CASE 4
Finding the Best Buy

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Introduction

In the battle to become the largest consumer electronics retailer in the US, some might say that Best Buy is up by a few rounds. Beginning as a single location car and home stereo store in 1966, Best Buy has grown into a massive firm with 1,400 stores in North America and over 2,600 stores in Europe and China.[1] As recently as 2007, Best Buy was seen as the team to beat, boasting a strong lead in market share over its competitors, large and consistent profits, healthy stock returns, and a global expansion strategy. In accomplishing this feat, Best Buy brought down its biggest competitors—Circuit City and CompUSA.[2]

With CompUSA out of the way (at least temporarily) in 2007, the economic recession and the ensuing reduction in consumer discretionary spending added the last bit of leverage needed to topple Circuit City in 2009.[3] This allowed Best Buy to emerge as the clear champion of the large format consumer electronics retail segment; a position many consider prophetic of future success. However, whether the downfall of its competitors is the result of Best Buy's superiority or simply the inevitable demise of a retail model that is becoming obsolete remains to be seen.

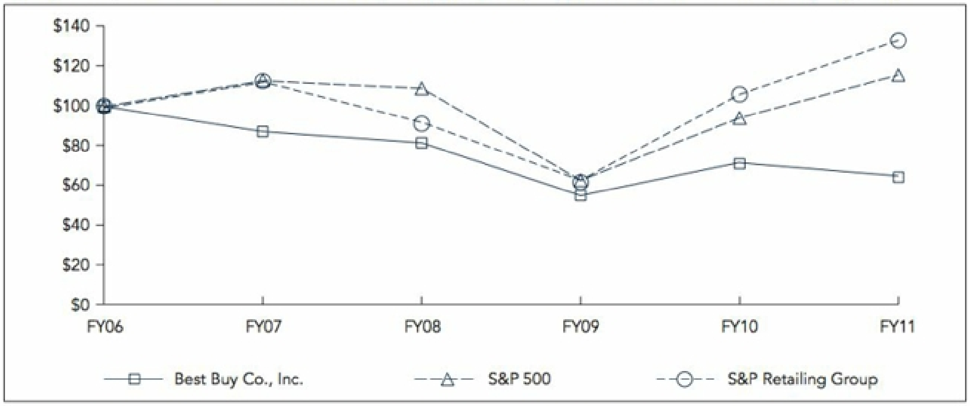
Unfortunately for Best Buy, recent results suggest that the latter might be the case. As shown in Exhibit 1, Best Buy's recent stock returns have been consistently below those of the S&P retailing group as well as those of the S&P 500.[4] In addition, revenue growth slowed to a miniscule 1.6 percent over the course of fiscal year 2011.[i] While the recession can be blamed at least in part for this reversal of fortunes, more of the blame likely lies with the presence of new competitors in the industry including the better diversified Walmart and Costco, additional "go straight to the source" Apple stores, and the monster of online retail—Amazon.com. In fact, Amazon's stock price increase is a near mirror image of Best Buy's stock price decline.[5] Likewise, these new competitors have been gaining market share in the consumer electronics segment while Best Buy has been losing it.[6] The threat of these new entrants is particularly ominous in that they are quite different from Best Buy in terms of their structure, focus, and features that customers find attractive. For example, it is not uncommon for a customer to browse Best Buy for a particular product, use Amazon's app on their smartphone to scan the barcode, and then purchase the product from Amazon at a better price while still in Best Buy—a scenario that has led to a new—and painful—nickname for Best Buy—"Amazon's showroom."[7]

History

In 1966, Richard Schulze, disgruntled that his suggestions for improvement weren't being taken seriously, quit his family's electronics distribution business and, together with a partner, started his Minnesota-based home and car stereo store called "Sound of Music." The firm grew through acquisitions and the opening of new stores and hit the million-dollar revenue mark by 1970. During the 70s, Schulze's company experienced significant financial success, allowing him to expand the chain and buy out his partner. Even early in his managerial career, Schulze showed an uncanny ability to adjust to market trends and seek out profitable opportunities. For example, his position on a school board gave him insight into the fact that the customer pool of 15- to 18-year-old males (his target demographic) was shrinking. Consequently, he adjusted his business approach by diversifying into appliances and video equipment with the goal of targeting the expanding demographic of older and wealthier customers emerging in the 80s. As another example, when a tornado destroyed one of his stores but left the inventory largely unharmed, Schulze held a "no

[i] Best Buy's fiscal year 2011 closed on February 26, 2011.

Exhibit 1 Comparison of 5 Year Cumulative Total Return among Best Buy Co, Inc., the S&P 500, and the S&P Retailing Group



Source: Best Buy Co. Inc. Form 10-K For fiscal year ended February 26, 2011. sec.gov. [Online] May 17, 2011. [Cited: May 17, 2011]. http://www.sec.gov

frills" parking lot sale with reduced prices. This approach was so successful that in 1983, Schulze reorganized the business into a superstore format under the "Best Buy" brand name and in 1985, took the new company public.[8]

As Best Buy continued to evolve, the sales approach used in the superstores changed from that of a specialty electronics retailer with highly knowledgeable commissioned sales staff, to a mass merchandiser with a larger variety of products, discounted prices, and a more dispersed and non-commissioned sales force.[9] Although customers seemed to appreciate the increased variety and did not seem to mind the reduction in sales assistance, some suppliers were skeptical of the superstore concept and, for a time, pulled some of their products from Best Buy's shelves.[10] Since the introduction of the superstore, Best Buy has refined the concept to allow for moderate levels of customer service, balanced with displays and product groupings designed to allow customers to shop for many items without extensive assistance.[11]

This moderated approach was successful and prompted the brand to expand rapidly throughout the US between 1989 and 1995—opening 47 new stores in 1995 alone. However, Best Buy's rapid expansion brought with it high debt levels and low profit margins that eventually forced the firm to slow its expansion and reconsider some of its low-cost strategy. This setback notwithstanding, Best Buy began to expand again in 1999, opening new superstores in additional regions of the US and launching a separate subsidiary—BestBuy.com—to claim its stake to the online market.[12]

If Best Buy experienced rapid growth in the last 34 years of the twentieth century, it was paltry compared to the meteoric rise it experienced during the decade beginning in 2000. Growth came through organic means (opening new store locations), new ventures within the firm (Best Buy Mobile stores), and both domestic and overseas acquisitions.[13] Domestic acquisitions included Magnolia Hi-fi (a chain of 13 high-end stereo electronics stores) in 2000, the Musicland Group (comprised of over 1,300 Sam Goody, Suncoast Video, and Media Play stores) in 2001, Pacific Sales Kitchen and Bath Centers (a chain of home appliance and remodeling stores) in 2006, and Napster (an online music download website) in 2008.[14] Also domestically, the firm acquired Geek Squad (an omnibus computer/electronics installation, repair, and support service) in 2003 to offer after-purchase support services to customers, and Speakeasy (a provider of broadband voice, data, and IT services to small businesses) in 2008.[15]

International acquisitions were even more extensive starting with Future Shop (the largest electronics retailer in Canada) in 2002.[16] Next up, Best Buy acquired 75 percent of Five Star Appliance (a major Chinese appliance and electronics retailer) in 2007, and scooped up the remaining 25 percent in 2009.[17] In 2009, Best Buy formed Best Buy Europe and entered a 50/50 joint venture in Europe with Carphone Warehouse, a company that included over 2,400 stores and, not coincidentally, had acted as a consultant when Best Buy opened its US mobile stores two years earlier. These acquisitions were all followed by the opening of Best Buy superstores in their respective markets of Canada, China, and Europe. Best Buy also opened superstores in Mexico in 2009 and Turkey in 2010.[18]

Not all of Best Buy's expansions were successful, however. Due to poor performance, the firm closed almost 100 Musicland Group stores in early 2003, and

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