

Case 3

JCPenney's Uncertain Turnaround

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- 1 Investors in JCPenney experienced a great deal of uncertainty in the past few years. Penney's replaced its CEO in 2011 and again in 2013, and made major alterations to its corporate strategy each time. The company also dramatically changed its pricing and sales approaches. During the same period, profits were negative, the availability of funds decreased, and the company's stock price was volatile while trending down.
- 2 Penney's success throughout prior years was driven by discounts, promotions, and clearance aisles. The company's pricing model centered on setting high regular prices, then offering discounts on those prices to create the impression of great sales. The feeling of finding discounted items appealed greatly to moderate-income shoppers who were attached to sales and coupons. This marketing tactic worked for many years. By the end of fiscal year 2007, Penney's had reached annual sales of over \$19 billion. The company had over 1,000 stores, opening an additional 50 in 2007 alone. On February 21, 2007, Penney's stock reached its all-time high price of over \$86 per share.
- 3 However, as the recession took hold, Penney's success began to fade. Consumers began to feel the effects of a weakening economy and store sales for Penney's began to decline. Sales dropped to \$18.4 billion in 2008 and to \$17.5 billion in 2009. By the end of 2009, Penney's stock had dropped nearly 70 percent to just over \$26 a share.
- 4 When the economy began to recover from the economic recession that ended in June 2009, Penney's saw only a marginal improvement. Sales increased 1.2 percent to \$17.7 billion for fiscal year 2010. The slight improvement in sales did not stir investor confidence. By the end of 2010 the stock price had only increased to a respectable but unremarkable \$30 per share.
- 5 The number of new store openings paralleled the multiyear decline in sales. In 2008, the company opened 35 stores, followed by only 17 store openings in 2009, and just two new store openings in 2010.
- 6 The company's financial situation became worse in 2011. Sales dropped by 2.8 percent to \$17.2 billion. Citing the continuing pattern of financial decline, Penney's fired CEO Mike Ullman in 2011. His replacement was Apple executive Ron Johnson. The new CEO was praised for his work as the head of retail operations at Apple. He had created the unique style of Apple stores and had pioneered the Genius Bar. The financial markets reacted very positively to the news when the change of CEO was announced. Penney's stock rose by 17.5 percent on the day that Johnson was hired.
- 7 Penney's hoped to utilize Johnson's innovative ideas to recreate the Penney's brand. Johnson's first change involved introducing "everyday low prices" instead of sales and discounts. To make up for the lack of sales prices, the company advertised their products more aggressively. The company turned away from special promotions, believing that promotions encouraged consumers to look for price breaks on products, which ultimately detracted from customers' loyalty to the Penney's brand. This was an approach that Johnson brought from Apple. He believed that consumers would buy more from Penney's when they were loyal to the company rather than simply looking for a good deal.
- 8 Johnson also began the process of changing the look of stores by creating in-store boutiques with higher-end fashion brands. The stores were transformed to appeal to a more

youthful demographic. The Apple stores were viewed as a place consumers went to hang out, and Johnson wanted to bring that characteristic to Penney's stores.

- 9 The changes were implemented by Johnson on a nearly simultaneous company-wide basis. Instead of using the traditional small test-market approach to gauge how successful the new tactics would be, all Penney's stores introduced the untested changes at the same time. The steady decline in company performance led Penney's strategic planners to believe that delaying a full rollout for testing purposes would allow the financial problems to grow and would rob the company of the positive buzz surrounding Johnson's much anticipated changes. However, the all-in approach put the company at greater risk, and it was a gamble that did not pay off.

- 10 One year after the plans were implemented, Penney's revenues had dropped by 25 percent and the company was unprofitable. By the end of 2012, the company's stock had dropped below \$20 per share. Penney's store closures continued to rise, albeit slowly. Perhaps most discouraging, Johnson's new store designs and change in prices were ineffective. Same-store sales were 30 percent lower than the previous year.

- 11 The decline of sales and increased costs of remodeling stores combined to drain Penney's cash.¹ In January 2013, Penney's had \$930 million in cash and short-term investments. This figure had dropped by over \$2 billion in two years. Closer inspection revealed that nearly 10 percent of the cash on hand was from deferring \$85 million in payments to suppliers. The lack of cash led the company to draw \$850 million from its revolving credit line of \$1.85 billion in April 2013.

- 12 In that same month, the company made another change of CEO, bringing back Mike Ullman to his previous position. Several possible explanations for Johnson's failure to turn around sales at Penney's were given. First, he might have misjudged customers' preference for discounts and promotions over everyday low prices. Second, customers might have been confused by the changes in pricing policies. Third, a combination of changes at Penney's, not just its pricing policies, might have displeased customers. Fourth, the consequences of the economic recession and the subsequent period of no or low growth might have affected Penney's more than analysts understood. Finally, Johnson's lack of presence at the company's headquarters in Plano, Texas was viewed very negatively. Johnson chose not to relocate from California, and instead spent three days a week at the headquarters and worked remotely the remainder of the time.

- 13 With Ullman back at the helm, Penney's looked to return to its former operations model. Ullman began by adding a greater variety of clothing styles and sizes, in contrast to former CEO Johnson who had stopped selling larger sized clothing, focusing more on a trendier, younger shopper. However, Ullman's major change as CEO was to restore the discounts and promotions offered by the company. He believed strongly that Penney's shoppers wanted to buy items at promotional prices. Ullman promised to bring back 26 annual event promotions, with most occurring around the holidays when there is a greater presence of shoppers in the stores. Interestingly, Ullman's reintroduction of promotional prices and discount coupons occurred just as consumer retail sales began to pick up in earnest nationwide, and as consumers measurably decreased their couponing in clothing stores.

- 14 Additionally, not everyone was pleased with Penney's return to its old pricing tactics. In response to a July 2013 article in *Today* that was critical of JCPenney for initially pricing items artificially high, then dropping the prices to a competitive level and calling them "sale prices," the company released the following statement:²

¹Lahart, J. 2013. "Not Much Future in Penney's Past." *Wall Street Journal*, April 17: C.16.

²Rossen, J., and A. Patel. 2013. "Some of JCPenney's Big Sales Are Misleading, Say Employees." *TODAY*, July 24.

Last year [2012] we implemented an everyday low pricing structure that was ultimately rejected by JCPenney's core customer. We learned that our customers are motivated by promotions and prefer to receive discounts through sales and coupons applied at checkout. As such, we have returned to the promotional pricing model employed often in the retail industry. This shift requires us to make pricing changes on much of the merchandise to remain competitive. In addition, under this promotional pricing model, any time an item is put on sale the item must have been previously sold at its original or regular price for a reasonable period of time. While we understand this transition back to promotional pricing may cause some temporary confusion, the Company remains committed to delivering the quality, price and value that customers expect from JCPenney.

- 15 Penney's also started focusing more on its "new home" department, which included bedding, cookware, and furniture. The company partnered with exclusive designers and home décor specialists, such as Michael Graves and Martha Stewart. Ullman felt the need to reverse the company's performance in 2012, when home goods sales dropped by \$1 billion. Home goods sales were critically important because they represented 12 percent of overall sales, down from 15 percent in 2011.³
- 16 U-turn changes were also made to the company's online offerings. During Johnson's short stint as CEO, the company had changed the design of its Web site, which many consumers complained had been made too difficult to navigate. In 2012, Web traffic fell compared to 2011, leading to online sales dropping double-digits. Part of the new approach involved restoring online promotions to the company's social media platforms. During April and May of 2013 Penney's posted discounts on its Facebook page for the first time in more than a year.⁴
- 17 However, Penney's did not return to all of its previous tactics. The company is continuing with its approach of creating in-store boutiques for specific brands. This was a tactic Ullman had implemented with Sephora products during his first tenure as CEO. The company also continued to try to expand its customer base by trying to attract a younger, more stylish demographic, but without alienating its already established consumers.
- 18 Part of this plan involved expanding Penney's brand offerings. The company partnered with Canadian-based apparel maker Joe Fresh to drive up traffic to stores. The Joe Fresh products were available in nearly 700 Penney's stores. Even though the Joe Fresh brand made up only a small portion of the overall inventory, results showed that customers were starting to return.
- 19 Near the end of Johnson's run as CEO, JCPenney's stock dropped to near record low levels, at less than \$15 per share. By mid-2013, the stock recovered slightly to just above \$16 as the new changes took hold. Whether the return to Ullman's traditional model, which customers had abandoned less than two years earlier, would attract them to return as active supporters and enthusiastic buyers would determine Penney's survival.