Organizational Behavior

(MNGT 5590) – Summer (2014)

CASE STUDY – GUIDELINE

Name______________________________________

Case Analysis Process

- Define the problem issue(s) or opportunities
- Analyze the case data
- Identify the key decision criteria
- Analyzing and evaluating alternatives
- Selecting the preferred alternative
- Developing an action/implementation plan
- Recommendations for the future

KMART-SEARS

CASE STUDY

Abstract

Kmart demonstrated a remarkable emergence from bankruptcy when it announced its acquisition of another big US retailer, Sears for $11 billion in 2004. The merger deal was structured by its chairman – Edward Lampert, a 53% stakeholder in Kmart with 15% stake in Sears. The merger was expected to make Sears Holdings the third largest retail company in the US – after Wal-Mart and Home Depot apart from synergistic benefits worth $500 million in the form of cost savings and additional profits. However, analysts were skeptical about the potential benefits from the merger as both companies were struggling amidst fierce competition in the US retail industry, faced with declining sales and profitability.

Internal & External Comments about the Kmart-Sears Merger

Unless this new retail giant proves that it's capable of creating stronger customer connections, there will be no real value to this **merger**" (William J. McEwen, Gallup Management Journal)

"As a retailer, we really have not grown at all for the last 35 years" (Alan Lacy, Vice Chairman of SHC, Ex-Chairman of **Sears**) "The idea is to form "one great culture" (Edward Lampert, Chairman of SHC, Ex- Chairman or **Kmart**)

BACKGROUND OF COMPANIES

Sears, Roebuck & Co.

Richard W. **Sears** found the R.W. **Sears** Watch Co. in 1886. The early days of the organization were filled with changes in structure and partnership--moving to Chicago, taking on Alvah Roebuck (an Indiana watchmaker) as a partner, and publishing the company's first mail order catalog (which comprised of 80 pages) in 1888. The watch business was sold in 1889 and by 1891 **Sears** had developed the nation's first mail-order business. In 1893, the company's name changed to **Sears**, Roebuck and Co. At that time, the company's sales had exceeded $400,000. By 1895, the 532-page **Sears** catalog offered a variety of merchandise, including apparel, shoes, china, saddles, musical instruments, firearms, buggies, wagons, fishing tackle, watches, jewelry, etc.

In 1911, when banks did not lend to consumers, **Sears** opted to offer credit services to its customers. Around this time, **Sears** also established a research lab to ensure product standards and conduct merchandise quality control checks. In February 1925, **Sears** opened its first retail store. In terms of retail history making, Richard **Sears** is credited with creating the modern department store; he also came up with the idea of "unconditional money back guarantee."

Like most other U.S. companies, **Sears** struggled during the great depression. After the depression, the company continued its growth in terms of number of retail locations, business line diversification (e.g., **Sears** introduced a line of tires, "Allstate," which was ultimately expanded into an automobile insurance and life insurance company), international expansion (e.g., early expansions included Cuba in 1942 and Mexico in 1947), acquisitions of several other organizations (e.g., Simpsons Ltd. of Canada, Coldwell Banker Co., etc.), and the erection of the **Sears** Tower in Chicago in the 1970's (i.e., at the time, the tallest building in the world). By 1963, **Sears** was the number-one retailer in the U.S. and one-in-five consumers shopped at **Sears** regularly.

Early success ultimately made **Sears** complacent. By the 1970's, competition became stiff and other discounters (S. S. Kresge Co., which later became **Kmart**) started cutting into **Sears**' profits. In 1974 alone, **Sears** experienced a $170 million drop in profits. In an effort to continue its growth, **Sears** attempted to further diversify its businesses. Despite diversification in the 1980's (e.g., purchase of Coldwell Banker, then the nation's largest real estate broker; Dean Witter Reynolds, a securities firm; the launch of Prodigy, an on-line service with IBM and CBS; the launch of the Discover Card; and ultimately the transformation of **Sears** into a collection of specialty stores), profits continued to decline through the 1990's. In 1992, **Sears** slashed jobs and suffered a year-end loss of almost $2.3 billion. This outcome prompted **Sears** to sell off several of its businesses (e.g., Coldwell Banker, Dean Witter Reynolds, etc.).

STRATEGIC MOVES

As a strategic response to declining revenue in the 1990's, **Sears** made an effort to target female consumers, introducing the "softer side of **Sears**." To support this strategy, **Sears** restructured its stores (i.e., moving appliances, hardware, and furniture were moved from mall stores to their own freestanding retail outlets). By 1995, profits hit $1 billion again; and in 1997, **Sears** stock reached an all time high of $65.25 per share. By 1998, however, **Sears** again saw downturns in business and many executives, including the chief executive officer, departed. In October 2000, current President Alan Lacy took the reins and created "The Great Indoors" store concept. Another strategic move made by Lacy was to transfer **Sears** account holders to MasterCard as **Sears** had come to rely too heavily on its credit card financing operations. This move resulted in many consumer defaults because of the higher interest rates. **Sears** in-store sales also continued to falter. In 2003 sales were slumping and staff layoffs were instituted again. In addition, the credit card business was sold for $3 billion to Citigroup. The "softer side of **Sears**" was ultimately considered to be too "soft" as witnessed by the eleven consecutive months of declining sales seen in 2004 (see Exhibits 1 and 2 for **Sears**' revenues and net income).

THE ACQUISITION

The acquisition of Sears Roebuck & Co, cost to Kmart Holding Corporation $ 11 billion (Dess, Lumpkin, Eisner, Strategic Management, 211, 2008). This merger occurred for economical reasons. This merger will benefit both companies in different ways separately and as Sears Holding Company.

Kmart will benefit from the planned cost sharing of several of Sears leading proprietary brands as well as present opportunities to capture significant revenue and cost synergies including merchandise and non-merchandise purchasing, distribution and other SG&A expenses.

Sears will be out of malls, and will benefit from Kmart' stores locations which are in the high-income customer target of Sears. Moving out of malls means that Sears will sell some of it real estates which will bring money to the company.

According to Edward S. Lampert, former chairman of Kmart and new chairman of SCH, the goal were to seek to leverage the combined strengths of Sears and Kmart to obtain greater long-term value either could have generated on a stand-alone basis.

SHC will offer a wide variety of products and combining both their strong brands such as Kmart's brands; Martha Stewart Home and Sears's brands like Kenmore, Craftsman and Die Hard, they will compete among others.

Combining two forces (even in our case where we have two weak companies) increase their merged company's market presence. Choosing from previous companies the best human resources, information technology, operations, finance, strategy lead them to a stronger organization.[1] Based on the information listed above, SHC will become the third largest retailer in the United States with $ 55 billion in annual revenues and 2,350 full-lines and off mall stores and 1,100 specialty retail stores in the USA.

Higher market shares often result in greater purchasing power over suppliers. Increased orders result in lower purchase prices for materials and services, allowing the company to be more price competitive.[2]

The issues SHC will face are internal and external such as organizational culture, organizational structure, organization identity, competition, trained staff, customer's loyalty and SHC store's design.

ORGANIZATIONAL CULTURE

Organizational culture is a system of shared values (what is important) and beliefs (how things work) that shape a company's people, organizational structures and control systems to produce behavioral norms (the way we do things around here) (Dess, Lumpkin, Eisner, Strategic Management, 309, 2008).

In the merger there will be employees from Kmart and Sears which will share different organizational culture. According to an AT Kearney research study; in mergers the more powerful partner imposes his culture on the less powerful one. The key to a strategic merger is to create a new organizational culture for SHC.

First, the executive team need to understand what the organizational culture is prior to the merger. They can do this through an assessment of the Organizational Customer Indicator (OCI) which provides a picture of an organization's operating culture in terms of the behaviors that members believe are expected or implicitly required. By guiding the way in which members approach their work and interact with one another, these "behavioral norms" determine the organization's capacity to solve problems, adapt to change, and perform effectively. [3]

ALTERNATIVES ..... WHAT DO YOU THINK?

First alternative is that they can conduct a separate OCI for Kmart and Sears's employees and decide which is the best organizational culture to apply. The advantage is that this will not be time consuming, since one part is already being used in the daily operation of the company. The disadvantage is that there will be resistance from the employees of the other company since they will see this is not the same culture of SHC, but as Sears or Kmart culture is created(depending on which of the two company's culture will be chosen) – employees must be involved in the process.

The other alternative for the company will be to conduct a cross analysis of both cultures and the best cultural elements from both Kmart and Sears will be selected from both companies. The advantage here is that the employees will see this as SHC culture and will share these values. The new SHC culture will encourage individual identification with the organization and its new objectives (Dess, Lumpkin, Eisner, Strategic Management, 309, 2008).

This is important because people should start to cooperate; they are not competitors anymore. Organizational structure refers to the formalized patterns of interactions that link a firm's tasks, technologies and people. Structures help to ensure that resources are used effectively in accomplishing an organization's mission (Dess, Lumpkin, Eisner, Strategic Management, 340, 2008).

Since SHC is a new company there should be a new applied structure. In this type of situation, many management consultants think the best structure in this case is a Matrix structure. Since SHC will operate under at least six different formats and since there were past problems related to the organization's identity and image, the Matrix structure will keep them in contact and through continuous communication between the "directors of stores" they can manage to combine their changes and so keep uniform corporate image and identity.

The advantages of this structure are that it: Increases market responsiveness through collaboration and synergies among professional colleagues, allow more efficient utilization of resources, improves flexibility, coordination and communication and increases professional development through a broader range of responsibility.

The disadvantages is as follows: the dual-reporting relationship can result in uncertainty regarding accountability, intense power struggles may lead to increased levels of conflict, working relationships may be more complicated and human resources duplicated and excessive reliance on group processes and teamwork may impede timely decision making (Dess, Lumpkin, Eisner, Strategic Management, 350, 2008).

Even after the merger both companies will continue to operate separately under their respective names. However, this may not be the right thing to do, because there should not be any more Kmart or Sears. The quicker they manage to change their previous identity into Sears Holding Company, the better. Buyers need to see that this merger brought changes and the reason they are going to do better is because processed have improved within this new company. As longer they continue to act as Kmart as Sears the more difficult issues there will be. They need to have "one" identity and show improvements and they will finally get some attention, people must perceive SHC as a new company but which still have good quality (their brand names are preferred from the clients) and low prices. The company cannot be seen as a 'second hand" store.

Kmart was placed as a discount store and Sears as a department store. SHC must be placed as a discount store since department stores are no longer liked by customers.

Before the merger Kmart was competing against a low-price Wal-Mart and a high-style Target and Sears against Home Depot and Lowe. Also as SHC they have to compete against the image of Kmart and Sears as they was and change the way people sees them, and through their past experience try to not make the same mistakes and improve their products.

Now as SHC, the company executives have to decide on whom they want to compete against directly. Who is more important? They definitely can't compete against Wal-Mart which is for several years have been the largest US Corporation. The best move is to compete against Kohls, Target or Home Depot's who are more easily to compete. They can take advantage of the good allocation of Kmart stores in key urban and high density suburban markets with high-income customers and far from these two competitors. They also can fill areas that are overlooked from the others.

There are three types of competitive advantage: overall cost leadership, which is based on creating low-cost position, which means that SHC must also be able to manage the relationship throughout the value chain and lower costs throughout the entire chain.
(Dess, Lumpkin, Eisner, Strategic Management, 156, 2008) The advantage here is that SHC will increase sales but due to cut high costs in operating expenses the company's operations will become weaker, and if they offer low prices means they will compete directly with Wal-mart which is a leader in low-prices, and SHC can't afford such direct competition with them.
Then there is differentiation which means that SHC must launch in the market products there are unique and valued, and the price is not an issue, since the high quality customers will pay more. The disadvantages is as follows: SHC cannot be easily perceived by customers as a high-quality company and the high prices they will offer will push the customers away.

However, the company could use a focus strategy where the company can gain competitive advantage through a combination of low cost and differentiation. This may be the best strategy since they can compete through their strong brand such as Martha Stewart, Kenmore, Craftsman and Die Hard, which are perceived very well from customers, against Target which is known for the high-style provided, and with low-cost they can compete against Home Depot. They need also develop more brands offerings for the SHC customers.

Both companies had problems with human resources. SHC must recruit talented people-employees at all levels with the proper skill sets and capabilities coupled with the right values and attitudes. Such skills and attitudes must be continually developed, strengthened and reinforced and each employee must be motivated and his efforts focused on the organization's goals and objectives (Dess, Lumpkin, Eisner, Strategic Management, 119, 2008). They need to find and train people who are able to identify with company's mission and values, and who will work hard to achieve their personal goals, as well as the company's goals.

There will also be lay-offs which SHC need to manage well. Because there will be people affected by this merger and the biggest mistake companies make is that they do not have a well defined firing process that is fair for employees (eg., fair compensation, referrals for new jobs etc..). The remaining people will be demotivated because of the large number of firings and think they can be next, so this process is crucible; CEO must talk to them, tell them the truth about the situation, explain to them the reasons why they fired their colleagues, motivate them and show them that SHC counts on them and that they are part of the merger process which will be a difficult one and there will be a lot of stress. SHC need to keep the remaining staff motivated in order to share the same vision and mission of the company.

The most important part of the remaining employees is the former high level managers, who probably will lose their previous positions and need to work in lower positions. So, this is the part there could resist more to the changes and maybe the part where the attention of SHC should be concentrated.

Another issue to be solved for SHC is customers. SHC should focus primarily on them and then in profit maximization, which will come if they are able to fill the customer's need for good quality, competitive prices, service and customer service convenience. Marketing should try to anticipate needs and have customer satisfaction as its primary goal. They need to do surveys to see how people perceived them as Kmart and Sears and what they are expecting from SHC.

The design of their stores is keeping customers away because they see the stores as old, not attractive and with a cheap design. SHC stores are what people see first, and in order for someone to enter the store they need to redesign its ambience. Such as, the internal design team should really take time to develop a new image for SHC stores and gradually phase in the changes.

THE MERGER (Recap .. overview)

In late 2004, two giant U.S. retail corporations--**Sears**, Roebuck and Co. and **Kmart** Holding Corporation--announced that they would merge operations to form the **Sears** Holding Company (SHC). In terms of how the new entity's name was selected, the **Sears** name was apparently held in higher esteem by consumers than the **Kmart** name. Based on a survey conducted by Rivkin & Associates, Opinion Research Corp. (of 1,050 U.S. adults), 75% of Americans preferred the "**Sears**" name over "**Kmart**."

Under the terms of the **merger**, SHC became the third largest retailer in the U.S. with approximately $55 billion in annual revenues and 2,350 full-line and off-mall stores and 1,100 specialty retail stores in the U.S. **Kmart** shareholders received one share of SHC common stock for each **Kmart** share. **Sears** shareholders had the right to elect $50 in cash or 0.5 of a share of SHC for each share of **Sears**'s common stock. At the time of the **merger**, it was estimated that the former shareholders of **Kmart** would have an approximate 63% interest in SHC and former shareholders of **Sears** would hold a 37% interest in SHC. On the morning of March 24, 2005, the **merger** approval date, **Sears's** shares fell $6.06 (about 11%) to $50.74 (NYSE) and **Kmart** shares rose $1.19 (about 1%) to $126.02 (NASDAQ).

Twelve teams--comprised of members from both companies--were created to ease the **merger** process. According to Alan Lacy, former President and Chief Executive Officer of **Sears** and new Vice Chairman of SHC, one post-**merger** goal is that "**Kmart** will benefit from the planned cost sharing of several of **Sears** leading proprietary brands" as well as present opportunities "to capture significant revenue and cost synergies, including merchandise and non-merchandise purchasing, distribution and other SG&A expenses." Ultimately, the goal of the **merger**, according to Edward S. Lampert, former Chairman of **Kmart** and new Chairman of SHC, was to "seek to leverage the combined strengths of **Sears** and **Kmart** to obtain greater long-term value than either could have generated on a stand-alone basis. SHC plans to offer customers a new, more compelling experience with a differentiated and expanded product range" (SHC Press Release, 2005).

These changes are the first of many for these historic and somewhat disparate companies, both of which were founded in the late 1800's and are woven in American culture. The newly merged entity--SHC--will face challenges of marrying two distinct retail entities in terms of their unique cultures, in order to create requisite synergies to keep pace with (or surpass) the competition. Before looking on to the future, it is important to look at the historical evolution of **Sears** and **Kmart** to better understand the respective organizations' strategies and cultures.

CONCLUSION

In general, **Sears**' retail business had been weak, consistent with its declining store sales. **Sears**' in-mall locations had been a major impediment to its sales of home-related categories because the majority of home goods are sold in off-mall locations.

On March 5, 2012 Sears announced the closing of hundreds of stores "So, what is the next move for Kmart and Sears"?

Sears Holdings Revenue from 2004 - 2008

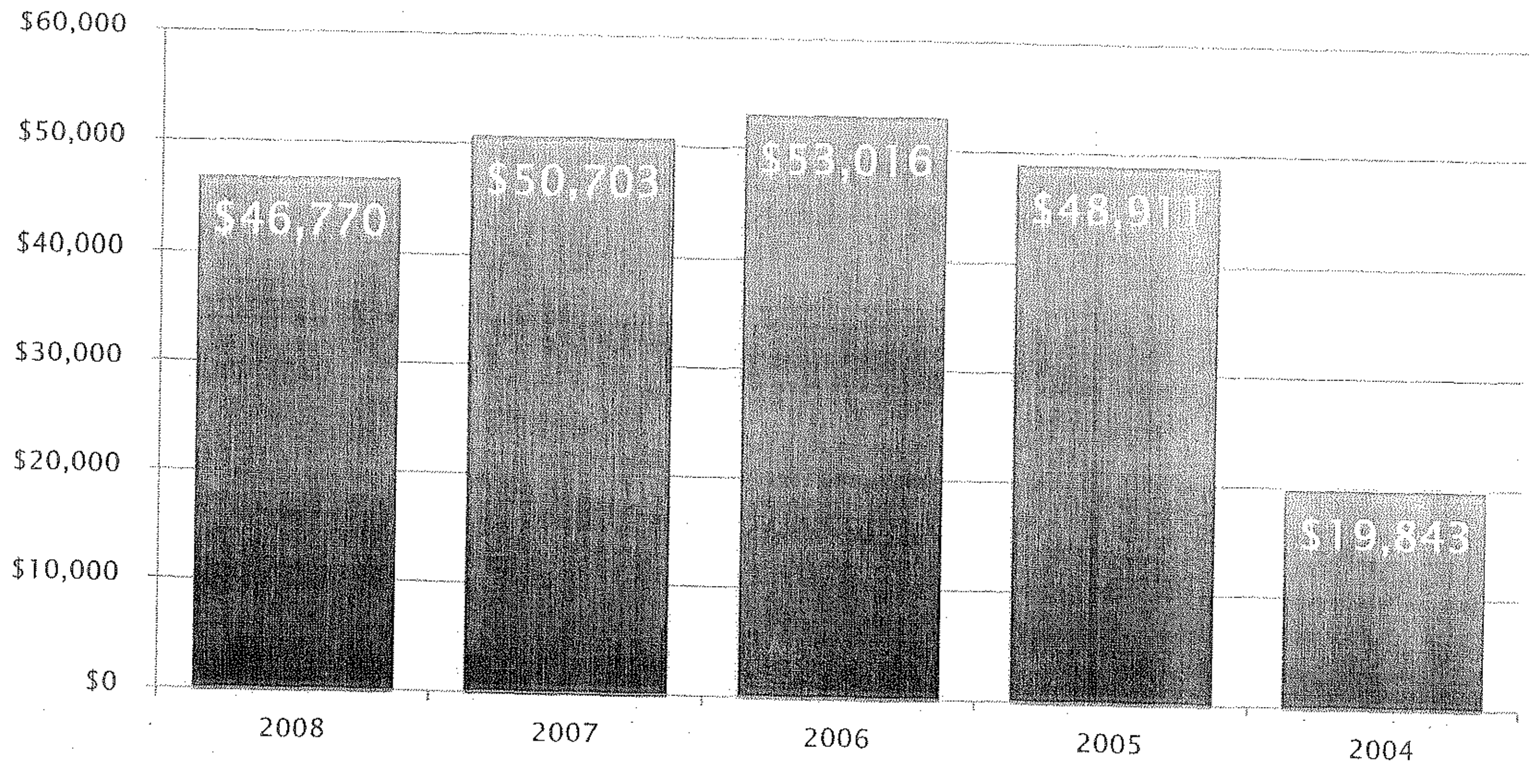


Exhibit 1

Industry Analysis

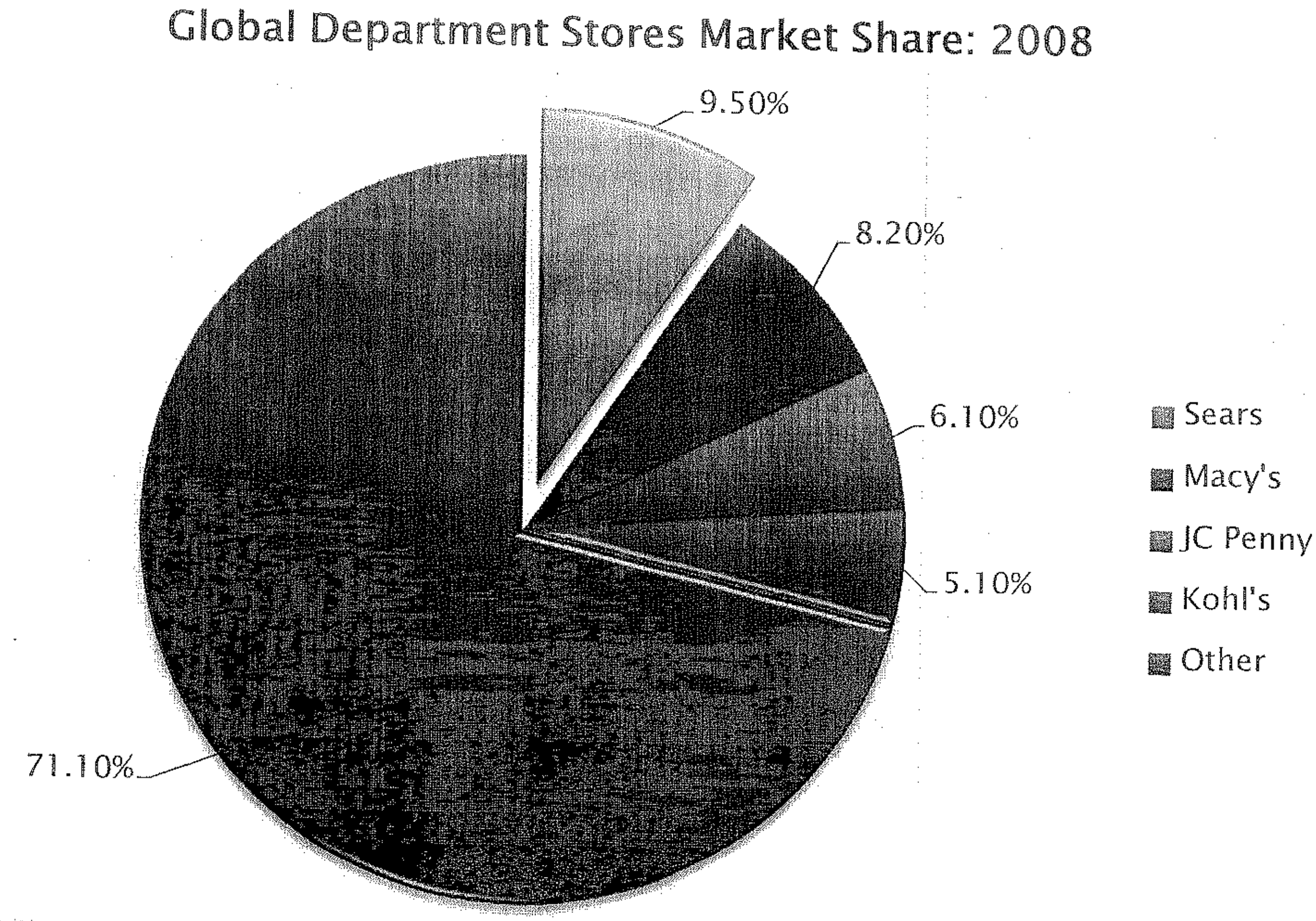
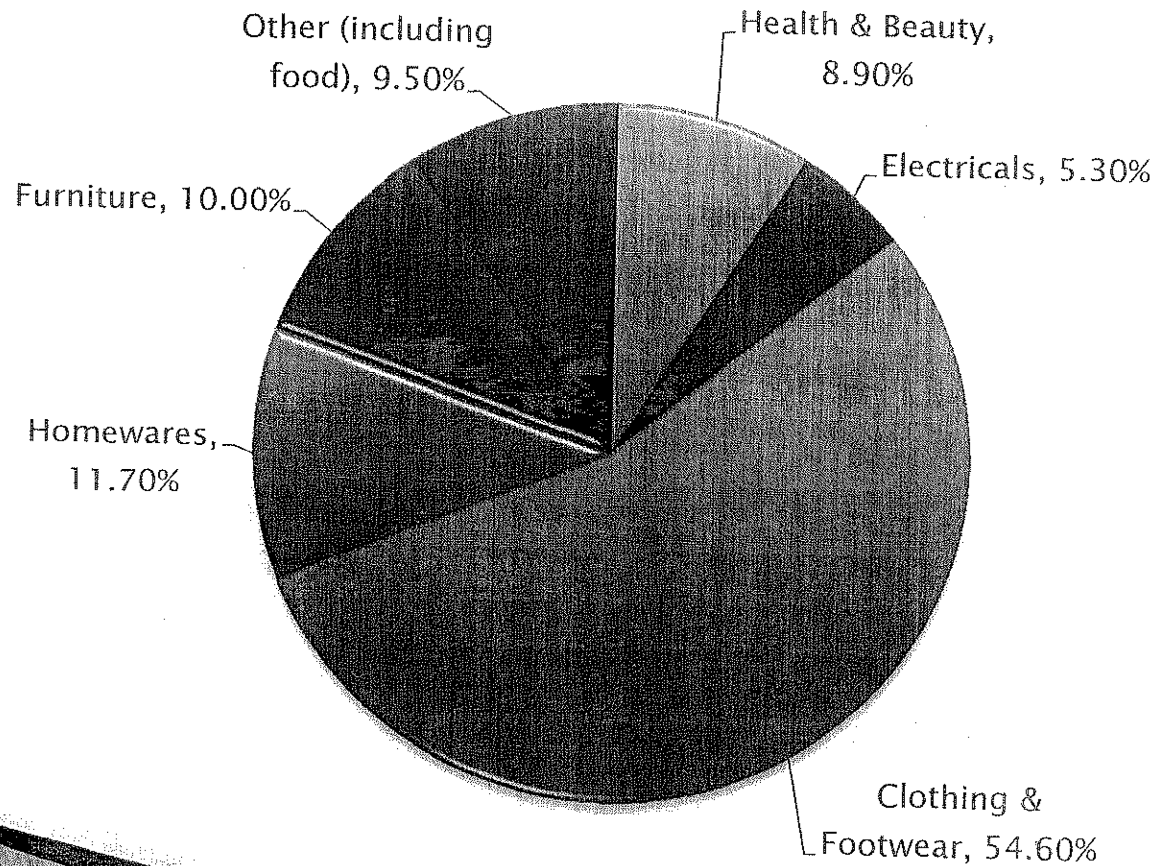


Exhibit 2

Industry Analysis

Global Department Stores Market Segmentation: 2008



Industry Analysis

- Retailer type
  - Department Store
    - JC Penny, Macy's, Sears
  - Discount Store
    - Wal-Mart, Target
  - Off-Price retailer
    - Ross
  - Specialty Store
    - Home Depot

Wal-Mart Stores, Inc.

Sears

- Established in 1962
- 2.1 million employees
- Supercenter, neighborhood market, discount store
- Abundant capital, business model, global operation, sales strategies

Walmart
Save money. Live better.

Home Depot, Inc.

- Formed in 1978
- World largest home improvement retailer
- 2,234 stores
  - 322,000 employees
  - Revenue exceeded 71,000 million in 2009
- Professional, private brands, special deployment center

Kohl's Corporation

Sears

- Formed in 1962
- Middle income group of people
- Family oriented products
- 1,000 stores in 48 states
  - 126,000 employees
  - 16,389 million revenue in 2009
- Efficient inventory management

KOHL'S
That's more like it.