

Your Turn

The Role of Labor Costs in Retail Electronics

Let's get started with trying to assess the degree to which compensation is an important cause of company success (or lack of success) in two different competitive environments.

First, let's consider the case of consumer electronics and the experiences of Circuit City and Best Buy. Circuit City had traditionally used a commission pay plan that paid off big for

experienced, high-performing salespeople. Top salespeople knew the products and kept up to date and customers knew that they could get expert advice at Circuit City. The strategy differentiated Circuit City from archrival Best Buy, which featured self-service stores with huge inventories, but less expert salespeople. Best Buy hired young, less-experienced people and offered lower wages and smaller bonuses. However, Best Buy's sales and total shareholder returns soared past those of Circuit City. Subsequently, Circuit City laid off 3,900 top-earning salespeople in 2003 and replaced them with 2,100 less-experienced people who received lower wages and smaller bonuses. Circuit City said it could no longer afford to pay big commissions to its sales staff while its rivals paid less.⁷⁷

In 2007, Circuit City fired 3,400 of its highest-paid store employees and began to replace them with lower-paid workers in hopes of reducing labor costs. In the following quarter, Circuit City reported that the company lost money. Some commentators attributed the loss to the fact that Circuit City had gotten rid of many of its most experienced and highly trained employees, which they believed translated into a poorer customer experience and, in turn, lower revenues and profits.

For example, according to *BusinessWeek*, "In the world of pricey consumer electronics, where customer service is arguably as important as quality products, Circuit City Stores is missing the mark and further eroding its profits." However, a company spokesman said that only a few salespeople per store were affected by the workforce reductions and that many of the employees affected worked as customer service representatives or in the warehouses. As such, he questioned whether the cuts had significantly affected the in-store customer experience and thus whether the cuts had caused the decline in the company's performance. Eventually, the bottom fell out of Circuit City's profits and stock price and it had to liquidate, closing its over 500 stores (resulting in over 30,000 employees losing their jobs).⁷⁸

Now consider the next part of the story. Best Buy itself subsequently sought to further cut its own labor costs by essentially demoting 8,000 senior sales associates to positions that could pay half as much. A question was whether the Best Buy pay-level cuts would have the same consequences as what one person described as the "disastrous personnel moves" made at Circuit City just a few years ago.⁷⁹ Apparently, Best Buy did not see it that way. Subsequently, Best Buy announced that it would close 50 stores and also cut 400 corporate jobs in an effort to cut \$800 million in costs. Why is Best Buy aggressively cutting costs? *USA Today* stated that Best Buy "is trying to avoid the fate of Circuit City, which went out of business in 2009. (See also Radio Shack.) It faces slower sales of expensive items like TVs, plus increased competition from Amazon.com and discount stores such as Walmart and Target."⁸⁰ Employment at the headquarters has been an ongoing target and is now around 5,000 employees, down from its peak of 9,000 in the mid-2000s. After those cuts, store closings, and pay cuts, Best Buy next (in 2014) cut employment by around 2,000 in its stores and regional offices. However, the cuts are being made in a way that Best Buy hopes will minimize any negative impact on the customer experience. Most of the cuts target middle managers, many of whom have six-figure salaries and who supervise product categories at more than a dozen stores each. That will leave fewer middle managers (spread more thinly across more stores) and give more responsibility to the store managers who will now have the "full ability to run their (respective) stores." The cuts, which target regional offices rather than stores and employees who directly help shoppers, are intended to minimize the impact on customer service inside stores, while helping Best Buy continue to lower costs as it continues to successfully compete on price (and service) against Amazon, Walmart, Target, and others with low cost structures.



Here are data on stock prices and customer satisfaction for Circuit City, Best Buy, and two other competitors, Amazon and Walmart.

Year	Opening Stock Price			Customer Satisfaction (ASCI Index)				
	Circuit City	Best Buy	Amazon	Walmart	Circuit City	Best Buy	Amazon	Walmart
2000	48	26	82	68			84	73
2001	16	18	16	53			84	75
2002	29	32	11	58			88	74
2003	7	18	19	51	73	72	88	75
2004	9	36	53	53	73	72	84	73
2005	14	37	45	54	72	72	87	72
2006	23	47	48	46	70	71	87	72
2007	19	50	37	47	69	76	88	68
2008	4	44	96	47	71	74	86	70
2009	0	28	51	56	72	74	86	71
2010	*	40	136	53	*	77	87	73
2011	*	34	181	54	*	77	86	70
2012	*	24	176	60				
2013	*	12	257	69	*	77	88	71
2014	*	41	398	79	*	77	86	68
2015	*	39	309	86				

ASCI = American Customer Satisfaction Index™, <http://www.theasci.org/>. ASCI scores for Circuit City and Best Buy not available prior to 2003.

*Circuit City no longer in business.

QUESTIONS:

- Thinking back to our discussion in the chapter section, *Caveat Emptor*—Be An Informed Consumer, evaluate whether the replacement of highly paid workers with lower-paid workers did or did not cause Circuit City to perform so poorly. How confident are you in your evaluation? Why?
- Do you believe that the compensation changes at Best Buy are a major reason for its current difficulties?
- Why are Walmart, Sam's Club, and Costco doing better than Best Buy (and Circuit City)? Do they have high pay?
- Are there larger problems in the competitive landscape for Best Buy that cannot be solved by compensation strategy changes alone? When customers look to buy electronics, what options do they have other than Best Buy and why would they choose these options over Best Buy? Where do customers "test drive" the product and where do they buy it? Can compensation changes address these challenges? Explain.
- Is Best Buy focusing too much or too little on cost reduction? Explain.