

## CASE

### SEARS, ROEBUCK, AND CO.: THE AUTO CENTER SCANDAL

Sears, Roebuck, and Co. began in the late 1800s as a mail-order company that sold farm supplies and other consumer items. Its first retail store opened in the mid-1920s. Responding to changes in American society, such as the move from farms to factories and the presence of the automobile in many homes, hundreds of retail stores opened over the years. The company expanded rapidly, and eventually it diversified to include other businesses: insurance (Allstate Insurance), real estate (Coldwell Banker), securities (Dean Witter Reynolds), and credit cards (Discover). Each of these other businesses became its own division, in addition to the merchandising group which included retail stores, appliances, and auto service centers. By the early 1990s, the company was reporting revenues and earnings in the billions of dollars.<sup>49</sup>

Despite its long history of high earnings and its penetration into the U.S. market, Sears' retail business began to experience serious financial difficulties in the 1980s. Discount retailers such as Wal-Mart were pulling ahead in market share, leaving Sears lagging. Sears responded by adding non-Sears name brands and an "everyday low price" policy. But despite these efforts, in 1990 Sears reported a 40 percent decline in earnings, with the merchandising group dropping a whopping 60 percent! Cost-cutting measures were planned, including the elimination of jobs and a focus on profits at every level.<sup>50</sup>

In 1991, Sears unveiled a productivity incentive plan to increase profits in its auto centers nationwide. Auto mechanics had traditionally been paid an hourly wage and were expected to meet production quotas. In 1991, the compensation plan was changed to include a commission component. Mechanics were paid a base salary plus a fixed dollar amount for meeting hourly production quotas. Auto service advisors (the counter people who take orders, consult with mechanics, and advise customers) had traditionally been paid a salary. In order to increase sales, however, commissions and product-specific sales quotas were introduced for them as well. For example, a service

advisor might be given the goal of selling a certain number of front-end alignments or brake repairs during each shift.<sup>51</sup>

In June 1992, the California Department of Consumer Affairs accused Sears, Roebuck, and Co. of violating the state's Auto Repair Act and sought to revoke the licenses of all Sears auto centers in California. The allegation resulted from an increasing number of consumer complaints and an undercover investigation of brake repairs. Other states quickly followed suit. Essentially, the charges alleged that Sears Auto Centers had been systematically misleading customers and charging them for unnecessary repairs. The California investigation attributed the problems to Sears Auto Centers' compensation system.<sup>52</sup>

In response to the charges, Sears CEO and Chairman Edward A. Brennan called a news conference to deny that any fraud had occurred, and he defended Sears' focus on preventive maintenance for older cars. He admitted to isolated errors, accepted personal responsibility for creating an environment where "mistakes" had occurred, and outlined the actions the company planned to take to resolve the issue. These included:

- Eliminating the incentive compensation program for service advisors
- Substituting commissions based on customer satisfaction
- Eliminating sales quotas for specific parts and repairs
- Substituting sales volume quotas

According to Brennan, "We have to have some way to measure performance."<sup>53</sup>

Sears also introduced "shopping audits" of its auto centers in which employees would pose as customers, and Brennan published a letter of explanation to the company's customers in the *Wall Street Journal* and *USA Today* on June 25, 1992.

Note that the compensation system for mechanics, based on number of tasks performed and parts replaced, was maintained. In the summer of 1992, Chuck Fabbri, a Sears mechanic from California, sent a letter about Sears' wage policy for mechanics to U.S. Senator Richard Bryan. Fabbri said:

It is my understanding that Sears is attempting to convince your committee that all inspections in their auto centers are now performed by employees who are paid hourly and not on commission. This is not the case. The truth is that the majority of employees performing inspections are still on commission....

The Service Advisors ... sell the repair work to the customer.... The repairs that they sell are not only based on their inspections, but to a larger degree based on the recommendations of mechanics who are on commission....

On January 1, 1991, the mechanics, installers and tire changers had their hourly wages cut to what Sears termed a fixed dollar amount, or FDA per hour which varied depending on the classification. At present the mechanic's FDA amount is \$3.25 which, based on current Sears minimum production quotas, is 17% of my earnings. What this means is that for every hour of work, as defined by Sears, that I complete, I receive \$3.25

plus my hourly base pay. If I do two hours worth of work in one hour I receive an additional \$3.25 therefore increasing my earnings.

Sears calls this type of compensation incentive pay or piecework; however, a rose by any other name is still a rose. This is commission plain and simple. The faster I get the work done the more money I make, and as intended, Sears' profits increase. It is therefore obvious to increase his earnings, a mechanic might cut corners on, or eliminate altogether, procedures required to complete the repair correction. In addition to this, since the mechanic often inspects or performs the diagnosis, he has the ideal opportunity to oversell or recommend more repair work than is needed. This would be especially tempting if it has been a slow day or week. In part greed may create this less than ethical situation, but high pressure to meet quotas by Sears' management also presents a significant contribution. I have recently been threatened with termination if my production didn't at least equal Sears' minimum quotas. I might add that prior to this new wage policy, management had only positive response to my production, and my record proves this....

There is no doubt in my mind that before their auto center employees were put on commission Sears enjoyed the trust of its customers. Today presents a different story. The solution is obvious not only for Sears, but for the industry.<sup>54</sup>

Sears agreed to a multimillion-dollar settlement with the state of California and the 41 other states that had filed similar charges. The company was placed on three-year probation in California. It also settled a number of consumer class-action suits. In July 1992, the U.S. Congress held hearings on fraud in the auto repair industry.

The long-term impact of the scandal is unclear. Sears has now sold off its securities firm, the Discover card, most of its real-estate and mortgage business, and 20 percent of Allstate Insurance. At the end of 1992, auto center sales lagged behind prior levels.<sup>55</sup> Also in 1992, *Business Week* reported that employees in other areas of Sears' business, such as insurance and appliance sales, were feeling the same kinds of pressures from sales quotas.<sup>56</sup>