COLUMBIA BUSINESS SCHOOL

STEWART'S DILEMMA

October, 2003[1]

Brad Stewart, Chairman and CEO of Stewart's Department Stores sat back in his chair as the last of the Directors walked out of the Board Room. It had been a long meeting and the Board was very concerned. "Brad," Geoff Carleton, one of the most vocal directors had said,"we really need to put a strategy in place. Right now I don't even see Abbey and you agreeing on much." Abbey Doolittle, Executive Vice President of Merchandising for Stewart's had joined less than two years ago in July 2000. Her perspective, refreshing at that time, now appeared to be mostly contrary to Brad Stewart's instinct. They agreed on precious little, except that they faced a difficult situation.

Stewart's, a 52 store regional chain of mid-priced department stores was facing steadily increasing competition in a market that was already complex. Over the years Stewart's had built a reputation of providing good value with its competitive pricing. This reputation, however, had been diluted over the past five years as competition in their markets increased significantly. Picard's Stores and M. Lyons Department Stores, their primary department store competitors, were pursuing aggressive promotional pricing. In addition, Stewart's also faced competition from category killers like Toys 'R' Us, national speciality stores like The Limited and The Gap and discounters like Wal-Mart and K-Mart.

Thus far, Stewart's pricing had become increasingly promotional in reaction to the competition. Doolittle saw this as a 'defensive' approach aimed at assuring customers that their prices were on par with the competition. She advocated a more aggressive pricing policy aimed at re-establishing the image of being lower priced than the competition. Stewart saw this as just another step in a vicious cycle of price cuts that hurt both sides.

The competition also varied across the chain. While stores in the larger urban areas faced competition from Picard's and Lyons, in rural areas Stewart's did not face significant department store competition except for J.C. Penney and Wal-Mart which were important competitors in almost all markets. Historically, Stewart's pricing had been consistent and decided centrally. Doolittle favored empowering store management to make pricing decisions based on the competition. Stewart was reluctant to change policy on this.

[1] *This case was revised by Mukund Rajagopalan MBA 2001, 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. Most of the names and numbers have been disguised. The original case was prepared by Professor Gwen Ortmeyer under the supervision of Professor Walter Salmon of the Harvard Business School. This case is to be used as a teaching tool and should be used internally only by Columbia Business School students for class discussion purposes.*

What concerned the Board most was the fact that Stewart's did not have a consistent strategy to address the competition and make its pricing decisions. The Board meeting had ended inconclusively. Now Stewart had a fews days before the next meeting to put together a strategy that he was convinced would work. Further, he would need Doolittle's support in presenting the strategy to the Board.

Company

Context

Stewart's Department Stores had originated in Lansing, Michigan and had been in Brad Stewart's family since his grandfather built it up from a single store. In the early days and up until the 1970s, Stewart's had carried very few brands as its competitor –Picard's - had exclusive arrangements with many of the major vendors. In the early 1970s, however, Stewart's had managed to obtain most of the major brand lines.

Brad Stewart believed that department stores should offer the customer a broad assortment of merchandise, in both style and price. He wanted Stewart's to carry upscale items including designer brand names while also carrying opening price point merchandise (the lowest price points in the moderate category). He also believed that there were various unexploited opportunities in various segments including housewares, soft home (including sheets, towels and table linens) Christmas trimming and decorations, and bridal. In housewares and electronics he planned to focus instead on upscale brands such as Braun and Krups and drop low end brands such as Black and Decker.

However, Abbey Doolittle, Stewart's Executive Vice President, was concerned about the possible 'proliferation' of SKUs. She preferred to examine the inventory carefully and carry a more limited line where possible. She also looked for particular merchandise that would sell in large volumes, under the 'Key Item' program. For the 2001 Christmas season, Doolittle had purchased some regularly priced spring merchandise anticipating that items such as polo shirts might be popular gifts for retired parents living in warmer climates. As a result, Christmas sales of regular priced polo shirts had reached 13,000 units.

In order to spur growth, Stewart's aim was to remodel two stores and add two stores per year. Doolittle was also looking for increases in net sales and gross profit dollars from existing stores but was not overly concerned with maintaining gross margin as a percent of net sales. In Lansing, in particular, Doolittle noted that Stewart's had been quite successful at converting same store sales increases, often done at a lower gross margin percent, into more gross profit dollars.

Store Locations

In May 2002, Stewart's Department Stores existed in 52 locations in 35 cities. Picard Stores was Stewart's only department store competition in Lansing and many of its outlying communities such as Jackson, Michigan. In Flint, Lyons was the only significant department store competitor. Both Picard Stores and Lyons competed aggressively against Stewart's in Grand Rapids and its suburbs, one of which, Middletown, was only 30 minutes from Lansing. In the smaller and more remote communities, Columbus, Indiana for example, Stewart's operated without significant department store competition other than J.C. Penney and Wal-Mart, which had locations that essentially competed with all Stewart’s stores. Various sales and sales force expense data for 2002 by location are shown in Exhibit 1.

In the smaller communities in which it operated, Stewart’s was typically the best quality department store in town and located in the town's only mall. A typical mall in a smaller town might include, along with Stewart’s, a K-Mart discount department store, perhaps another discount department store, and a J.C. Penney. Stewart’s planned to continue to build stores in smaller communities, so long as they continued to be successful against existing small town competitors.

Merchandise Mix

All Stewart’s stores carried basic assortments of clothing (men's, women's, and children's), soft home and housewares, cosmetics and women's accessories, and at least a limited selection of electronics. The mix had gradually become more focussed on soft goods, though most in the organization agreed that Stewart’s would continue to retain a presence in electronics, and other home furnishings.

Some Stewart’s Stores also carried toys, records and books, though these merchandise areas received far less emphasis. Fine jewelry was a leased department. Stores that were not in mall locations also tended to include certain ‘departments’ to generate store traffic like health and beauty aids, candy and prescription drugs.

In an attempt to convey a modestly upscale image a few stores also carried a limited selection of bridge and designer merchandise. Generally the upscale merchandise was carried in the larger big city stores. The heart of Stewart’s business, however, was the upper moderate labels such as Liz Claiborne in women's sportswear. Alissa Peck, General Merchandise Manager of Ready to Wear believed that, "bridge and designer merchandise is a tough sell in this part of the country."

Doolittle wanted to focus attention on the key divisions that had substantial impact on the rest of the store's business. These included cosmetics (a business that generates repeat customers), intimate apparel (a high margin business), women's and missy's sportswear (the dominant areas of women's ready-to-wear that generate carryover business to other divisions) and accessories (strong in a recessionary period). As a result, she planned to give these businesses additional advertising space, the best sales associates, and generous inventory allotments. 2002 sales data by merchandise division are shown in Exhibit 2. Pre-tax income as a percent of total revenue for Stewart’s as against industry benchmarks is given in Exhibit 3.

Management Structure

Stewart’s had a formal organization chart which was typical of many department stores. A Senior Vice President and Director of Stores, a Senior Vice President of Marketing and Advertising, a Vice President and Visual Merchandise Manager, and four Senior Vice Presidents and General Merchandise Managers reported to Doolittle. Each of the General Merchandise Managers (GMM's as they were typically called) was responsible for a number of Divisional Merchandise Managers who, in turn, managed the buyers. Stewart’s had 95 buyers in 2002.

While Stewart's buyers were paid a straight salary, Divisional Merchandise Managers received a salary and bonus, which was related to the DMM's net sales, gross margin dollars, return on investment, and shrinkage. Specifics on the DMM bonus plan are given in Exhibit 4. Brad Stewart was considering adding a bonus plan for buyers.

In addition to the these tangible measures, Stewart and Doolittle evaluated both the buyers and the DMM's from a "qualitative standpoint," based on specific goals established by top management. In particular, they considered whether their long term views of merchandise content was consistent with the company's goals.

Their interactions with the merchandising organization were informal. These interactions often included discussions of particular items that the buyers and DMM's felt would be particularly strong and/or could be purchased from the vendor at a good price.

In contrast with the merchandising organization, store managers were responsible only for sales, the expenses that were under their control, customer service, and shrinkage. Store managers were not responsible for pricing or gross margin. Many believed that store management was the weakest level of company management.

Doolittle hoped to improve it. "We have to give up control of pricing decisions Brad," Doolittle had said,"The competition is fragmented and we need to respond to each location differently. Let the store managers have more control." Stewart however, felt that the concerns of Store Managers were often limited to the current and next season. Aggressive pricing decisions, Stewart felt, might work in the short term but would fuel the price wars and affect profitability in the long term.

Distribution and MIS

Stewart's had recently occupied a new distribution center. The company was also upgrading its management information systems, particularly those that tracked inventory and sales. The buying staff checked the system periodically throughout the day, looking at sales, versus last year and plan, and markdowns. These statistics were available by store as well as overall. Store inventory data, however, was not always accurate due to problems in tracking merchandise transfers that were particularly prevalent among smaller stores.

Competition

Top management, the store managers and the buying organization monitored the prices, advertising, and merchandising of Stewart's traditional department store competitors very closely. Competition from other types of retailers was also monitored by management, albeit to a lesser extent. This extended competition included national specialty store chains, category killers, discount department stores, and even warehouse clubs. The various competitors are discussed below.

Picard Stores

Picard Stores ranked number two in department store market share in both Lansing, which Stewart's dominated, and in Grand Rapids. Beginning in January 1999, Picard Stores had begun weekly distribution of a Sunday sale circular known in the retail industry as a magalog[2]. Picard Stores' promotional intensity peaked between April and October of 1999, when merchandise often was sold at cost to drive cash flow.

In January 2002, however, Picard Stores' parent company filed for bankruptcy. In February, Lindsay Picard, the CEO, resigned. The stores had begun to reduce the intensity of its promotional activity. Its recent pricing, merchandising, and advertising was less aggressive and seemed to have been driven by the financial difficulties faced by its parent company.

Though Picard Stores continued to distribute Sunday magalogs, its more recent versions were shorter and also reflected less aggressive discounts on sale merchandise. It backed up its Sunday magalogs with two-page midweek advertisements that reemphasized its sale prices.

Picard Stores often ran one day sale events in which the bulk of the merchandise in the store was offered at discounts of up to 20%. These sale events were promoted extensively with print, television, radio, and "door knob" advertising. The latter were expensive print pieces that were dropped to residents in selected zip codes.

Picard Stores experienced a considerable drop in sales in 2001. Many at Stewart's believed that the loss was due both to adverse economic conditions and to market share losses created by news of problems at the parent and its impending bankruptcy. Much of this business was captured by Stewart's in Lansing.

Lyons Stores

Perhaps Stewart's most troubling competitor was Lyons. In Flint, Lyons was the leader and Stewart's was a weak second among the traditional department stores. In addition, there was some concern that Lyons might move aggressively into the Lansing market. Its Middletown store was already quite close to Lansing.

Lyons'advertising, most of which was sale oriented, had a less upscale look than Picard Stores' magalogs. Lyons' had low expenses and spent very little money on capital improvements. The stores had little ambience, appeared crowded with merchandise, and placed little emphasis upon displays.

Lyons' tended to be more apparel oriented, with huge assortments and heavy discounting. In addition, Lyons' had a significant private label business, being primarily lower priced, budget merchandise. Since buyers were not focussed on inventory turns, they tended to stock the stores generously, then promote the merchandise in order to drive sales volume. The Lyons' store in Middletown was about the same size as the Stewart's store in the same mall, but, with more inventory and lower gross margins, its sales volume was approximately $31.2 million compared to $25 million for Stewart's.

[2] A magalog was a full color, multiple page circular, distributed in Sunday newspapers, which included primarily promotionally priced merchandise. Magalogs were very expensive to produce, at approximately $17,000 per page, and had an upscale appearance.

Lyons' had responded to Picard Stores' heavy discounting in 2002 by changing prices to match Picard's sale prices. They used primarily in-store signage to announce their competitive prices and did not increase advertising intensity. Consumers responded to Lyons' sale pricing. Its inconsistent, but promotional, pricing across stores was quite frustrating to Stewart's executives, who rarely allowed a store manager to make pricing decisions.

In 2001, Maureen Lyons retired as CEO and the company appointed as its new Chairman, Jeffrey Reiser, a veteran of the retailing industry. One of the changes instituted was to include return on inventory investment as a performance measure. As a result, Lyons' seemed to have retreated somewhat from its emphasis on immense assortments.

Other Competitors

In addition to full line department stores, Stewart's faced other potent competition. Category killers were aggressive competitors in the children's area (Toys 'R' Us and Kids 'R' Us in toys, clothing, and children's furniture) and in electronics (Best Buy, The Appliance Store). Often, these competitors varied by geographic area, with Best Buy, for example, being particularly strong in Grand Rapids. In certain merchandise categories, housewares and electronics, Sam's Wholesale Club periodically carried the same brands at dramatically lower prices, though their selection was often limited to one item in a particular manufacturer's line.

In merchandise lines with significant lower end competition, Stewart's endeavored to differentiate itself by focussing on more upscale merchandise. Often this meant ordering the "department store" model of a vendor's line, which had additional features and a higher suggested retail price than the model sold to the discounters and wholesale clubs. This strategy was becoming more difficult to execute, however, because even upscale brands such as Braun were becoming available at discount stores and wholesale clubs. Inevitably, the discounter would price substantially below the typical department store price. For instance, when Tadd Chessen, the DMM of Housewares found a discounter carrying items also sold by Stewart's, he had to decide whether to "keep his customers from shopping elsewhere and match the discounter's price."

In apparel, Stewart's faced additional competition from both off-price stores, such as Marshall's and TJ Maxx and national specialty stores including The Limited, Victoria's Secret, and The Gap. Off-price stores carried well known brand names at discounted prices. Their selections, however, tended to be less seasonally current.

National specialty stores carried in-season merchandise mainly under their own store label, with quality and styling often equivalent to the branded merchandise carried at department stores like Stewart's. The Limited (and its Limited Express and Victoria's Secret divisions) and The Gap were particularly strong competitors because their more efficient procurement system enabled them to obtain wanted in-season fashion merchandise more quickly and at lower cost than department stores.

Stewart's Pricing Policy

Prior to 1998, Stewart's pricing policy was to provide a regular price which represented good value to the customer and at the same time provided an initial markup that was profitable to the company. The pricing policy was a "high/low" approach, i.e., they had high regular prices on their merchandise, but reduced these prices often for sale events. Major storewide sale events occurred four times a year, but there were numerous other kinds of sales going on fairly often. During 2002 however, Stewart's introduced the 'Every Day Low Prices' (EDLP) program on selected merchandise designed to directly compete with J.C. Penney. A $50,000 advertising campaign was launched to promote the EDLP program. However, there was little effect on sales.

Presently, Stewart's Every Day Low Prices aims to provide branded or private label merchandise at least equal to the competition's sale price. Sample EDLP program information for private label and branded items across merchandise divisions is provided in Exhibits 5 and 6.

Some of Stewart's more recent pricing policies had been in response to aggressive sale pricing both by J.C. Penney and by Picard's, which operated in Lansing and Grand Rapids. Approximately 55% of Stewart's stores were exposed to Picard's stores.

Lyons', on the other hand, was an even more aggressive competitor. While more apparel oriented, Lyons' maintained a heavy promotional emphasis and had wide assortments and heavy inventories. It seemed to combine successfully a high volume, heavily discounted, branded merchandise program with a substantial, higher margin, private label business. Approximately 30% of Stewart's stores were exposed to Lyons'.

Brad Stewart was keen on expanding EDLP to items not presently included and further reducing the number of sale events.

Advertising

Currently, advertising at Stewart's consisted primarily of direct mail and newspaper advertising, though in the past radio and television had been used more extensively. The company advertised in approximately 33 newspapers. Like many department stores, Stewart's advertised primarily to announce sale events, with perhaps 5% of expenditures being non-sale oriented image advertising. Sale advertisements used primarily print media since price reductions on numerous items could be communicated effectively.

Stewart's used full color inserts and broadsheets for sale advertisements in Sunday newspapers. A broadsheet was printed on a bigger newsprint sheet and served as the wrapper for the rest of the Sunday inserts. Although less visually appealing, many at Stewart's believed that the broadsheet had great impact. Tadd Chessen, the DMM of housewares stated, "Since many people throw away the Sunday inserts, if we are the wrapper, at least they will look at our ad as they throw others in the trash!" The full color glossy Sunday inserts, often produced for the divisional events, emphasized that assortments were at their peak and at the best prices Stewart's could bring to the customer. The bulk of Stewart's newspaper advertising, however, was done on Wednesday and Thursday, under the assumption that a Sunday insert was received too late for the major end of week shopping days.

In any given month, Stewart's might have a number of store-wide and divisional sale events, as shown in Exhibit 7, a promotional calendar for May, 2002. According to Steven Fisch, Senior Vice President of Marketing and Advertising, "Not a day on our promotional calendar doesn't have some kind of sale event."

For storewide events, advertising space was allocated across divisions by Doolittle depending primarily upon the business done during the same event in the previous year. Storewide sales included one or two one day events per month, usually held near a weekend, and a monthly theme event that lasted seven to twelve days. The theme events included, for example, the Easter sale in March, the Anniversary sale in April and four Super sales, held in 2002 in February, May, August, and October.

Specific funding for advertising by the merchandise division, beyond the divisions cooperative advertising dollars, was not budgeted. Instead it required direct approval by Doolittle, who monitored quite closely the sales volume resulting from advertising. She usually approved funding for events that had an historic basis, such as the men's million dollar sale that was run three to four times per year.

Popular, regularly priced items were often included in the divisional sale events, particularly in the apparel divisions. For example, a recent young men's and juniors insert had included some regularly, priced Guess Jeans merchandise (Guess Jeans did not generally provide cooperative advertising support if the money was used for sale advertising). This was one of the ways, according to Fisch, to "make the sale advertising look like image advertising."

One day storewide sale events had become more important during Doolittle's tenure. The company's best day in 2001, with approximately $12 million in sales, had been the "one day sale" on December 15. Another one day, "sixteen hour sale" on the first Friday of December, had produced about $9 million in sales. According to Doolittle, however, these dramatic sales increases were often followed by a slight sales slump.

Advertising expenditures, in the latter part of 2001 and now in 2002, had been reduced by cooperative advertising with the company's suppliers. The net cost of advertising, after co-op, was approximately 4% of sales; including co-op, advertising was 6% of sales, i.e. close to $51 million.

Stewart's regularly received market research from its media suppliers. Exhibit 8 shows the results of a recent study on the Lansing market.

Merchandise Divisions

Significant differences existed in the business climate confronting Stewart's merchandise divisions. These included the nature of the competition, relationships with vendors, and the degree to which the merchandise carried was dominated by fashion items.

Children's

Intensive competition was the issue on which Children's DMM, Michael Green, was focused. "The popular children's clothing brands like Osh Kosh and IZOD show up everywhere!", he declared. Competition included, in addition to department stores, Penney's, Sears, Kids 'R Us, and several discount department stores. For layette and children's furniture, Toys 'R' Us was a particularly aggressive competitor. Still Stewart's tended to have one of the area's best selections of children's clothing and furniture and was an important player in the category. The competition, however, made it very difficult to sell branded merchandise at regular prices. Other department stores, including Picard's and Lyons', seemed to respond by increasing their initial markups and at the same time advertising sale discounts of as much as 30% off on in-season merchandise.

Approximately 30% of the sales in the children's division was EDLP merchandise, though the mix differed across boys, girls, and infants departments. In branded merchandise, a percentage was off of "regular" prices, representing a 20% - 25% savings. Some vendors provided Stewart's with promotional allowances to participate in the EDLP program, anticipating that such participation would increase the sales of their merchandise. Stewart's had done very well, for example, with a Buster Brown "three" pack of socks, EDLP priced at $7.99, and as a result, had become Buster Brown's best customer for that item. Other prominent vendors, however, offered no additional incentives.

Housewares

Competition in housewares included other department stores, mass merchants and Sam's Wholesale Club. Walmart, for instance, used everyday low pricing in its housewares department, occasionally supplemented by promotional prices on special purchases. While mass merchants competed with Stewart's primarily on opening price point items like the Black & Decker line, some upscale brands had begun appearing in these outlets as well, albeit only sporadically.

Tadd Chessen, DMM of housewares, tried to compete with Wal-Mart and K-Mart on comparable items, including Black & Decker, whenever possible. By carrying the vendor's higher end department store models, he also attempted to avoid competing with them on approximately 25% of his sales. For example, in 2001, electric ice tea makers had been particularly popular and were widely available. He had carried one of the most popular items, the Mr. Coffee Iced Teapot, at an everyday price equal to Walmart. This year he had ordered Mr. Coffee's department store model, which had a few additional features, carried a somewhat higher retail price, and was not to be offered to discounters.

Only four Black & Decker items were currently EDLP priced in housewares. These four items, however, were some of the department's biggest sellers. Picard's tended to put its entire housewares department on sale, while Stewart's continually supplemented its EDLP program with discounts on other selected items.

Men's Apparel

Since the men's clothing specialty stores in Stewart's markets were not particularly strong, the major competitors were Picard's, Lyons', and Penney's. Competitors for men's and boy's jeans and other casual clothing, however, also included The Gap and Old Navy.

The Senior Vice President and GMM for men's apparel, Douglas Heyman asserted that Stewart's was trading up in its assortments and carrying more fashionable styles. He maintained, however, that his assortments would continue to include lower priced EDLP items. Budget merchandise was carried primarily in the men's apparel selling areas on the main floor of the stores, while moderate and better merchandise was displayed in a separate area, often on a different floor than budget apparel.

In men's apparel, vendors offered merchandise at a "line price" which resulted in an initial markup of up to 55%. Retailers rarely paid the line price, however, negotiating instead for a variety of volume discounts, markdown protection, and coop advertising funds which, in effect, further increased the gross margin and profit. The higher initial markup was designed to offset the increasing quantities of merchandise sold at reduced prices.

In men's apparel, EDLP merchandise constituted approximately 20% of sales. Douglas Heyman emphasized that "you had to have the right merchandise" on EDLP. These were generally more basic items, most important selling styles of major brand name vendors such as Levi.

Though vendors like Levi often liked the EDLP program, many others objected to the sale of their merchandise under this designation. For example, at one point Arrow shirts had been EDLP priced, but because Arrow was not supportive, the line had been removed from the program.

Soft Home

Soft home included domestics (sheets, towels, and other items for the bed and bath) and decorative home (china, glass and silver). Primary competitors were other department stores and Penney's and Bed, Bath and Beyond. The DMM for soft home, Ed Lee, was particularly concerned with Penney's because it was focussed on the moderate customer that comprised the bulk of Stewart’s business. Other competition included discount department stores. According to Lee, off price outlets and power retailers such as Bed, Bath and Beyond, were a major source of competition in soft home.

Pricing in soft home was highly promotional. Lee believed that sales based on discounts from regular price were key to his business. He feared a substantial sales loss if comparative prices were prohibited. For the most part, merchandise was offered at the regular price for thirty days then was discounted, with further discounts often taken for specific sale events.

EDLP merchandise in soft home was typically a popular brand, where the vendor offered a particularly attractive price to Stewart’s. For example, Wamsutta had offered 10% in cooperative advertising funds when its solid color sheets were added to the EDLP program.

Women's Ready-to-Wear

Competition in women's ready-to-wear included other department stores, J.C. Penney, off price outlets, national specialty store chains including The Limited and The Gap, and, for lower price points, mass merchants. Other department stores like Picard’s and Lyons’, however, were considered the primary competition.

Approximately 10% of sales in women's ready-to-wear were EDLP priced brand items. This merchandise was primarily moderate in price. Amongst the private label merchandise, approximately 5% of sales was in EDLP items and was typically lower price point merchandise. Stewart’s had been particularly successful with a polo shirt that, when included in the EDLP program, increased in sales from 30,000 to 70,000 units during the Spring 2002 season versus 2001.

The criteria for participation in the EDLP program in women's ready-to-wear was potentially high impact and high sell-through for the suggested item. EDLP items were often well known, best sellers at prices that provided recognizable value to customers. When designated as a EDLP item, the merchandise was to be carried in greater depth than competitors. In the Dockers line, for example, Stewart's set a particularly attractive EDLP price on the most popular pant and shorts styles. Often, however, the customer would also purchase other Docker items which had a higher initial markup.

The Senior Vice President and GMM for women's ready-to-wear, Julie Betts maintained that EDLP merchandise would continue to play a limited role because of the need to maintain a fashion image. Fashion sensitive merchandise was not appropriate for EDLP, in her view, because such merchandise needed to be discounted whenever its movement was disappointing, which often was immediately after its introduction. Even a strong brand like Liz Claiborne, with an average selling cycle of six weeks prior to the first clearance markdown, sold only 35% at regular prices. In addition, with the large number of storewide and divisional sale events, Betts believed strongly in the importance of having new fashion merchandise available at discounted prices.

Some competitors' pricing tactics were of particular concern. Stewart's was adamant about taking permanent markdowns on out-of-season merchandise to reflect its lower value. When additional discounts were taken on this merchandise, advertising and in-store signs reflected a discount off the already marked down price, such as "25% off already reduced prices." In contrast, Picard's would advertise a greater discount off the original retail price, such as "45% off original prices." Betts believed that customers did not necessarily compare net purchase prices, but instead compared discount percentages. Thus, even though competitors might be offering identical selling prices, Picard's benefitted by the implied offer of a greater discount from an initial price. This problem was particularly severe in seasonal categories like coats and swimwear.

Options

Brad Stewart was aware of the pressures that Stewart's faced. Competition was increasing and more so at the low end. On the flip side though, Picard's had decreased their promotional activity since the bankruptcy filing.

EDLP, for its part, had worked well. However, the jury was still out on whether the one day sale events had been extremely successful. They certainly produced sales volume, but were they creating an image in the customer's mind that said "I'll just wait for the next sale before I buy that item."?

So what did all that imply for the future? One option was to further reduce the reliance on Sale events. Stewart believed that aggressive promotions had created a situation where Stewart's had lost its regular priced customer. He preferred fewer, stronger sales in an attempt to recapture them. The EDLP program had helped the company develop core items that produced high sell throughs at everyday prices. He believed that the program should be expanded to cover more items in the inventory. Doolittle, on the other hand, felt that aggressive sale pricing was essential to maintain market share.

A push towards greater stabilization in prices had a number of operational benefits. First Stewart's could save on advertising expenses (primarily print) for sale events. Doolittle and

Stewart debated, however, how much of this money should be channeled into image advertising, at least in the short run. Second, some savings in personnel costs were expected, with less additional staff needed to handle the surges in demand that occurred during sale events.

A third benefit would be better inventory turnover. With more predictable day-to-day sales, many departments could operate with less inventory. In addition, a reduction in the quantity of residual merchandise from sale events was likely, which could reduce markdown costs. A more predictable sales pattern could also lead to fewer stockouts.

Finally, with more stable pricing, the merchants could spend more time planning their assortments and merchandise presentations. The resulting improvements, together with better service, could help rebuild customer loyalty for Stewart's.

Though there seemed to be a number of good reasons for more stable prices, the decision was risky. Would customers have difficulty in comparing Stewart's prices to its competition, and instead rely on the size of the discount as an indication of good value? Why hadn't other department stores switched to EDLP?

With the variety of competitors in its trading areas, several only occasionally carrying the same merchandise as Stewart's, another unresolved issue was how competitive Stewart's everyday pricing had to be. One issue was whether to keep lines, like Black & Decker, that were also carried in discount department stores, and, if so, how to price such merchandise. In categories like home electronics, with specialists like Best Buy and Circuit City carrying huge assortments at very attractive prices, Brad Stewart wondered whether Stewart's currently served only the most sale conscious customers. Was stable pricing a viable option in categories in which Stewart's was a rather weak competitor?

Finally, Stewart's competitiveness varied among particular geographic markets. Stewart pondered whether a commitment to stable, competitive prices, would need to incorporate price variations to correspond with local competitive conditions. The model for this approach was Lyons', which, with greater autonomy at the store level, responded quickly to local competition.

Doolittle and Stewart had debated on how they could quantify the benefits and risks of greater price stabilization, and how they would execute such a policy. Which additional storewide sale events, for example, should they discontinue? For those that remained, should more restrictions be placed on the merchandise available for sale pricing? These were only some of the difficult, unresolved issues in the reevaluation of Stewart's pricing policies.

As Brad Stewart was preparing for the next Board presentation at home on Sunday night 3 days before the meeting, the phone rang and the following conversation took place.

Voice : "May I speak to Brad Stewart."
Stewart : "Speaking."
Voice : "My name is Terry Lundgrin. I'm the President of the Federated Department Stores and I want to buy your company."

Exhibit 1 2001 Sales and Sales Force Data by Store

Store	Gross sq. ft.	Sales	Sales/ sq. ft.	Sales force expense	Sales force exp (% of sales)
Lansing Area					
Eastown Budget	152,244	13,298,958	87.35	1,324,928	10.0%
Diamondale	176,327	10,901,144	61.82	1,492,258	13.7%
Centerville Budget	25,133	1,666,404	66.30	312,165	18.7%
Courthouse	419,820	35,857,504	85.41	4,197,645	11.7%
Van Buren	158,177	26,906,688	170.11	2,797,315	10.4%
Valley Farm	351,818	76,890,990	218.55	6,151,279	8.0%
Northwest	319,551	42,721,946	133.69	4,858,218	11.4%
Southtown	205,236	26,608,276	129.65	3,056,227	11.5%
Concord	88,174	15,636,876	177.34	1,548,205	9.9%
Fairborn	57,812	16,683,266	288.58	2,184,387	13.1%
W.Windsor	257,008	6,401,022	24.91	1,695,635	26.5%
South Windsor	197,379	9,715,698	49.22	1,805,472	18.6%
Grand Rapids Area					
Grandville	211,240	23,231,422	109.98	2,782,205	12.0%
Richmond Hills	79,963	8,453,572	105.72	794,227	9.4%
Kentwood	203,900	17,691,316	86.76	1,858,576	10.5%
Forest Fair	252,073	31,025,736	123.08	4,192,666	13.5%
Flint Area					
Bleacher	264,370	36,651,030	138.64	4,047,043	11.0%
Richfield	171,032	17,658,540	103.25	2,450,448	13.9%
Northtowne	255,071	20,582,808	80.69	2,961,555	14.4%
Other Michigan					
Newark	87,671	15,466,188	176.41	1,546,618	10.0%
Defiance	78,149	11,009,704	140.88	1,288,627	11.7%
Saginaw	110,480	16,784,998	151.93	1,840,714	11.0%
Munroe	85,680	12,231,998	142.76	1,349,738	11.0%
Chillicothe	92,516	20,628,876	222.98	2,216,669	10.7%
Towne Mall	71,674	8,729,950	121.80	1,080,002	12.4%
Ann Arbor	291,720	27,613,856	94.66	3,153,616	11.4%
Jackson	131,619	18,302,756	139.06	2,195,232	12.0%
Middletown	97,334	24,943,580	256.27	2,545,264	10.2%
Kalamazoo	71,674	10,206,110	142.40	1,014,272	9.9%
Indiana					
Indy Meadows	87,448	8,706,734	99.56	1,760,163	20.2%
Honey Creek	112,615	21,061,732	187.02	2,574,390	12.2%
Richmond	159,975	21,035,690	131.49	2,295,846	10.9%
Marion	91,414	12,784,096	139.85	1,717,427	13.4%
Anderson	102,743	16,943,014	164.91	2,018,528	11.9%
Columbus	88,137	14,519,698	164.74	1,525,379	10.5%
Muncie	33,356	6,497,014	194.78	648,890	10.0%
Kokomo	116,409	13,451,348	115.55	1,909,686	14.2%
Elkhart	173,429	14,110,940	81.36	1,994,480	14.1%
Ohio					
Piqua	103,103	18,520,938	179.63	2,038,067	11.0%
Athens	78,141	11,492,064	147.07	1,581,024	13.8%
New Philly	85,440	12,590,838	147.36	1,263,030	10.0%
Lancaster	85,818	12,938,288	150.76	1,375,498	10.6%
Sandusky	103,958	13,302,732	127.96	1,448,902	10.9%
Bowling Green	108,674	11,910,098	109.59	1,339,155	11.2%
Illinois					
Carbondale	83,290	14,239,624	170.96	1,139,170	8.0%
Mattoon	80,456	10,916,416	135.68	1,467,754	13.4%
Danville	130,169	15,298,600	117.53	1,837,670	12.0%
North Carolina					
Raleigh	96,470	9,804,824	101.64	1,078,195	11.0%
Chapel Hill	60,857	7,952,244	130.67	1,097,808	13.8%
Winston Fair	17,993	7,136,214	396.61	975,891	13.7%
Tennessee					
Knoxville	90,146	14,855,972	164.80	1,884,976	12.7%

West Virginia					
Morgantown	116,357	7,110,086	61.11	1,137,600	16.0%
Total	**7,171,238**	**901,680,416**	**125.74**	**97,669,482**	**10.8%**

Exhibit 2 2001 Sales per square foot by Merchandise Division

Merchandise Division	Sales (000,000)	Total sq. ft. (000)	Sales per sq. ft.
Women's Outerwear	25.2	166.26	151.57
Women's Dresses	46.2	393.09	117.53
Women's Better Sportswear	67.4	510.74	131.96
Women's Moderate Sportswear	93.8	616.88	152.06
Juniors	52.2	418.41	124.76
Accessories	63.4	439.78	144.16
Intimate Apparel	38.4	383.79	100.06
Children's	55.8	617.40	90.38
Men's Clothing	100.6	773.45	130.07
Men's Sportswear	77.2	573.08	134.71
Decorative Home	71.8	890.48	80.63
Electronics	38.6	120.82	319.47
Furniture	49.0	529.52	92.54
Housewares	51.2	400.47	127.85
Cosmetics	70.8	337.06	210.05
Total	**901.6**	**7171.24**	**125.74**

Exhibit 3 Pre-tax income as a percent of total revenue

Department Store	Percentage
Stewart's	3.0
Federated Department Stores	7.3
May Co.	10.4
Dillards	6.0

Exhibit 4 Stewart's Stores Division Bonus Computation for DMM's

A. The bonus will be paid provided:

1. Gross Margin dollars achieved is at least equal to the previous year in comparable stores. Dollars to be determined by multiplying the sales for those stores opened twelve (12) full months in both years times the gross margin percent.
2. After-tax Profit for Stewart's Corp., excluding extraordinary items must equal or exceed 1.8% of sales.

B. The Bonus Dollars will be computed as follows:

1. DMM -The Maximum bonus paid will not exceed 20% of salary.

C. The components used to determine the bonus will be as follows:

1. Minimum bonus of 25% of potential provided that (A) is met.
2. Sales will represent 40% of the bonus and will be paid as follows:
a. Plan to plus 3.99 basis points, 25% of sales bonus or 10% of total available.
b. Four to 6.99 basis points over plan additional 25% of sales bonus or 10% of total available.
c. Over 7 basis points additional 50% of sales bonus or 20% of total available.

3. Return On Investment (ROI) will represent 30% of the bonus and will be paid as follows:
a. ROI improvement over plan 50% of ROI bonus or 15% of total available.
b. ROI greater than Johnsons[3] median to the 75th percentile additional 30% of ROI bonus or 9% of total available.
c. ROI greater than Johnson's 75th percentile additional 20% of ROI bonus or 6% of total available.

4. Shrink will represent 5% of the bonus and paid as follows:
a. Receive 100% if you meet or are lower than goal and total company does not exceed 1.5%.

[3] Johnson was a group of non-competing department stores that made private label merchandise under the Johnson label available to group members. The group also exchanged operating data.

Exhibit 5 EDLP Program, Spring 2002 – Sample of Private Label Items By Merchandise Division

Division/ Description	Vendor Name	Item	Cost ($)	EDLP ($)	Markup %
Moderate Sportswear (10 Items)[4]					
Mainfloor Blouses	C. M. Sherman	Camp Shirt	10.80	23.98	54.9%
Accessories (6 Items)					
Handbags	J. Resnick	Vinyls, Fabric Bags	18.40	39.98	54.0
Decorative Home (17 Items)					
Housewares	Durand	Drinkware Set	19.96	39.98	50.1
Childrens (12 Items)					
Infants	Rashti	Creepers	8.50	19.98	57.5
Boys 4-7	Randy	1 Pocket Tee	6.00	11.98	49.9
Intimates (4 Items)					
Robes	FWC/Clock	Duster Robe	20.00	39.98	50.0
Women's Dresses (1 Item)					
Misses		Assrtd Knit Dresses	53.98	99.98	46.0
Juniors (4 Items)					
Denim	Palmetto	5 Pocket Jean	26.98	49.98	46.0
Men's Clothing (5 Items)					
Dress Shirts	Warren Scott	Short Sleeve Oxford	18.10	35.98	49.7
Men's Sportswear (13 Items)					
Mainfloor Sportswear	Chest	Pattern Knit Polo Shrt6.62	25.98	49.0	47.0
Young Men's Budget	Lee	Dark Denim Jeans	24.98	49.98	50.0
Women's Better Sportswear (2 Items)					
Women's Sportswear	Allison Smith	Polo Shirt	11.90	22.98	48.2

[4] Denotes the total number of products that are in the ELDP Program for that division.

Exhibit 6 EDLP Program Spring 2002 – Sample of Branded Items by Merchandise Division

Division/ Description	Vendor Name	Item	Cost ($)	EDLP ($)	Markup %	Regular Retail Price	Regular Retail Markup%
<u>Women's Sportswear</u> (8 Items)[5]							
Moderate Blouses	Laura & Jayne	Camp Shirt	20.60	39.94	48.4	$56.00	63.2
<u>Accessories</u> (13 Items)							
Handbags	Contessa	Leather Bags	32.10	58.94	45.5	na	na
Riviera Sunglasses	Riviera	Sunglasses	7.20	15.00	52.0	na	na
<u>Housewares</u> (20 Items)							
Solid Towels	Stevens	Excaliber Towels	5.74	9.94	42.3		
Photo Albums	Burns	Photo Albums	8.90	19.94	55.4	22.00	60.0
<u>Intimates</u> (8 Items)							
Bra	Warners	Just Your Fit	12.78	21.94	41.8	28.50	55.2
<u>Juniors</u> (3 Items)							
Junior Fashion Denim	RIO	Denim Shorts	18.58	29.00	35.9	38.50	51.7
<u>Men's Sportswear</u> (15 Items)							
Levi	Levi	Rigid Jean	27.44	45.00	39.0	55.00	50.0
Topcoats & Rainwear	London Fog	Andes Raincoat	147.88	265.00	44.2	295.00	49.9
Men's Activewear	Jockey	T-shirt	10.00	15.99	37.5	20.00	50.0
<u>Children's</u> (All Items Listed)							
Osh Kosh	All Classes			25% off Regular Retail			
Healthtex	All Classes			25% off Regular Retail			
Buster Brown	All Classes			25% off Regular Retail			
Bugle Boy	Shorts			12.97 14.97			
Carter's	Layette			20% off Regular Retail			
Carter's	Underwear			20% off Regular Retail			

[5] Denotes the total number of products that are in the ELDP Program for that division.

Exhibit 7 May 2002 Sales Promotion Calendar

Sunday	Monday	Tuesday	Wednesday	Thursday	Friday	Saturday
	1	2	3	4	5	6
	Last 2 Days Coupon Sale ROP[6] (3) 4 pg. Broadsheets 1. RTW – Mother's Day Intimate Apparel and Accessories Soft Home		(3) 4 pg. Broadsheets RTW – Mother's Day Soft Home	8-pg. Budget Store Mother's Day Tab - DH	**Moonlight Sale** @ 19,25,26 Open till 11pm 2 day sale Western Region ROP	**Super Saturday** ROP all but Western Region
7	8	9	10	11	12	13
MOTHER"S DAY (2) 4 pg. Broadsheets Men's sale Towel Riot 8 pg. Thomasville	Tab in L only			**DOWNTOWN LANSING DAY** #20 7.30 am to 10 pm	**SUPER SALE BEGINS** 40/32 pg tabloid[7] All markets	**SUPER SALE**
14	15	16	17	18	19	20
SUPER SALE Sun Week in-store promo for cosmetics	**SUPER SALE**	**SUPER SALE ENDS**	**Daffy Day** at #45 8 am to 10 pm Richmond Moonlight Madness @ #32 9 am to 11 pm	**Downtown Ann Arbor Days** @ #31 Memorial Day Sale 8&4 pg Broadsheet Includes family swim Inserts Wed/ Thursday		
21	22	23	24	25	26	27
Memorial Day 2 day Special	Memorial Day Govt. offices & Schools closed	Ready White Sale 24 pg. Book in homes **CLOVER DAY**	8 pg 13 hour sale to kick off June Sale 10 am to 11 pm Store # 20 & 54 10 am to 9 pm **CLOVER DAY**	**CLOVER DAY**		(2) 4 pg June Broadsheet Sale Broadsheets All Divs.

6 Run of Press (ROP) refers to a black and white newspaper print advertisement

7 The number of pages of printed depended on the size of the market to which the tabloid was distributed.

Exhibit 8 <u>Lansing Daily News</u> **Market Research, Lansing and its Surrounding Areas**[8]

1. Have you shopped these (department or discount stores) in the past thirty days, whether or not you bought anything?

Stewart's - 45%
Picard's Stores - 35%
J.C. Penney - 33%
K-Mart - 59%
Wal-Mart[a] - 46%
Sears - 32%

[a]Figure represent 8 months (2 Wal-Mart locations had been open less than one year).

2. Have you shopped these (department stores) in the past thirty days whether or not you bought anything?

	'95	'96	'97	'98	'99	'00
Stewart's	60%	61%	55%	52%	52%	45%
Picard's Stores	49%	52%	48%	40%	41%	35%

3. Composition of Shoppers

	Total Adults (575,000 total shoppers)	Stewart's (260,000 shoppers)	Picard Stores (202,000 shoppers)
<u>Sex/marital Status</u>			
Married Men	33%	30%	29%
Married Women	31%	36%	39%
Single Men	15%	11%	14%
Single Women	21%	23%	18%
<u>Age</u>			
18-24	14%	10%	18%
25-34	22%	18%	19%
35-44	21%	23%	23%
45-54	14%	13%	9%
55-64	13%	14%	16%
65+	16%	22%	15%
<u>Education</u>			
Less than high school	13%	11%	9%
High school or tech grad	41%	39%	34%
Some College	24%	25%	25%
College Grad	22%	25%	32%
<u>Income</u>			
Under 15.000	8%	6%	5%
$15-$24.999	17%	15%	14%
$25-$34,999	28%	29%	22%
$35-$49,999	29%	27%	31%
$50,000 +	18%	23%	28%
<u>Occupation</u>			
Professional/Manager	25%	31%	37%
Sales/Administration	32%	34%	30%
Service Worker	13%	14%	15%
Craftsman/Laborer	25%	18%	15%
Other	5%	3%	3%

[8] This exhibit is the summary of the results of telephone surveys conducted by the local newspapers in each city.

Exhibit 8 (continued)

4. Department Store Cross Shopping. Percentage of each store's shoppers who have also shopped at other stores.

	Picard Stores	Stewart's	Wal-Mart
Total Shoppers	202,000	260,000	267,000
Picard Stores	100%	56%a	35%
Stewart's	72%	100%	48%
J. C. Penney	49%	60%	58%
Wal-Mart	47%	49%	100%

5. Have you purchased anything there (department or discount store) in the past 30 days?

Stewart's	- 38%
Picard Stores	- 38%
J.C. Penney	- 26%
K-Mart	- 52%
Wal-Mart	- 42%
Sears	- 24%

6. Purchaser to shopper ratio.

	1999	2000	2001
Stewart's	81%	83%	83%
Picard Stores	76%	78%	81%
J.C. Penney	79%	76%	78%
K-Mart	92%	91%	88%
Wal-Mart	NA	NA	90%
Sears	80%	74%	77%

7. Store Image

	2001 PAR Values*
Stewart's	- 16%
Picard Stores	- 13%
J.C. Penney	- 12%
Sear	- 11%
K-Mart	- 21%
Wal-Mart	- 17%
Other	- 10%

Summary of Image Scores for Selected Stores (Points from Store's PAR Value)

	Stewart's	Picard Stores	J. C. Penney	Wal-Mart
Best Values	-2[9]	-6	-5	17
Best Quality	10	15	0	-6
Best Handling of Refunds	5	4	-3	-3
Best Service Overall	10	4	-3	2
Best Appearance	9	22	-1	-3
Easiest Store Layout	6	4	-2	0
First with New Fashions	15	29	-2	-12
Best Variety and Selection	9	11	-4	3
Best Price	-1	-7	-5	18
Best Sales Staff	11	5	-2	5

*Respondents were asked which store's image was best for a number of key image factors. These data were adjusted, using PAR values, for the number of shoppers at the store so that the largest store did not automatically have the best image. Each store's shoppers were assumed to have a favorable view of the store. Therefore, each store's shoppers as a share of all stores' shoppers is its PAR value. For example, Stewart's shoppers (260,000) divided by

[9] 14% of Stewart's shoppers judged it to have the best value. This is two percentage points below Stewart's PAR value of 16%.

the total shoppers across all competitors (1,610,000) is 16%. If a store cannot even get all of its shoppers to vote for it on an image factor, then its image is below PAR and vice versa.