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CIRCUIT CITY STORES, INC.

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In September, 2008, as James Marcum took the helm at beleaguered electronics retailer, Circuit City, he faced considerable challenges. From the firm's inception in 1949, it had built on a history of innovation and had actually developed the electronics superstore concept. Circuit City had been the market share leader for many years, but fierce competition had loosened the company's grip on the industry. By 2008, the company had given up considerable market share to Best Buy and saw sales and profits eroding. Additional pressure came from large discount retailers. In response to these challenges, the company made some changes, but these did little to affect Circuit City's free-falling stock price.

It was September 23, 2008, and James A. Marcum had a lot on his mind. Just the day before, Marcum had been appointed to succeed Philip Schoonover as President and CEO of Circuit City, the nation's second largest electronics retailer.

Things were not looking good for the company. At the beginning of Marcum's first day on the job, Circuit City's share price was $1.75 a share, a far cry from the $25.00 price two years ago. A good deal had happened to push share price down. The electronics retailer had posted a $200 million loss in fiscal 2007 and competitors continued to outperform the company. Further, after attempts at restructuring and controversial firings, Circuit City had developed a tarnished reputation in customer service. Adding to Marcum's already full plate was a global economic crisis that exploded shortly before he took the helm at Circuit City. Now, with the threat of store closings and bankruptcy on the horizon, Marcum was facing monumental challenges. How could this pioneering company in the electronics retail industry have fallen to such a low point?

HISTORY OF CIRCUIT CITY

The foundations of Circuit City could be attributed to two unlikely events: a family vacation and a haircut. It was in the summer of 1949 that Samuel Wurtzel, after selling his business in New York, took his family on a vacation to Richmond, Virginia. It was there, while getting a haircut, that the barber told Wurtzel interesting news: Richmond would soon be airing the first commercial television station in the southern United States. Predicting a potentially strong demand for television sets in the area, Wurtzel moved his family to Richmond and opened the city's first television retail store. The company name, an acronym derived from Wurtzel, his son Alan, wife Ruth, other son David, and his own first name Samuel, was called "Wards."[1] Ten years after its founding, Wards had four stores and was generating one million dollars in sales a year. Little did Wurtzel know that nearly fifty years later, his humble television business would grow to an electronics chain with over 600 locations nation-wide. (See Exhibit 1 for a time line of the firm's history.)

Wards experienced rapid growth during the 1960s and 1970s. After expanding into products like appliances in 1960, Wards had a successful public stock offering a year later. During the 1970s, the company gradually evolved from a small-scale retailer into a larger superstore format, beginning with the acquisition of the audio retailer Consumer Electronics, Inc. Later in 1977, the company changed the operations of the audio stores acquired through the Consumer Electronics buyout, expanding them into full-fledged electronic superstores under the name Circuit City. Wurtzel continued to convert all stores and brands under the Wards brand into the superstore setting and opened new locations in both east and west coast areas. During this time, Samuel Wurtzel transferred control of the company to his son Alan. Wards officially changed its name to Circuit City Stores, Inc. in 1984.[2]

Circuit City remained the leader in consumer electronics for much of the 1980s and early 1990s, capturing 11 percent of sales of consumer electronics during this period. Despite lagging sales of non-electronics items, like appliances and tires, the company launched the used car retailer CarMax in 1993. CarMax would later split from Circuit City in 2002.

A major challenge to Circuit City came in 1993 with the advent of a new player in the electronics retailing industry, Best Buy Co, Inc.[3] Best Buy gained market share by quickly expanding its operations, much as Circuit City had done in the 1980s, but there were differences in strategies. Best Buy sought to present itself as a more trendy, modern shopping experience. Another difference between the two retailers was that Best Buy focused heavily on minimizing the cost of operations. For example, Best Buy used an hourly pay scale for employees whereas Circuit City still paid employees a commission-based salary as it had been doing for decades.

Another innovation that Best Buy introduced was the "Geek Squad", a group of technicians who were available to trouble-shoot customer technology problems, either in the store or at the customer's home or office. The technicians, called "agents" arrived for off-site work in dramatically colored mobile units marked "Geek Squad."

The following decade saw a shift in market dominance from Circuit City to Best Buy. Between 1993 and 2002, revenues at Best Buy rose from $1.62 billion to $19.6 billion. In 2002, Circuit City had revenues of $12.8 billion, trailing well behind Best Buy. In that same year, Circuit City posted its first negative growth rate in decades.[4] (See Exhibit 2 for graph of comparative sales.). The need for Circuit City to adapt in order to compete seemed inevitable.

RESTRUCTURING IN THE NEW MILLENNIUM

Working to combat the sluggish performance of previous years, Circuit City began to re-structure in 2003. A number of significant changes were introduced, among these efforts to simplify the shopping experience for customers and create a more streamlined process. A new company logo was introduced and store design was radically altered to mirror that of competitors. The changes also included abandoning the commission-based salary that Circuit City had been using since its inception and converting to an hourly pay scale like Best Buy. In a 2003 letter to shareholders, CEO and President Alan McCollough explained that "[b]y converting to a single pay structure, we believe that we can simplify store operations, better serve our customers with a store team unified around that single objective and reduce operating costs." [5] At this time, the company also made the decision to fire 3,900 employees who worked on commission, almost ten percent of its workforce. The firings were quite controversial and generated a good deal of negative publicity. Analysts who followed the company considered this a poor decision because it meant the loss of experienced salespeople in an industry that required high knowledge of technology.[6]

In an effort to increase sales in 2006, Circuit City introduced its Firedog service, a computer technician service designed to combat Best Buy's Geek Squad. The term "Firedog" was chosen because "it is a name that captures the attributes that we want our technicians and installers to embody—helpful, knowledgeable, friendly, and reliable. It is simple, it is fun, and it is focused on our customers," said McCullough's replacement as CEO, Phillip Schoonover in a September, 2006, conference call. At the same time the company instituted a strategy called "North Star" that focused on customer service. The strategy had employees looking to several key principles as the guiding light, or the 'North Star,' in order to better serve customers.[7]

Also, during the quarter ended August 31, 2006, the company bought back a total of 2.6 million shares of its own stock. This brought the total of stock repurchases to 52.1 million shares for a cost of $800 million. Despite these efforts, financial troubles continued to plague the company.

In 2007, with sales of flat screen TVs declining significantly, Circuit City decided to cut another 3,400 employees. The company's stock price fell sharply from $20 a share to below $5 a share by the end of 2007. The stock price continued to drop even further during 2008. (See Exhibit 3.)

Other concerns during 2008 included a bid from Blockbuster, Inc., an entertainment rental retailer, to buy Circuit City for $1 billion. However, the move was widely panned by analysts who questioned the practicality of purchasing a struggling company like Circuit City. Blockbuster soon withdrew its bid, sending shares of Circuit City further down. Later that year, as economic woes increased, rumors became validated when the chain announced the closing of 155 stores amid a holiday shopping season that could determine the company's future.[8]

The efforts to restructure did not, however, result in improved financial health. CEO Schoonover cited his dissatisfaction with the company's poor financial results during the 2007 third quarter in a letter to shareholders. "We underestimated the financial impact from the disruption of our transformation work," Schoonover stated, "which contributed to lower close rates, reduced attachments of higher margin accessories and firedog services and lower extended warranty net sales as compared with the prior year."[9]

During this period, Circuit City posted significantly higher operating costs, contributing to its poor performance. In 2008, Circuit City's deteriorating position led to negative operating cash flows. In turn, the company shifted its cash flows to investment activities by selling over three billion dollars in investment securities. Company earnings had steadily decreased over the years; 2006 was the last year to experience positive net earnings.

Mark Wattles, one of Circuit City's largest independent stockholders, had repeatedly called the management of the company into question and had pushed for the ouster of Schoonover and the entire board of directors. He believed that management had lost its retail focus and was simply looking for a cure for the company's financial woes.[10]

Philip Schoonover resigned as president and CEO on September 22, 2008, only three years after he replaced Alan McCollough. James Marcum, who had considerable experience in the retail electronic industry, was named his successor.

At the end of fiscal 2008, Circuit City reported a net loss of $319 million. Declining shareholder's equity brought more pressure from investors wanting to see change. (See Exhibits 4 and 5 for financial statements.).

HUMAN RESOURCE PRACTICES

According to the company's career website, associates enjoyed "a fun and fast-paced work environment," and "helping customers find the right product."[11] These included respect and teaching others, engaging with the company, simplifying processes, and maintaining the highest integrity.

Once hired, new Circuit City associates underwent several hours of training under a custom e-learning training process developed by a training company, DigitalThink. These interactive courses were provided over the internet and designed to instill product knowledge as well as sales and customer service techniques, all in short intervals that allowed employees to get back to the sales floor quickly between training sessions. Circuit City believed that its partnership with DigitalThink allowed the retailer to save over $100 million in training costs. According to DigitalThink, "The training has been so successful that more expensive commission-based associates have been replaced with less-expensive hourly associates. Circuit City has found that hourly associates sell just as well—when they are trained with DigitalThink's courses."[12].

THE ELECTRONICS INDUSTRY

The electronics industry was complex and ever-changing. Electronics products, such as computers and televisions, were so intricate that they tended to be designed in one country, manufactured in another, and then assembled in the United States for distribution.[13] While this outsourcing of manufacturing was advantageous to electronic manufacturers, retailers like Circuit City found profit margins increasingly declining on the low-priced, low labor-cost electronics. Electronic products tended to be in high demand by consumers, often placing a strain on electronic companies to promote rigorous research and development projects. Research and development (R&D) costs were the largest and most costly expense in the electronics industry, but the payoff from extensive R&D projects resulted in newer products, but less costly, products. Furthermore, rapid R&D between several companies often resulted in a battle of dominance between two particular technologies.

One example involved Toshiba's HD DVD format that directly competed with Sony's Blu-Ray format for supremacy in the high definition DVD player market. Sony's vast resources, including owning a movie and television studio, as well as other factors such as implementing Blu-Ray players into Playstation 3 gaming consoles, eventually led to Blu-Ray taking enough market share from HD DVD to win the war in early 2008. Retailers like Circuit City were put in difficult positions in these situations, because they ended up promoting both formats at once without any idea as to which would become the primary format. It was only when Blu-Ray's victory became apparent did stores like Best Buy officially offer Blu-Ray players exclusively.[14]

As technology improved products, there were often quick, steep declines in product prices and electronics retailers often found themselves in highly competitive pricing situations. For example, flat panel televisions became very popular with consumers as their prices fell. Circuit City, along with many other retailers, predicted that the flat panel television industry would begin to see rapid, significant growth during 2005. This assumption eventually prompted a "television war" between many retailers vying to attract customers to buy televisions from their stores. However, Circuit City failed to realize just how quickly television prices would fall. According to Schoonover in 2007, flat panel TVs declined in price a year ahead of Circuit City's initial prediction, causing an impact in business in the third and fourth quarters of 2006. Circuit City was clearly impacted by the unusual forces of an industry that experienced rapid technological improvement in its products.[15]

COMPETITION FROM "BIG BOX" RETAILERS

In addition to direct competition from other specialized retailers such as Best Buy, superstore retailers such as Wal-Mart and Costco began offering more consumer electronics. These superstores quickly took market share away from Best Buy and Circuit City, especially during difficult economic times.

Wal-Mart, for example, offered electronics at much cheaper prices than either of the two major electronics retailers. Brad Anderson, CEO of Best Buy, saw the threat of Wal-Mart, but reasoned that superstore retailers would never provide the training their employees would need in order to help customers with the technical knowledge required to operate evolving electronic devices. This thought process led to the adoption of Geek Squad, providing a competitive edge over Wal-Mart.[16]

Online retailers provided a completely different shopping experience. Companies like Amazon.com, Newegg, and even Best Buy and Wal-Mart's own online websites brought shopping directly into the consumer's own home. Customers were able to browse among several retailers at the click of a mouse button, comparing prices, checking product reviews, and searching for the best deal.

Further, electronics shoppers typically were not committed to shopping only at a particular store. For Circuit City, this meant that customers who regularly shop-ped

at several retail locations would likely go Wal-Mart or other discount retailers as soon as prices undercut those at Circuit City. Even worse, a 2008 study showed that over 72 percent of Circuit City shoppers also shopped at Wal-Mart, compared with only 55 percent of Best Buy consumers.[17]

Given this competition and the economic crisis, some analysts were concerned that Circuit City would not be able to survive the 2008 holiday season. Britt Beemer, President of the market research firm America's Research Group, put it bluntly: In the event of a poor 2008 Christmas, "Best Buy can survive, Circuit City cannot.[18]

DISCUSSION QUESTIONS

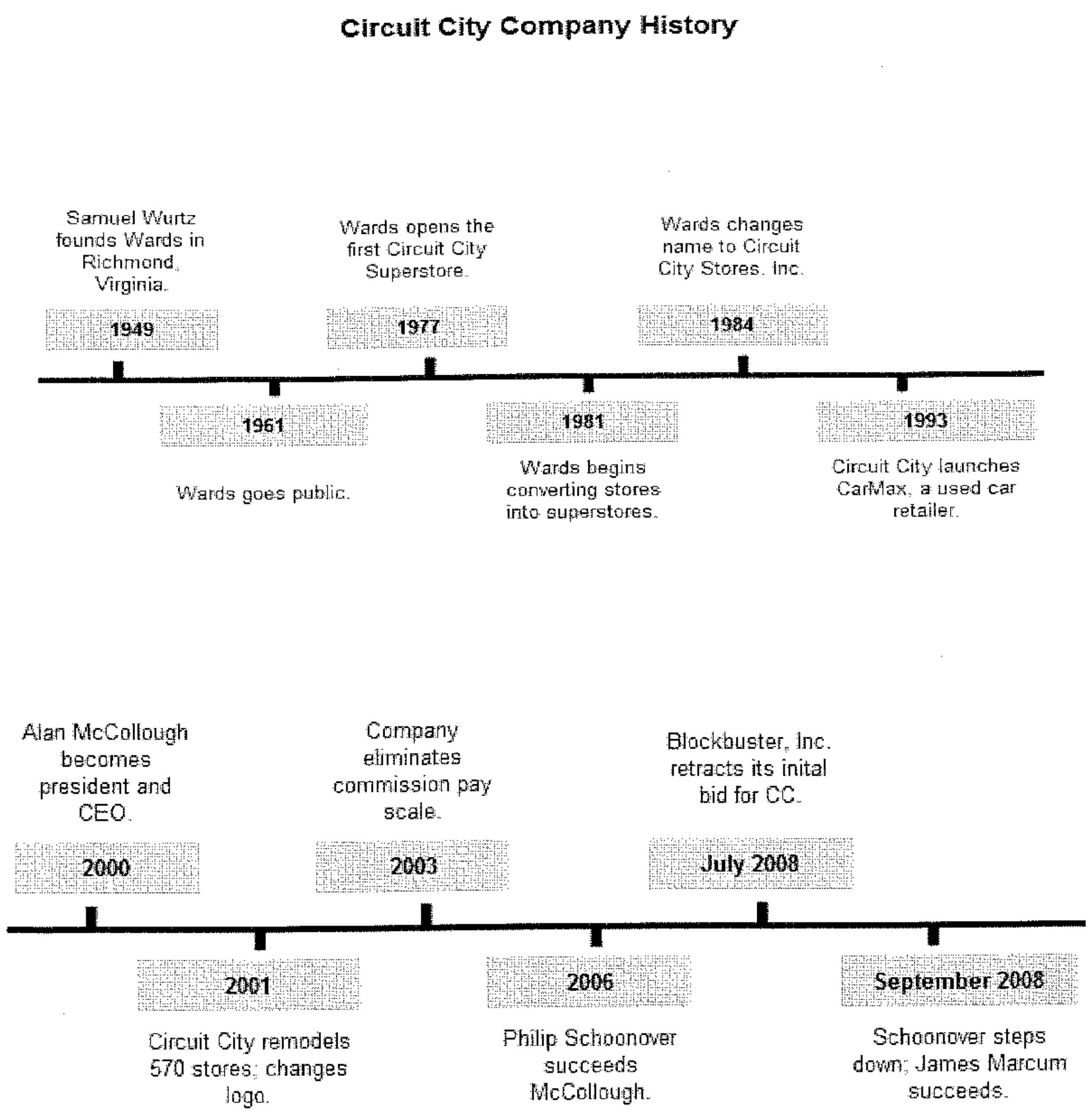
1. Why was Circuit City successful in its early years? What was it doing right?
2. Analyze the decline of Circuit City. What were the primary factors leading to the company's decline? Explain.
3. Assess the firm's financial condition in 2006-2008. What are your concerns?
4. Present an analysis of the company and your recommendations for Marcum. What are his options?

EPILOGUE

On Monday, November 10, 2008, Circuit City Stores, Inc. announced that it had filed for Chapter 11 bankruptcy protection. After months of poor performance, losses, and dwindling equity, the economic crisis proved to be too much for an already battered Circuit City to handle. With this announcement came the closing of 155 stores, a number that was nearly four times the number of stores that the company built during 2007. Circuit City's ultimate goal in applying for bankruptcy protection was to restore the company's finances well enough to remain a solid competitor in the electronic retail industry. However, with an economy that continued to slump and many people losing work, the forecast was bleak for consumer shopping during the 2008 holiday.

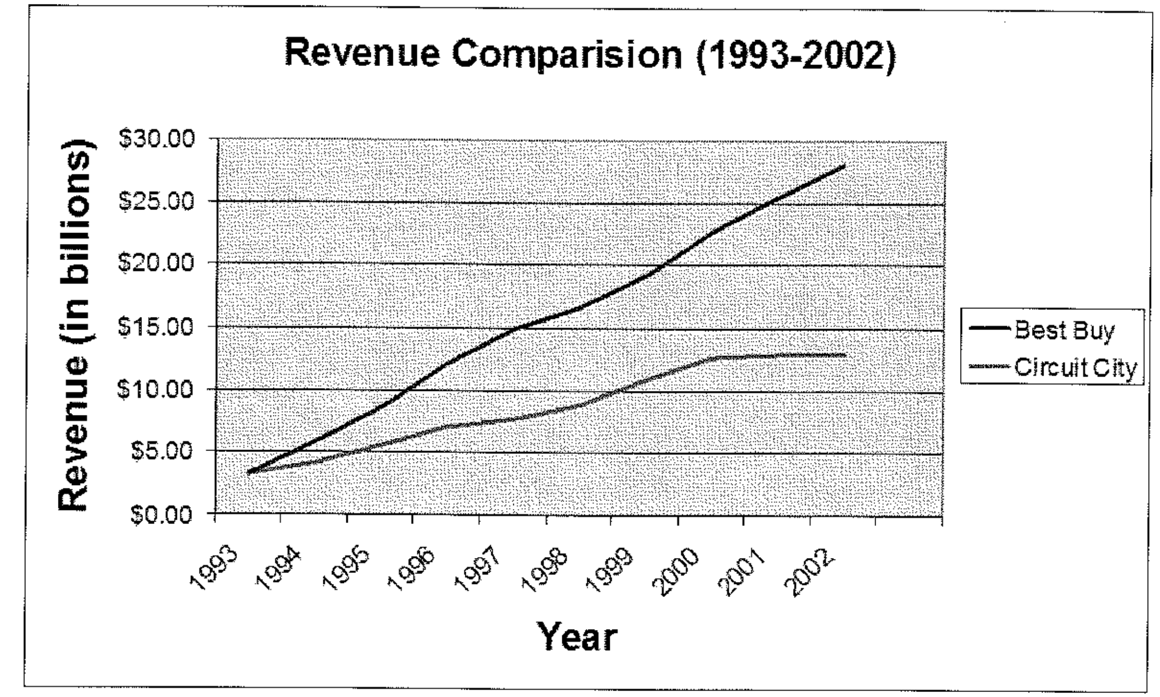
Two months later, on January 16, 2009, customers logged onto the Circuit City website to read this headline: "Circuit City Stores, Inc. to Liquidate." The ride was finally over for Circuit City as the nation's second-largest electronics retailer bowed to overwhelming financial problems. Circuit City was taken over by a liquidator and all stores began closing their doors to prepare for a final sale. By early March, it was expected that most of store inventory would be gone and many stores would seal their doors for good. A company almost as old as television itself, one that once led the electronics retail market, was finished. Many looked back and wondered how Circuit City had come to such an end.

EXHIBIT 1. Timeline of Selected Events in Circuit City History



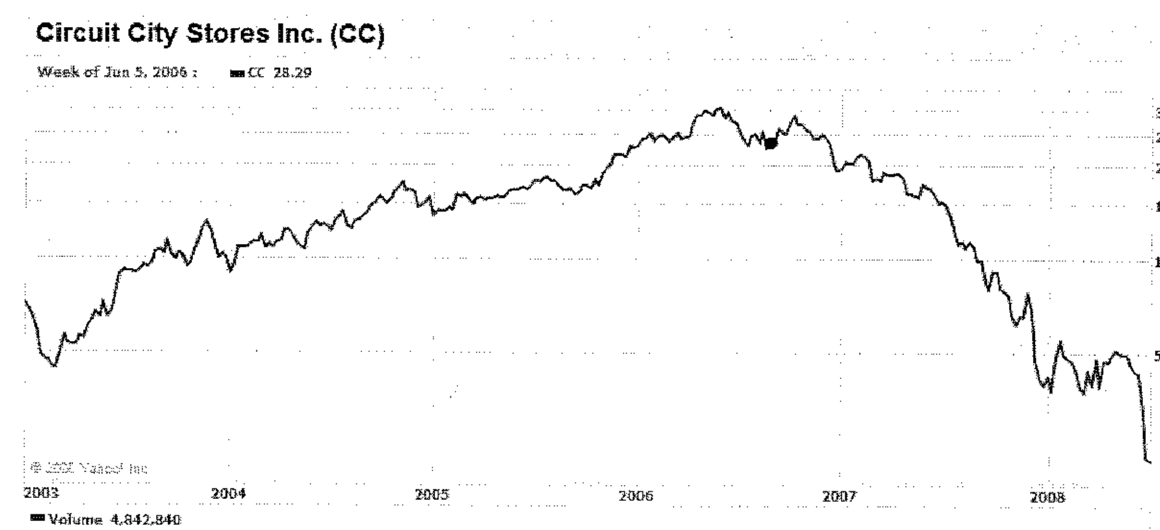
SOURCE: "Circuit City Stores, Inc." Funding Universe. November 3, 2008. <http://www.fundinguniverse.com/company/histories/Circuit-City-Stores-Inc-Company-History.html>.

EXHIBIT 2. Revenue Comparison of Circuit City and Best Buy



SOURCE: Faizi, Solomon, Ly, Hanh, Nguyen, Son and Vo, Jackie. "Circuit City Stores, Inc." San Jose State University. December 9, 2002. September 17, 2008.

EXHIBIT 3. Circuit City Stock Price From 2003 - 2008



SOURCE: Yahoo! Finance. September 10, 2008. <http://finance.yahoo.com/q?s=CC>

EXHIBIT 4. Earnings Statements for the Years 2006 - 2008

EARNINGS STATEMENTS FOR THE YEAR ENDED FEBRUARY 28			
Amounts in thousands	2006	2007	2008
Net Sales	11,514,151	12,429,754	11,743,691
Cost of sales, buying and warehousing	8,703,683	9,501,438	9,318,974
Gross Profit	2,810,468	2,928,316	2,425,517
Selling, general and administrative expenses	2,595,706	2,841,619	2,770,104
Impairment of goodwill	0	92,000	26,000
Operating (Loss) Income	214,762	(5,303)	(370,587)
Interest income	21,826	27,150	18,188
Interest expense	3,143	1,519	1,180
(Loss) earnings from operations before taxes	233,445	20,328	(353,579)
Income tax (benefit) expense	85,996	30,510	(32,226)
Net Loss (Earning) From Continued Operations	147,449	(10,182)	(321,353)
Earnings (Loss) From Discontinued Operations	(5,350)	128	1,456
Cumulative Effect On Change In Accounting	(2,353)	1,773	0
Net (Loss) Income	139,746	(8,281)	(319,897)

SOURCE: "Form 10-K." SEC EDGAR Filing Information. Pg. 47. April 28, 2008. Accessed September 24, 2008. <http://www.sec.gov/Archives/edgar/data/104599/000119312508093063/d10k .html>.

EXHIBIT 5. Balance Sheets for the Years 2006-2008

BALANCE SHEET FOR YEAR ENDED FEBRUARY 28, 2008			
Amounts in thousands	2006	2007	2008
ASSETS			
CURRENT ASSETS			
Cash and cash equivalents	315,970	141,141	296,055
Short-term investments	521,992	598,341	1,366
Accounts receivable	220,869	382,555	330,599
Inventory	1,698,026	1,636,507	1,573,560
Deferred income taxes	29,598	34,868	38,672
Income tax receivables	5,571	42,722	158,116
Prepaid expenses	41,315	47,378	41,352
TOTAL CURRENT ASSETS	2,833,341	2,883,512	2,439,720
Property and equipment	839,356	921,027	1,037,321
Goodwill	223,999	31,910	118,031
Other assets	172,348	80,970	301,176
TOTAL ASSETS	4,069,044	4,007,283	3,745,930
LIABILITIES & EQUITY			
CURRENT LIABILITIES			
Merchandise payable	850,359	922,205	912,094
Expenses payable	202,300	281,709	232,386
Accrued expenses	464,511	404,444	346,818
Accrued compensation		85,127	98,509
Accrued income taxes	75,909		17,680
Long-term debt installments	29,251	7,162	11,582
TOTAL CURRENT LIABILITIES	1,622,330	1,714,029	1,605,687
Long-term debt installments	51,985	50,487	57,050
Accrued straight-line rent	256,120	133,759	145,690
Other liabilities	183,976	434,058	317,764
TOTAL LIABILITIES	2,114,411	2,216,039	2,242,755
STOCKHOLDER'S EQUITY			
Common stock	87,395	85,345	84,430
Additional paid-in capital	458,211	344,144	319,573
Retained earnings	1,364,740	1,336,317	981,112
Comprehensive income	44,287	25,438	118,060
TOTAL STOCKHOLDER'S EQUITY	1,954,633	1,791,244	1,503,175
TOTAL LIABILITIES & EQUITY	4,069,044	4,007,283	3,745,930

SOURCE: "Form 10-K." SEC EDGAR Filing Information. Pg. 47. April 28, 2008. Accessed September 24,2008. <http://www.sec.gov/Archives/edgar/data/104599/000119312508093063/d10k .html

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[2] "Circuit City Stores, Inc." *Ibid.*

[3] "Circuit City Stores, Inc." *Ibid.*

[4] Faizi, Solomon, Ly, Hanh, Nguyen, Son and Vo, Jackie. *Ibid.*

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