SEVEN DECADES OF SELF-DESTRUCTION

Sears’ bankruptcy filing last year sparked torrents of criticism for its current leaders. But the problems that brought down this former Fortune 500 stalwart date way back to the Eisenhower era. Here’s what leaders can learn from an icon’s slow-motion collapse.

By GEOFF COLVIN with PHIL WAHBA

SIGN OF THE TIMES
A closed Sears location in Nanuet, N.Y., in January.

SEARS HOLDINGS

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*Sears Holdings filed for Chapter 11 bankruptcy 10/15/18. Revenue and profits are for the 12 months through 10/31/18. Employee figure is as of 1/31/18.

PHOTOGRAPH BY MIKE SEGAR—REUTERS
SEARS: SEVEN DECADES OF SELF-DESTRUCTION

HE KINDER MEDIA ATTENTION SEARS has attracted in years arrived in April, when the company announced it was opening three small stores. "The start of a new Sears era?" The retailer announces openings, not closings," read USA Today's hopeful headline, which echoed others nationwide. But viewed through a longer lens, the coverage was more pathetic than upbeat. This is what now passes for good news at the once-colossal of global retailing: three stores, one of them in Alaska, each smaller than owner Eddie Lampert's house, offering a somewhat puzzling product line consisting mostly of appliances and mattresses. Sears insists this tiny event is the leading edge of a new strategy for becoming "a stronger, more profitable business." No one else in retailing seems to think it has a chance. "Lampert has never initiated a format that didn't fail," notes longtime retail consultant Burt Flickinger. The verdict of consultant Steve Dennis, a former Sears executive: "It will almost certainly amount to zilch, plus or minus bubkes."

Still, even today, sheer inertia may enable the Sears brand to linger. Despite its mortal wounds, the company brought in $13.2 billion of revenue in 12 months through last Oct.31. But the only significant question about Sears is how long it can hang on. Dennis's bottom-line take: "There's nothing in the portfolio with any viability." Allstate CEO Tom Wilson, a Sears executive in the 1980s and 1990s, says Lampert "is the janitor cleaning up the ashes. There's no way it's going to come back."

The Lampert era has played out in a continual drumbeat of catastrophic numbers and negative headlines, during which Sears squandered intrinsic advantages and opportunities for reinvention. (See our sidebar for a sample of those mistakes.) But for students of management and leadership, today's death throes are merely the denouement of the Sears dream. The truly epic conflicts that doomed the company happened long ago, when Sears was dominant and its demise was unthinkable. That's where to look for the lessons for today's leaders. Sears' story is unique, of course, and the decisive events took place in an era much different from ours. But a close examination shows that its critical mistakes are universal and as contemporary as tomorrow's news.

BUILDING A Boom
Shoppers in a Sears tool department in 1943 (left); a Sears in Jackson, Miss., in 1949. Sears' decision to expand its store network during the 1940s was key to its dominance during the post-World War II expansion.

SORES: SEARS' SINKING FLEET
The retailer's portfolio of aging mall stores put the "ick" in "brick-and-mortar.

AFTER ENGINEERING the 2005 merger of KMart and Sears, Sears Holdings CEO Eddie Lampert made it clear that he would prioritize e-commerce over department stores. He followed through—so much so that both sides of the business suffered. "When you're a $50 billion brick-and-mortar retailer, you can't just ignore your brick-and-mortar portfolio," says Mark Cohen, director of retail studies at Columbia Business School and a former CEO of Sears Canada. Between 2005 and 2012, Sears spent only about $3.3 billion on capital improvements to stores. (Sears bought back $6 billion in shares over that time frame.) Its immediate rivals, including Walmart and Target, outspent Sears five to one on a per-square-foot basis, according to analyst estimates. Cutting off funds for even basic upkeep created a vicious cycle in which stores grew shabbier and shabbier, making them less likely to generate revenue that could be used to assess strategy for up. But closing decaying stores didn't drive traffic to Sears.com; nor did closures help the stores that remained. Indeed, Sears Holdings never enjoyed a single year of comparable sales growth, a metric that strips out the impact of newly closed stores. Lampert and his predecessors experimented with stores modeled after nimble competitors. In 2003 the company launched the Sears Grand prototype—a smaller, "off mall" location with food and pharmacy offerings. Former CEO Alan Lacy says the typical Sears Grand pulled in between $45 million and $65 million a year—more than twice as much as some mall-based stores of double that size. But Sears ultimately opened only 12 Grands—too few to blunt the impact of red ink and peeling paint elsewhere.

P.W.
FOR DECADES, Sears was homeowners’ go-to place for big-ticket appliances like washing machines and ovens. In 2001 it commanded 42% of the U.S. appliance market; as recently as 2013, that $12 billion business gave Sears a 29% market share.

Appliance revenue today is a fraction of what it was in its glory days. And Kenmore, Sears’ former crown-jewel brand, has been spun off into a separate holding company whose products, ironically enough, you can buy on Amazon.

What went wrong? Sears built its dominance in appliances in part on its credit card business. As recently as the 1970s, legions of consumers built their credit ratings by buying appliances with Sears store cards. But the growth of Visa and Mastercard loosened Sears’ grip on that channel. More crucially, big-box competitors Home Depot and Lowe’s started spreading in strip malls more convenient for shoppers. Strip centers had fewer restrictions on loading docks than traditional malls did, enabling the new players to offer more large goods like lumber and making it easier for customers to cart them away. Stuck in mall stores, Sears could never seriously counteract their incursions.

Alden Lacy, Sears’ CEO from 2000 to 2005, notes that Sears looked very hard at buying Lowe’s during his tenure. “That’s one that got away,” he lamented. As recently as 2015, Sears technicians were visiting 8 million homes a year for appliance deliveries and repairs, gathering valuable customer info. This offered Sears a head start in the smart-home and smart-appliance markets. But worrying financial woes kept Sears from following through in “home services,” and Best Buy and Amazon now dominate that arena.

APPLIANCES: SQUANDERING A HOME-FIELD ADVANTAGE

Why homeowners stopped building their kitchens and their credit histories at Sears.

SEARS’ NEW STORES “WILL ALMOST CERTAINLY AMOUNT TO ZILCH PLUS OR MINUS BUKKES.”

SEARS’ HUGE APPLIANCE AND TOOLS BUSINESS DISTINGUISHED IT FROM RIVALS LIKE J.C. Penney and Macy’s, which were best known for apparel. The problem: People buy a fridge or power drill only once every few years, but when they stock up on clothing three or four times a year. In the 1980s, then-CEO Arthur Martinez tackled the dilemma by committing Sears to selling higher-quality apparel and home goods, supported by the clever “Softest Side of Sears” ad campaign. But the retailer never caught on with consumers in those categories. “Sears struggled with brands not wanting to be associated with it,” says Chad Bright, a former Sears online apparel executive and a sewer for big-box stores at Garden L.L. Penney’s. “It was pressured better-known vendors that sold in their stores, urging them not to overexpose themselves by selling through another chain. The fact that Sears simply wasn’t known for fashion scared others away. Even when Sears did lure desirable brands, its increasing dumpy stores hurt momentum. A 2010 partnership with fast-fashion retailer Forever 21 didn’t go far. In 2011, even peak Kardashian mania couldn’t keep the Kardashian Collection from flopping. Things got so bad that in a 2018 survey, female shoppers said they preferred thrift store Goodwill over Sears for clothing.

But turning undying one “what if” partnershps. Former CEO Alan Lacy says that in 2004, he was in talks with Martha Stewart, who had a successful product line at Kmart, to create home goods for Sears. The talks were scotched by Stewart’s conviction on charges related to an insider-trading case. “We were darn close to getting that done—then Martha goes to jail,” Lacy says. “That was a bit of a snag.”

The world was changing, and Sears leaders didn’t see, perhaps didn’t want to see, that their business model—based on broad selection, high service, and periodic steep-discount sales—was becoming an antique.

Sears had grown into a towering American institution during the period that Northwestern University economist Robert J. Gordon dubbs “the special century” of U.S. economic expansion, 1870 to 1970, which Gordon calls “a singular interval of rapid growth that will not be repeated.” For Sears, founded in 1886, the special century was the only reality the company had ever known. It rode that fast growth and its human essence, young blue-collar families, to greatness. But as the special century faded in the 1960s, fewer new blue-collar families were being formed, and those that remained had less to spend.

At the same time, consumers were enthusiastically embracing a new way of buying: the discount store, built on low prices, minimal service, and high merchandising turnover. In 1962, a miracle year for retailing, Walmart, Kmart, and Target all opened their doors; all three would surpass Sears in annual revenue by the time Lamport took over in 2005. Sears leaders were aware of the phenomenon but felt serenely unthreatened. After all, they told themselves, Sears was the monarch of discounts. They seemed not to grasp that this new breed was fundamentally different, offering much lower prices in relatively bare-bones settings. But customers noticed the difference.

Sears was doing so well that its leaders apparently saw no need to update its control board. Sears did not name a successor to the retiring Arthur Martinez until four years after his departure. And even as the board was a revolving door, Lacy says, Sears was being spun off to fashionable online apparel retailer Shopbop. The board made the opposite decision, pulling out in 2004, he was in in 2004, he was in

When shoppers prefer thrift stores to your mall stores, you’ve got a problem.
Sears could have been an e-commerce pioneer. ‘The Web was lost’

HOW THE WEB WAS LOST

Seventy decades of self-destruction

Sears’ prosperity was compounded by the board’s failure to find the next Bill and Ted. Wood set the stage for trouble. By 1967 the company realized it needed to shift strategy. Its new plan—tracking higher-priced items to attract more affluent shoppers—worked briefly. Gross margins peaked near 40% in 1969. But the strategy undermined Sears’ long-built-up foundation as America’s great supplier to the masses. Then a recession hit, followed a few years later by a deeper recession and double-digit inflation. The special century was over, and Sears’ new strategy was exactly wrong. Consumers wanted cheap, and all those divisions were perfectly positioned to serve them. By the mid-1970s Sears could no longer ignore these problems, so it moved to the next stage of denial: insisting its declining performance was not the company’s fault. It’s the economy, said Sears’ researchers. Also, there are just too many stores in the U.S. Plus, profit margins are shrinking across the industry. And the population is getting older. Bottom line: It’s everything except us. “As night follows day, no matter how good we are, it’s just going to be more difficult to make money,” is how Donald Katz summarized the 1970s internal view.

In retrospect, signs of a debacle were apparent. The company’s planning masterminds, like many big-picture strategists, regarded the company’s customers not as humans to be served but as a natural resource to be mined. After the acquisition of a 59%-owned stake in the MSA stock was over, and Sears’ new strategy undermined Sears’ huge 300-page catalog, 1P.0atalog’s emphasis was on catalog service and Sears was still part of the Big Three, perched on the merchandise group, turning the competition. But overall, says John Pittinger, a consultant to Sears at the time, “there was almost no synergy with the other companies.”

By diversifying, Sears got the worst of both worlds. It didn’t achieve the synergies it had counted on from financial services. And for the first time in Sears history, retailing was not the company’s central focus. “I don’t think they set out not to be focused on the merchandise group,” says Allstate’s Wilson, “but that’s what happened.” It was a terrible time for a retailer to take its eye off the ball, with big-box category killers—Home Depot, Staples, Best Buy, for a merger far afield—very far afield. An initial wish list of merger partners included AT&T, Chevron, John Deere, IBM, and Walt Disney. All those candidates got shot down internally or when Sears approached the target. Eventually the strategic planners concluded that the new business must be one that would benefit heavily from Sears’ existing strengths. A Roper poll had recently declared Sears to be America’s most trusted corporation. In what industry was trust most valuable? The answer, the plans

ners determined, was financial services.

Having bated El Dorado, Sears began acquiring portions of it. The company bought the Coldwell Banker residential real estate firm and the Dean Witter Reynolds brokerage firm in 1981. Combining these with Allstate made Sears suddenly the largest financial services company in America by revenue. The elements of a grand strategy were in place.

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Bed Bath & Beyond—transforming the industry, and Walmart becoming a giant. “The board viewed the stores as a cash cow, which they were,” says Pittinger. “The directors were planning to milk the retail operation until it stopped.”

The effect on performance was stark. In 1981, when the diversification was announced, the Sears retail group’s return on sales was already an appalling 36% worse than the retail industry median; during the period when Sears also owned the financial firms, it averaged 49% worse. Combining an underperforming finance business with a cratering retail business produced an unthinkable result: By 1988, Sears’ market value had plunged 66% in constant dollars from its 1965 peak, and Wall Street had pegged as a takeover target.

Sears finally pulled the plug on its financial services strategy in 1992, announcing it would sell or spin off not just Coldwell Banker and Dean Witter but also Allstate, which had been part of the company for 61 years. It was the best thing that ever happened to those three businesses. Liberated from Sears, all of them blossomed and thrived.

But it was too late for the retail operation—what most people meant by the word Sears—to return to glory. In early 1991, after its worst holiday season in 15 years, new figures showed that Sears had been surpassed as North America’s largest retailer by Walmart, “a one-time backwoods bargain barn,” as Time called it in a story announcing the new king. Sears, characteristically, dismissed the comparison as meaningless: “We compete with Walmart on only 30% of the goods we sell,” sniffed a spokesman. It seems, in hindsight, an unwitting admission that Sears was selling only 30% of the goods consumers wanted most.

With Walmart’s revenue rocketing while Sears’ was essentially stagnant, Sears couldn’t plot any path to regaining the throne. “By the early ‘90s, the game was over,” says Pittinger. “The most important part of strategy is being on the right side of history, and they were on the wrong side of history.”

EARLY 30 YEARS LATER, Sears survives, barely. It regained momentum briefly in the 1990s when top executives and the board became so desperate that they broke with a century of tradition and hired an outsider to run the place—Saks Fifth Avenue executive Arthur Martinez. He found an organization still in its dysfunctional mode. “It was inward-looking and upward-looking,” he recalls. “Everything rose to the top. There was no accountability.” He brought in his own team of outsiders, quickly elevating sales, operating profit, the stock price, and morale. But when he left in 2000, the stock was right back where it had been when he took over.

His successor, former CFO Alan Lacy, tried hard to move Sears out of its mall locations because those stores “had a service-based model that our customers weren’t willing to pay for,” he says. He tried a Walmart-like, off-mall style of store called Sears Grand, but it didn’t take. The stock swung wildly. When Eddie Lampert came along in 2004, the board decided his buyout offer was the best option they faced.
IN 1969, TWO-THIRDS OF AMERICANS SHopped AT SEARS IN ANY GIVEN QUARTER, AND ITS SALES WERE 1% OF THE ENTIRE U.S. ECONOMY.

What lessons should we distill from this long, sorry tale? Jim Collins, author or coauthor of business mega-sellers Built to Last, Good to Great, and Great by Choice, also wrote a slimmer, less famous book called How the Mighty Fall. Collins describes analyzing and writing about decline as a far tougher task than writing about success. “To become a great company is a narrow path,” he says. “There are things you have to do. But it’s so hard to get a framework of decline. It’s like a pool table—there are only a few ways to rack the balls but an infinite number of ways to disorder them.”

Collins didn’t study Sears for his book, but the framework he identified, and on which he elaborated in recent interviews, fits Sears’ demise almost precisely. It begins with arrogance, which Sears developed at mammoth scale. Until the troubles of the 1970s, Sears’ retail operations had never hired a consultant, believing no outsider could possibly tell them anything of value. “Searsmen” didn’t attend retail industry conferences, considering themselves members of a higher caste. The loudest expression of arrogance was the 110-story Sears Tower in Chicago, commissioned in the 1960s. “Being the largest retailer in the world, we thought we should have the largest headquarters in the world,” then-CEO Gordon Metcalf explained to Time. By 2000, the company forecast, Sears employees would occupy all 110 floors. In reality, Sears shrunk rather than grew and had vacated the building by 1995. It’s now known as the Willis Tower.

Arrogance erodes discipline, and discipline is central to Collins’s analysis of decline. Cost discipline is often the first to go; it certainly went at Sears. Outsiders long assumed that economies of scale would forever give Sears an unassailable cost advantage in pricing merchandise, but it wasn’t true. The company could indeed buy goods for less than anyone else—but its profligate corporate overhead was so massive (think of that building) that its total costs were bloated far beyond the industry average.

Success creates growth, which spawns bureaucracy, which subverts discipline. “The what replaces the why,” Collins says. “You have to make sure not just 10 or a hundred or a thousand people can do something, so you give everyone the recipe book. The irony is that all those people don’t know why they do it this way. It becomes dogma rather than understanding.” At Sears, the problem was as big as the company; the employee manual reportedly ran to 29,000 pages.

In the next stage of decline, leaders externalize the blame for what’s going wrong, Collins says; Sears certainly did that in the 1970s. A related pathology is neglect of “the fundamental flywheel,” the basic business idea on which the company is built. “People often underestimate how far a great flywheel can go,” Collins says. Sears’ leaders bet on financial services because they thought that retail, their own flywheel, had run out of growth 40 years ago. Home Depot, Lowe’s, Walmart, and others showed how wrong they were.

As leaders cast about for solutions, they typically reorganize the company, sometimes obsessively, and Sears checks that box. At various times in the 1970s and 1980s, it adopted a holding company structure and shuffled bits and pieces of its financial services empire among shape-shifting fiefdoms overseen by warring executives. None of it helped. In the late stages of decline, companies may invest their hopes in an outsider as savior-leader, under whom an initial upswing is common, followed by disappointment. The Arthur Martinez era fits that bill.

The final stage can be literal corporate death—insolvency and disappearance—or it can just be irrelevance, which the company has already reached. An entity bearing the Sears name could persist for years. But as an element of today’s American culture, and as a retailer with plausible prospects for long-term growth, Sears is done.

It’s astonishing how long it has taken. By virtue of its tremendous success at its height, Sears extended its decline much longer than most. But even for lesser companies, failure is almost always a deceptive slow process. “Greatness gets built very slowly—think of Walmart or Southwest Airlines,” says Collins. “Decline is just like ascent, a cumulative process. The decline of a great company only looks instantaneous because you notice it when it’s acute. That’s what’s so dangerous about it.”

As we mourn Sears, maybe we shouldn’t weep too long over its demise. No company lives forever, and it has had a long, laudable, productive life. But the Sears story should scare us. It shows every business leader that no matter how celebrated or dominant his or her business may be, the forces of destruction could be at work right now, unnoticed, caused by success but also hidden by success, undermining all the work the leader has done. Rare indeed is the executive who can spot those forces before they lead to an ugly end.