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RETAIL APOCALYPSE: THE CASE OF SEARS CANADA INC.

INTRODUCTION

In January of 2017, the prospects of Sears Canada seemed particularly bleak. It is not as if things had been particularly good before then; the company had been struggling for nearly a decade. In the four years prior, the Sears Canada had gone through four CEOs, all of whom were unable to set a clear direction for the company.[i] In 2015 the leadership seemed to stabilize as Brandon Stranzl was named Executive Chairman and Carrie Kirkman was named CEO. Stranzl and Kirkman had a seemingly herculean task in front of them. They were faced with what the Atlantic would later call the "retail apocalypse," a situation where retail executives are left with seemingly few strategic options.[ii]

The problems for Sears Canada go back even further, however. In 1998, Sears Canada had a unique opportunity with a first mover advantage to be the first Canadian retailer to move their business online to an e-commerce platform. Just a year after the e-commerce platform launched however, Sears purchased the Eaton Company LTD and expanded their physical locations. Rather than expanding their e-commerce presence, Sears Canada proceeded to expand their retail presence through the early 2000's, ultimately expanding the operational costs associated with it.

By 2016, it had become clear that the firm would need to restructure. "We've got this network we're going to rationalize and we're going to figure out which stores makes the most sense," claimed Stranzl, as he announced a search for alternative uses for underperforming stores.[iii] "How did it come to this?" he thought. From its inception in 1952, Sears Canada was considered a household name. How does a retail superpower go from rapid expansion to being forced to liquidate its locations? He thought to himself about the history of the company, the Canadian retail environment and about the company's management strategy as he reflects on the steps Sears Canada could have taken then to mitigate its challenges.

HISTORY OF SEARS IN CANADA

Sears Canada began as a mail order business venture in the Canadian market in 1952. At the time, Sears Canada was part of a partnership between the Robert Simpson Company and Sears Robuck Co. From 1952 to 1978, Sears had became a household name across Canada. Sears maintained brand loyalty through having reliable goods, and offering in store service on appliances. Since opening in 1952, Sears opened hundreds of stores across Canada, including Sears Whole Home furniture stores. Their continued success hit a high in 1998, when Sears first launched their e-commerce website. This business move solidified Sears Canada's first mover advantage as one of the first companies to create an e-commerce site.

In 1999, only one year after the launch of the online platform, Sears purchased the T. Eaton Company LTD as the Eaton Company was entering bankruptcy. The purchase of such a large brick and mortar company can be seen as a direct contradiction to the strategy of the e-commerce launch. In 2005, CEO Ed Lampert decided to combine Kmart and Sears to create the Sears Holding Company. This move, while being strategic, had a negative impact on the evolution of Sears' overall technological ability, by creating a holding company that three different companies feud of for resources. In turn, a resource scarcity and a culture of austerity was created, in order to make the retail businesses run with as little cash as possible.[iv] This strategic move lead to Sears Canada's e-commerce platform receiving less resources and time than it should have, and eventually lead to the e-commerce site's failure. In October 2016, Sears Canada reported a loss of $120 million over just a three month period, up from losses of $53 million in 2015. In early 2016, Sears Canada's stock price also dropped a staggering 75 cents to $2.26.

RETAIL INDUSTRY AND COMPETITIVE ENVIRONMENT

The Canadian retail market plays an important role in the Canadian economy, with 12 percent of the Canadian workforce employed in some form of retail.[v] In April 2011, retail sales in Canada were roughly equivalent to retail sales in the U.S. on a per capita basis for the first time and were seeing continuous growth.[vi] Despite the continued growth in sales in the retail industry, over the past five years it is larger department stores in particular that are seeing a decline in sales and market share.

The early success from Sears Catalog, lead to expansion into a leading supply chain; Sears had a distribution center and warehouse in every province in Canada. The logistics of having a distribution center that is able to supply directly to the stores in each province ensures that accessibility of products remains high and costs stay low. In the USA, continued growth in the Department store market found Sears (USA) in 1994 with $111.4 billion in revenue.[vii] This number compared to their close rival Walmart, who pulled in $111.9 billion, put Sears right on track with the competition. However, due to a change in strategy, and a lack of focus on an online environment, Sears (USA) quickly fell behind Walmart. Sears Canada and Walmart Canada saw similar trends through the 1990s and early 2000s, with expansions in the number of locations of both Sears Canada and Walmart.

After 2007, the retail landscape in Canada began rapidly changing due to e-commerce. The expectation is that by 2027, online channels will deliver over 35% of all Canadian retail sales growth.[viii] Unlike Sears, Walmart realized that their presence in Canada was reliant on leveraging their United States operations and filling the gaps that Canadian e-commerce consumers needed. In 2015, Walmart invested $100 million in Canadian e-commerce, by adding two e-commerce distribution centers and offering grocery delivery in Toronto. The reality facing Stranzl is that companies such as Walmart and Amazon are leveraging their successful United States operations to excel in Canadian e-commerce. Though Sears Canada maintained one of the biggest e-commerce operations in the country, with $505 million in sales in 2014, it does not benefit from the explosive growth seen by its competitors.

Sears Canada's lack of dedication towards e-commerce is further disadvantaged by the fact that there is little integration with Sears USA. Though Eddie Lampert, a major investor in Sears companies and CEO of Sears Holdings (USA), attempted to acquire Sears Canada entire in 2006, the companies remained independent with Sears Holdings (USA) holding 51 percent of Sears Canada's shares. The arrangement with Sears Holdings (USA) may have caused sears to simply miss the mark of understanding how much needed to be invested in the competitive landscape of Canadian e-commerce. Though slower to catch on than its American counterpart, by 2017 Canadian e-commerce has affected many aspects of the Canadian retail landscape. It is estimated that a further shift of 5% of retail sales to online channels (matching USA levels) would result in a sales decline of $20 to $30 per square foot for traditional brick and mortar only stores.[viii]

CUSTOMER DEMOGRAPHICS AND E-COMMERCE

In 2017, e-commerce sales in Canada held 7.2 percent of the total retail market, which can easily attribute to the ongoing loss of sales and market share to the brick and mortar department store. Approximately, 50% of Canadian consumers make a purchases online at least once a month, compared to 70% in the United States and this coupled with the population difference between countries constitutes a significant difference.[viii] Although United States is the largest regional market for e-commerce in North America, Canada is catching up, and was expected to reach almost $56 billion (CAD) Canadian by 2020, up from 29 billion in 2015.[ix] This change in method of purchase can be attributed to a change in demographic of buyer, with 59 percent of online shoppers being between 18 and 49 years old, despite the fact that Canadians between the ages of 20 and 49 make up only 40.5 percent of the population. As of 2014, 45% of Sears Canada's customers were between the ages of 45 and 65, and the number of customers was shrinking.

In 1998, Sears Canada held a competitive advantage as being the first Canadian ecommerce site. However, due to lack of initial investment and technological advancements, the department giant moved away from e-commerce toward expanding its retail operations. With the acquisition of Eatons in 1999, Sears Canada acquired its largest competitor and gained a dominant position in the traditional retail space. In 2005, Eddie Lampert pushed to maintain Sears Canada's business strategy by opening more retail locations, without focusing on an e-commerce strategy. In 2016, Canadian e-commerce was reportedly growing at nearly 15 percent while traditional brick-and-mortar sales grew at 2 percent.[ix]

In 2014, Sears Canada opted to reduce the number of locations in an attempt to shed unprofitable storefronts and return to positive earnings. The reduction in full department stores and independently owned Sears hometown stores coincided with an increase in outlet stores, long seen as a potential area of growth for the company. Additionally, the closure of Target Canada in January 2015 presented a unique opportunity for Sears Canada to acquire additional share of the "middle end" of the retail market, a group which Sears has historically done well.

By 2015, Sears Canada's direct channel remained Canada's largest merchandise catalogue and one of Canada's leading online retailers, with over 102 million visits to the sears.ca platform annually.[x] By investing in its e-commerce presence, Sears Canada can potentially win a larger share in a faster growing retail segment. However, e-commerce remains a small fraction of Sears Canada's overall sales. Further, despite its success in e-commerce, at year end 2015 the Sears was unable to halt its operating loss. By late 2016, Sears Canada found itself with shrinking revenue, a growing net loss, and a shrinking asset base.

LEADERSHIP AT SEARS CANADA

One of the main challenges facing Sears Canada during the early to 2000's was its management structure. In 2005, ESL investments, headed by Eddie Lampert, took a majority stake in Sears Canada. Lampert would later go on to become the CEO of Sears Holdings (USA) in 2013 and would remain to lead the majority share in Sears Canada. Many past have talked about Lampert's lack of physical presence at both Sears Canada and Sears Holdings. Lampert reportedly became more known as a man on a video conference screen because of how little time he physically spent in the office, choosing instead to conference in from his home in Miami.

Sears Canada further saw significant churn in its executive leadership following 2010.[xi] Dene Rogers, CEO of Sears Canada from 2006-2011, had led for nearly a decade which ended with disappointing results in 2010 year end and was subsequently replaced by Calvin McDonald formerly of Lablaw Companies Ltd. Originally promising a "three year transformation," McDonald would leave two years later following disappointing results. Doug Campbell replaced McDonald and prioritized accessing the value of Sears' real estate assets, selling four major locations for nearly $400 million, and later prioritized outsourcing call centre and warehouse labor. Campbell stepped down for family reasons, and was replaced by interim CEO Ronald Boire. When Boire's term came to an end in 2015, he was replaced by Carrie Kirkman as President and Brandon Stranzl as Executive Chairman. Though Kirkman would step down as President in 2016, she stayed on as the Chief Merchant, leaving Stranzl as the sole remaining leader of Sears Canada at a time where the company seems to need leadership most.

CURRENT STRATEGIC INITIATIVES

At the beginning of 2016, Sears Canada focused on new strategic initiatives to re-engineer the business for long-term growth. One of these initiatives labelled "Sears 2.0" focused on increasing and optimizing the productivity of retail locations. Using competitor price data collected from the web, Sears Canada locations would ensure that they would provide competitive prices on big ticket items such as appliances and mattresses. By offering streamlined financing options, retail locations would ensure fast sales to a greater range of customers.

A second parallel initiative to facilitate e-commerce was launched in early 2016. The Initium Commerce Lab, an innovation hub, was launched to facilitate new innovations and customer-centric, digital solutions. Initium conducted a beta-test of the new Sears Canada website in British Columbia and Alberta. The company entered into an agreement with CGI Inc. to improve and develop Sears Canada's information technology infrastructure and decommission legacy software.[xii] The ultimate goal of Initium is currently to gradually restructure Sears Canada into a digital commerce company with a network of storefronts, rather than a traditional retailer. Doing so would not only cut long run costs, but help acquire a share of the fast growing e-commerce market.

To symbolize its transition and reinvention, Sears Canada also plans to replace its iconic blue logo with a modernized design. Featuring a bold font and maple leaf, the new Sears Canada logo represents a reinvented company, complete with a Canadian identity. Leveraging its position as an iconic Canadian retail brand, Sears Canada aims to compete with American e-commerce competitors such as Walmart and Amazon for a larger share of Canadian retail e-commerce.

THE PATH FORWARD

Sears Canada requires radical changes to their business process in order to remain a player in the Canadian retail market, however it is not clear which changes to implement. Regardless of approach, Stranzl will face major challenges to implement a survival plan for the retail giant. Stranzl leads a cost-intensive operation faced with increasing competition, while simultaneously running a shrinking asset base. A movement from investment in brick and mortar locations to an e-commerce approach could help curb a devastating outcome for Sears Canada. However, investment in an e-commerce strategy and platform comes at a hefty price, especially at a time when Sears is crunched for money. A change in strategy is inevitable and necessary, but which will Stranzl take?

Physical stores have always played an important role in retail, and Sears is recognized as a cultural icon. There may be an opportunity to streamline Sears Canada's current assets and to access new markets. Yet, as more business shifts online, Sears will face increased pressure to adapt to changes in consumer behaviour. It is clear that any strategy must incorporate these changes. Alternatively, Stranzl can seek deeper integration with other Sears Holdings companies, in an effort to build greater scale. With a deep breath and a sigh, Stranzl realizes that regardless of choice, the dilemma facing him will not be resolved easily.

SUGGESTED QUESTIONS

1. In *Competitive Advantage* Michael Porter describes three generic strategies. Identify whether any of these strategies could help Stranzl navigate its competitive environment.
2. What are the competitive forces that are driving the challenges faced by Sears Canada?
3. Sears Canada's real estate initial seen as an asset by its leadership. Why did earlier leaders see it as an opportunity? What, if any, is the strategic value of the company's real assets?
4. When faced with seemingly unsurmountable challenges, organizations often shift their leadership. Did the change in leadership play a role in driving Sears Canada's strategic direction?
5. In an effort to source new digital capabilities, Sears Canada launched the Initium program, designed to foster innovation in retail. Are there alternative approaches to sourcing such skills or ideas?
6. Technological trends have driven changes in consumer behaviour. How did Sears Canada respond to these changes? Are there alternative approaches that the company could have taken?

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EXHIBIT 1: FIVE YEAR SUMMARY

	Fiscal 2016	Fiscal 2015	Fiscal 2014	Fiscal 2013	Fiscal 2012
	Results for the year (in CAD millions)				
Total revenue	$ 2 613.6	$ 3 145.7	$ 3 424.5	$ 3 991.8	$ 4 346.5
Depreciation and amortization	31.4	48.4	89.3	111.4	126.5
(loss) earnings before income taxes	(318.2)	(62.7)	(360.0)	490	114.2
Income tax (expense) recovery	(2.8)	(5.2)	21.2	(43.5)	(13.0)
Net (loss) earnings	(321.0)	(67.9)	(338.8)	446.5	101.2
Dividends declared	-	-	-	509.4	101.9
Capital expenditures	27.4	45.4	54.0	80.8	101.6
	Year end position (in CAD millions)				
Accounts receivable, net	$ 67.1	$ 59.4	$ 73.0	$ 83.3	$ 77.7
Inventories	598.5	664.8	641.4	774.6	851.4
Property, plan and equipment	227.1	441.1	567.6	785.5	1 118.5
Total assets	1 244.4	1 633.2	1 774.1	2 392.3	2 504.7
Working capital	460.6	543.0	522.0	567.0	410.7
Total long-term obligations, including principal payments on long-term obligations due within one year	20.3	24.2	28.1	35.9	59.4
Shareholders’ equity	222.2	554.2	570.8	1 073.8	1 076.4
	Per share of capital stock				
Basic net (loss) earnings	$ (3.15)	$ (0.67)	$ (3.32)	$ 4.38	$ 0.99
Dividends declared	-	-	-	5.00	1.00
Shareholders’ equity	2.18	5.44	5.60	10.54	10.57
	Financial ratios				
Current ratio	1.8	1.9	1.8	1.7	1.5
Debt/equity ratio (%)	9.1	4.4	4.9	3.3	5.5
Gross margin (%)	27.3	31.8	32.6	36.2	36.7

EXHIBIT 2: COMPANY LOCATIONS

	Atlantic	Quebec	Ontario	Parries	Pacific	As at Jan 28, 2017 Total	As at Jan 30, 2016 Total	As at Jan 31, 2015 Total
Full-line department stores	10	23	32	18	12	95	95	113
Sears Home stores[1]	-	5	15	4	2	26	41	47
Outlet stores[2]	1	3	7	2	1	14	23	11
Specialty type: Appliances and Mattresses stores	-	-	-	-	-	-	-	1
Corporate Stores	11	31	54	24	15	135	159	172
Hometown stores[1]	15	6	8	22	18	69	125	201
Corbeil franchise stores	-	14	2	-	-	16	16	16
Corbeil corporate stores	-	12	4	-	-	16	17	19
Corbeil	-	26	6	-	-	32	33	35
NLCs[3]	-	1	2	1	1	5	6	6
Travel offices	6	17	26	7	6	62	84	96
Catalogue and online merchandise pick-up locations	88	194	265	208	75	830	1213	1335

[1] Sears Hometown locations are primarily independently operated and are located in markets that lack the population to support a full-line department store.

[2] Sears Outlet stores offer clearance merchandise, primarily from the company's full-line department stores.

[3] National Logistics Centres ("NLC") are one of five logistics centres strategically located across the country.

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EXHIBIT 3: PROPERTY, PLAN AND EQUIPMENT AND INVESTMENT PROPERTIES

(in CAD millions)	Land	Buildings and Leasehold Improvements	Finance Lease Buildings	Finance Lease Equipment	Equipment and Fixtures	Total
Cost or deemed cost						
Balance at January 31, 2015	$ 228.4	$ 1 086.4	$ 41.5	$ 1.0	$ 1 136.0	$ 2 493.3
Additions	-	14.0	-	0.1	9.6	23.7
Disposals	(52.1)	(16.3)	(3.5)	-	(13.7)	(85.6)
Net movement to assets held for sale	(2.5)	(16.3)	-	-	(7.0)	(25.8)
Balance at January 30, 2016	$ 173.8	$ 1 067.8	$ 38.0	$ 1.1	$ 1 124.9	$ 2 405.6
Additions	-	13.6	-	-	11.5	25.1
Disposals	(57.2)	(84.2)	(5.0)	-	(40.7)	(187.1)
Net movement to assets held for sale	(45.0)	(130.0)	-	-	(36.0)	(211.0)
Balance at January 28, 2017	$ 71.6	$ 1 067.8	$ 33.0	$ 1.1	$ 1 059.7	$2 032.6
Accumulated depreciation						
Balance at January 31, 2015	-	$ 847.9	$ 34.1	$ 0.5	$ 1 043.2	$ 1 925.7
Depreciation expense	-	19.7	2.0	0.3	22.9	44.9
Disposals	-	(15.6)	(3.5)	-	(13.7)	(32.8)
Net impairment losses	-	10.5	5.4	-	23.3	39.2
Net movement to assets held for sale	-	(8.5)	-	-	(7.0)	(15.5)
Balance at January 30, 2016	-	$ 854.0	$ 38.0	$ 0.8	$ 1 068.7	$ 1961.5
Depreciation expense	-	11.7	-	0.3	15.6	27.6
Disposals	-	(38.1)	(5.0)	-	(38.1)	(81.2)
Net impairment losses	-	8.9	-	-	15.2	24.1
Net movement to assets held for sale	-	(91.9)	-	-	(34.6)	(126.5)
Balance at January 28, 2017	-	$ 744.6	$ 33.0	$ 1.1	$ 1 026.8	$ 1 805.5
Net balance at January 28, 2017	$ 71.6	$ 122.6	-	-	$ 32.9	$ 227.1
Net balance at January 30, 2016	$ 173.8	$ 213.8	-	$ 0.3	$ 56.2	$ 444.1

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EXHIBIT 4: CONSOLIDATED STATEMENTS OF NET LOSS AND COMPREHENSIVE LOSS

(in CAD millions, except per share amounts)	2016	2015
Revenue	$ 2 613.6	$ 3 145.7
Cost of goods and services sold	1 900.5	2 145.9
Selling, administrative and other expenses	1 135.5	1 298.1
Operating loss	(422.4)	(298.3)
Gain on lease termination, sale, and leaseback transactions	105.9	67.2
Gain on termination of credit card arrangement	-	170.7
Gain on settlement of retirement benefits	-	5.1
Finance costs	8.9	9.7
Interest income	7.2	2.3
Loss before income taxes	(319.2)	(62.7)
Income tax (expense) recovery		
Current	(0.3)	(8.1)
Deferred	(2.5)	2.9
Net loss	$ (321.0)	(67.9)
Basic and diluted net loss per share	$ (3.15)	(0.67)
Net loss	$ (321.0)	$ (67.9)
Other comprehensive (loss) income, net of taxes:		
Items that may subsequently be reclassified to net loss:		
(Loss) gain on foreign exchange derivatives	(12.6)	19.2
Reclassification to net loss of loss (gain) on exchange derivatives	5.0	(18.7)
Items that will not subsequently be reclassified to net loss:		
Remeasurement (loss) gain on net defined retirement benefit liability	(6.5)	50.8
Total other comprehensive (loss) income, net of taxes	(14.1)	51.3
Total comprehensive loss	$ (335.1)	$ (16.6)

ENDNOTES

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