merchandising Planning Cycle

The first step in J.C. Penney's merchandising planning cycle was developing the "open-to-buy's" for a season for both, private brand and nationally branded merchandise. There were four seasons per year for planning purposes—Spring, Summer, Fall, and Holiday. The planning process started at the end of the previous year's comparable season when Department Managers at the stores estimated sales for the same season next year. After review by senior store management, buyers used these plans to establish initial wholesale purchase quantities.

A Buyer would commence the private brand planning process for apparel about eight months before store delivery. Initial design for clothing line schedule to "hit the stores" in January, for example, took place the previous April. This was so that a buyer for domestic and foreign markets had been shopped to determine concepts and trends for colors, fabrics, and silhouettes. By the middle of May, Buyers and Brand Managers determined needed quantities and discussed specific requirements and approximate purchase prices with selected private brand manufacturers. These manufacturers sometimes relied on Penney to purchase fabrics directly from the mills. Major suppliers of national brand merchandise were also contacted at about the same time to discuss needs and seasonal timing requirements.

By mid-June or so, months prior to delivery, unit recommendations for private brand merchandise were established by color and style. By July 1, unfinished fabric emerged from the mills to be treated and dyed by September. Production of private brand merchandise, often in the Far East, took place in October and November. By December finished goods would leave by ship in time for distribution to the stores.

For national brand merchandise, typically purchased in smaller quantities, the detailed ordering process would not begin until October when J.C. Penney buyers visited suppliers and viewed merchandise. Orders for 50% to 75% of anticipated needs from these vendors were placed at this time. The balance was not ordered until the individual J.C. Penney stores had reviewed these selections. Final merchandise commitments by style, color, and size were ultimately placed in early December for January and later delivery.

<sup>5</sup> "Open to Buy" is the budget available for inventory purchases

## Management Team

Allen Questrom, Chairman and CEO, and Vanessa Castagna, Chief Operating Officer for J.C. Penney Stores, Merchandising, and Catalog headed the management team. Questrom had a modest upbringing in blue-collar Waltham, Massachusetts, where his father owned a machine shop (Exhibit 7, "Allen Questrom Resume"). After graduating from Boston University, Questrom joined Federated's Abraham & Straus division as a management trainee in 1965. He worked his way up to Divisional CEO, transforming both Atlanta-based Rich's Department Stores and the glitzy Bullock's Department Stores in Los Angeles. In 1984, he left Federated on a sabbatical to travel around the world with his wife, Melli. When he became Chairman of Federated, he did a masterful job in turning the company around and bringing them out of bankruptcy. He then abruptly retired in May, 1997, a year early, and shocked colleagues in the retailing industry by suing Federated for \$47 million in back pay, but lost the suit. Questrom joined J.C. Penney in September of 2000.

Vanessa Castagna had more than 27 years of retailing experience and was most recently Senior Vice President and General Merchandise Manager at the Wal-Mart stores division. She had a reputation as an outstanding merchandising executive.

## Turnaround Issues

In their turnaround strategy, Questrom and his management team had to address several issues towards improving the performance of Penney. Although cost-cutting through store closings and downsizing were important elements towards improving profitability, they were not the ultimate solution. Questrom and his team had to revive the chain by giving people, especially the younger customers, a reason to shop in the store again. Questrom's desire was to transform the entire organization to position J.C. Penney more boldly as a fashion and quality department store. Executing this strategy required convincing suppliers to sell Penney products similar to those being sold to stores such as Macy's, overcoming objections from such stores. It also meant encouraging the central buyers to offer the stores assortments, which were more fashion forward and slightly higher in price, and encouraging store personnel to stock and prominently display such merchandise.

In spite of the communications system, Questrom and Castagna remained concerned with the execution of this strategy. Store merchandising personnel, they thought, were still somewhat reluctant to emphasize fashionable merchandise and under the current organization, store personnel carried significant weight in merchandising decisions. The reluctance on the part of store personnel to adequately emphasize fashionable merchandise in turn affected corporate buying practices. Buyers hesitated to place large orders with vendors for the fashion items they had to wait for store reaction to the next broadcast or CD presentation (which could be as much as several weeks away) and hope that the items would be received well and ordered by the Department Managers. In essence, the split merchandising responsibilities resulted in too many decision makers and consequently slowed the ordering process for fashion-forward merchandise, where speed was critical.

Additionally, the limited knowledge and experience of Department Managers was a concern for headquarters' Buyers. When selecting both private brand and nationally branded merchandise, Buyers had to know what would play well on screen and what would appeal to Department Managers. If video failed to do justice to an important item, they might send out a swatch of material with the supplementary package. Because they were now presenters, Buyers also had to communicate effectively on television, but sometimes the characteristics of great Buyers and effective television communicators did not coincide. Again, because of the split responsibility, the experience and skill of a Buyer in selecting merchandise, fashion-forward or otherwise, was wasted unless Department Managers were equally capable of realizing the merits of the

product. It was more likely that a few central Buyers would have the required talent than the thousands of Department Managers.

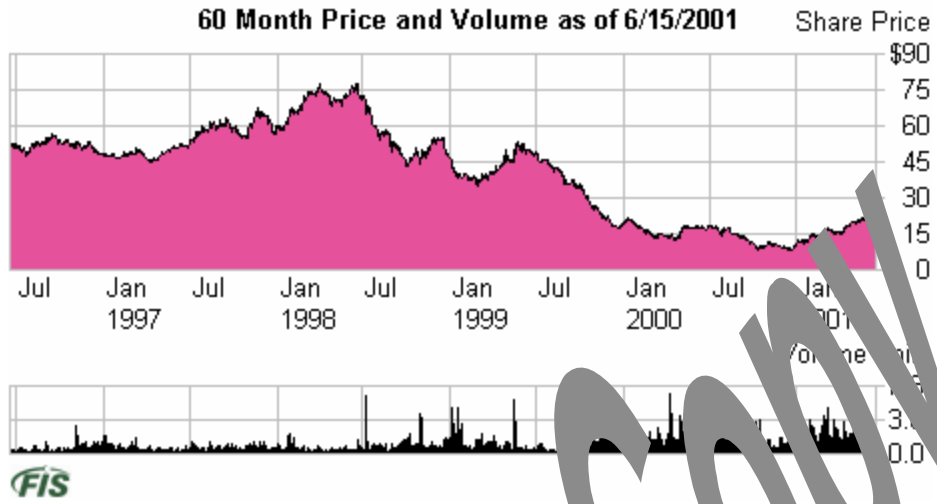
Moreover, Penney did not have a clear image and consequently lacked the status to move upmarket alongside chains like Macy's. On the other hand, it did not have the infrastructure or culture to go downmarket against discounters like Wal-Mart. While Penney had a national presence and a track record selling through catalogs and online, the stores were aging and most of them suffered from clutter and poor lighting. The last major success among private label brands was introduced by the brand, Meties. The hiatus in successful private label brands had weakened Penney's position vis-à-vis competitors like the Gap and Abercrombie & Fitch. The Eckerd chain of drug stores, which Penney acquired in 1997, was ailing and needed to be revived.

Questrom and Castagna recognized that drastic changes in a culture considered unresponsive and stodgy were essential for the turnaround. But the question was where should they begin and how should they proceed. If the decision was to proceed with a complete centralization of buying, would it be a gradual process or an immediate change? How would the store personnel react to a reduction in their input in merchandising decisions? Would J.C. Penney succeed in changing its image and customers' perception by changing the merchandise mix? Should the move to a centralization be independent of the success in changing the chain's image and reputation? If the strategy to move upmarket was not successful, what would be the backup plan to deal with the increasing competition from discounters like Wal-Mart and Target? What should be their strategy with the Eckerd Drug Stores and J.C. Penney Direct Marketing Services? What further changes in merchandise planning and selection activities, market research, the use of technology, organization, the recruitment and training of people, and in methods of compensation could contribute to the goal of turning around this battleship heading towards disaster?

As Questrom pondered over these issues, he realized that the turnaround would be a much tougher act than standing perfectly still as a mannequin in a store's window. He knew this was a situation that required bold action and many fundamental decisions. But he was also certain that every action of his would be scrutinized by thousands of Penney shareholders and millions of customer who shopped at J. C. Penney stores everyday – many more than the curious few evaluating his prowess as a mannequin.

## **Exhibit 1, "J.C. Penney Stock Performance"**

60 Month Price and Volume as of 6/15/2001



INSPECTION COPY

<b>Exhibit 2, "Financial Results of J.C. Penney"</b>			
<b>INCOME STATEMENT (\$M)</b>		<b>Year ending 12/00</b>	<b>Year ending 12/99</b>
Revenues		\$ 31,846	\$ 32,119
Cost of good		\$ 22,458	\$ 22,665
Gross Margin		\$ 9,388	\$ 9,454
Selling & Admin		\$ 8,631	\$ 8,100
Depreciation		\$ 695	\$ 710
Operating Profit		\$ 561	\$ 934
Interest + Other Costs		\$ 942	\$ 1,010
Tax		\$ (18)	\$ (103)
Net Income		\$ (56)	\$ 336
Dividends per Share (\$)		\$ 0.19	\$ 2.18
Earning Per Share (\$)		\$ 2.81	\$ 1.16
Operating Cash Flow		\$ (43)	\$ 1,010
<b>BALANCE SHEET (\$M)</b>		<b>Year ending 12/00</b>	<b>Year ending 12/99</b>
Cash & equivalents		\$ 944	\$ 1,233
Other Current Assets		\$ 6,313	\$ 7,239
Total Current Assets		\$ 7,257	\$ 8,472
Fixed Assets		\$ 12,485	\$ 12,416
Total Assets		\$ 19,742	\$ 20,888
Current Liability		\$ 4,235	\$ 4,465
Total Non-current Liab.		\$ 4,199	\$ 3,797
Long Term Debt		\$ 5,448	\$ 5,844
Equity		\$ 5,860	\$ 6,782
Total Equity + Liabilities		\$ 19,742	\$ 20,888
Shares Outstanding (000s)		263,000	261,000

**Exhibit 3, "Fashion Hierarchy in Apparel Market"**

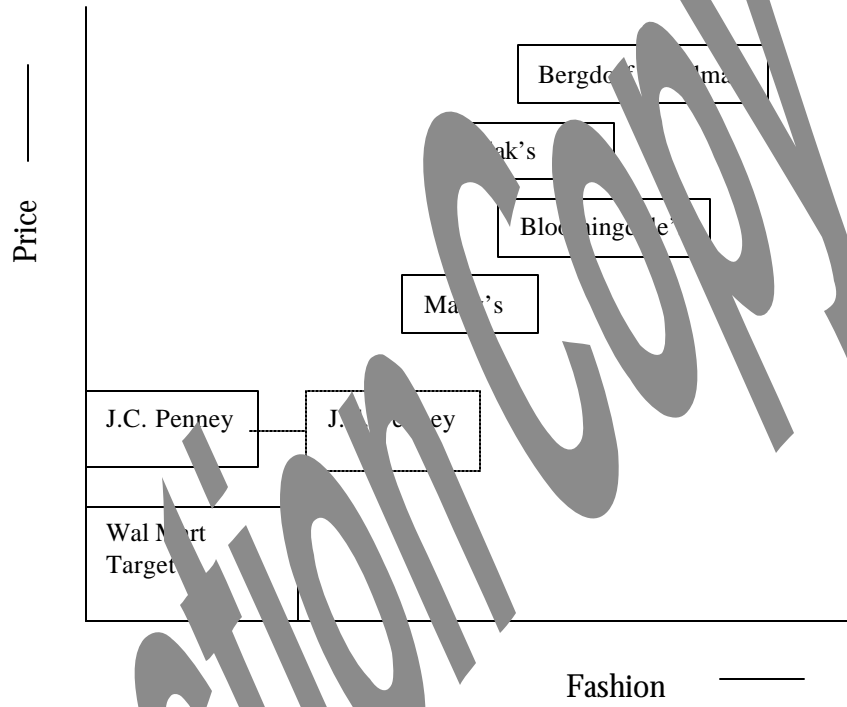


Exhibit 5, "Tenure and Remuneration of Member of the J.C. Penney Store Organization"								
Employee Position	Tenure with J.C. Penney (years)		Tenure in Current Position (years)		Range of Total Compensation (thousands of US\$)		Bonus as % of Total Compensation	
	Min	Max	Min	Max	Min	Max	Min	Max
Store Manager	15	40	1	10	\$ 50	\$ 150	20	50
Visual Merchandise Manager	1	30	1	30	\$ 15	\$ 35	10	25
General Merchandise	8	20	1	6	\$ 30	\$ 60	10	40
Business Planning Manager	10	20	1	6	\$ 35	\$ 70	15	40
Senior Merchandise	6	20	1	20	\$ 25	\$ 45	15	30
Merchandise Manager	1	20	1	20	\$ 24	\$ 35	15	30
Merchandise Assistant*	1	30	1	30	\$ 12	\$ 18		
Sales Associate*	0	30	0	30	\$ 9	\$ 15		

\* Does not include commissions

Source: Harvard Business School Case, J. C. Penney, #9-596-102, April 5, 1996

## **Exhibit 6, “Job Roles at J.C. Penney”**

### **Key Responsibilities – Store Organization**

#### **Executive Vice President (EVP), Stores**

Responsible for the management of all stores, including presentation of merchandise, assortments in the stores, display of merchandise, budgets and expense control, customer service and problems, receiving and marking merchandise, shrinkage control program and HR for the employees in the organization

#### **Senior Vice Presidents (SVPs), Regionals**

Same as an EVP except responsible for their region

#### **District Manager**

Same as SVP, except responsible for their district

#### **Store Manager**

Same as a District Manager, except responsible for their store

#### **Assistant Store Manager**

Supervises department managers and has similar responsibilities as a Store Manager, except responsible for their merchandise entities

#### **Operations Managers**

Responsible for all back-end operations in a store including receiving and marking merchandise, getting merchandise to the selling floor, shrinkage control, cash registers and equipment

#### **Visual Manager**

Puts the “icing” on the merchandise cake, and is responsible for mannequins, displays etc.

#### **Human Resources Manager**

Responsible for benefits, reviews, personnel problems and filling open positions

#### **Department Managers**

Responsible for one merchandise entity such as menswear. Determine assortments for their departments, supervise staff and their schedules, and handles customer problems, merchandise presentation, signs, in stock on sale goods, and personal selling.

#### **Business Planning Teams (BPT)**

In charge of a particular merchandise entity eg. Menswear in District 5. Consists of a store manager, an assistant store manager, and a few departmental managers that have a good understanding of the particular merchandise category. The team also helps stores in their district determine their assortments and serves as the communication arm with the merchandise organization.

## **Exhibit 6 (contd.), “Job Roles at J.C. Penney”**

### **Key Responsibilities – Merchandising Organization**

#### **Executive Vice President (EVP), Merchandising**

Responsible for sales, gross margins, inventory management for entire company, choosing suppliers, determining merchandise categories to grow and contract, choosing merchandise, determining price points, and determining merchandise to be advertised.

#### **General Merchandising Manager (GMM)**

Same as EVP, Merchandising except responsible for only their merchandise category, eg., Menswear

#### **Director of Merchandising (DMM)**

Same as GMM, except for a more specific merchandise entity, eg., men’s weekend wear

#### **Merchandising Managers (MM)**

Same as DMM, except for a more specific merchandise entity, eg., men’s casual bottoms

#### **Buyers**

Same as MM, except for only their merchandise entity, eg., men’s jeans

#### **Marketing Product Managers (MPM)**

Communication arm between stores and merchants

## **Exhibit 7, “Allen Questrom Resume”<sup>6</sup>**

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<sup>6</sup> Business Week: February 12, 2001, “Can an Outsider Fix J.C. Penney?”

**RESUME:** **Allen I. Questrom** (Business Week: February 12, 2001)

**BORN:** Apr. 13, 1940, Waltham, Mass.

**EDUCATION:** BS, finance, Boston University, 1964

**CURRENT JOB:** Chairman and CEO, J.C. Penney Co.

**RETAIL RESUME:** Built reputation as a turnaround artist at Rich's and Bullock's of Federated Department Stores, Neiman Marcus, and Barneys

**CAREER BREAKS:** Twice he has taken sabbaticals to bike and ski in places such as France and the Andes

**AFTER- HOURS:** Enjoys ballroom dancing with his wife

**MANAGEMENT CREDO:** Focus on a few big priorities and everything else falls into place

**MESSY GOOD-BYES:** Sued Federated in '98, claiming his \$16 million pay over five years was short \$47 million based on company's rising stock price; a judge threw it out

**FAMILY:** Lives in Dallas with wife of 33 years, Kelli, a former exec at Ralph Lauren; no children