ABSTRACT

The decline of the American middle-tier department store: A case study of JC Penney

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Founded in 1902, JC Penney was once the epitome of where the middle-class American consumer shopped for general merchandise and was initially perceived as an innovator within its segment in the retail industry. How was it that this giant fell to financial strife, an erratic and unfocused corporate strategy and a waning customer base? This thesis works to uncover the challenges that face not only JC Penney, but the middle-tier department store segment as a whole. Through the format of a case study, this work analyzes the factors influencing their decline in addition to charting financial performance across a thirty-year period (as far back as public records are accessible). Net sales and net income as a percentage of net sales data were collected in order to create a visualization which illustrates the prolonged decline of JC Penney and similar retail formats. This thesis offers insight to the current trends in the retail industry, and how examines the fate of middle-tier department stores.

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THE DECLINE OF THE AMERICAN MIDDLE-TIER DEPARTMENT STORE: A CASE STUDY OF JC PENNEY

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By

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TABLE OF CONTENTS

Chapter One: Introduction………………………………………………………………………………… 1

Chapter Two: Literature Review………………………………………………………………………13

Chapter Three: Methods…………………………………………………………………………...……38

Chapter Four: Results and Conclusions……………………………………………………………. 44

Appendix…………………………………………………………………………………………………….. 57

Bibliography……………………………………………………………………………………………... 65

CHAPTER ONE

Introduction and Scope of Project

On April 8, 2013, business headlines announced the official resignation of Ron Johnson from his seventeen-month period as chief executive officer of JC Penney. The media buzzed about the fall of the executive, who upon his arrival at the company was reveled as a retail genius. Just one month prior to his dismissal there were promises that a resignation was nowhere in sight, but on that day in April, journalists were quick to point the blame at Johnson for the financial downfall of JC Penney ("JC Penney", 2013). Johnson, famous for creating the retail strategy for Apple and putting Target on the map as a retail powerhouse, was hired on at JC Penney to revitalize the stagnant retailer. Through a series of bad decisions, the company has stumbled into financial trouble, and the retail giant is no longer resonating with the American consumer.

At the time of his installment, the company was looking for a way to recover from the recent recession and rework its strategy with the growth in online shopping. Johnson appeared to be the answer to Penney's troubles as he quickly swooped in with an arsenal of innovative ideas. It didn't take long for the retailer to see that their supposed hero wasn't going to save them. Red flags went up on May 16, 2012, as quarter one numbers came in far below expectations. Some analysts refer it to as the worst day at JC Penney in its corporate history (Minato, 2012). Company stock plummeted by an astounding 19.7% that day (Minato, 2012). By the

end of Johnson's short stint as CEO, JC Penney had lost $427 million and sales had dropped 28 percent (Farrell, 2013). Reuters reported, "The decline was the worst percentage decline since the company listed its shares on the exchange in 1929, according to Center for Research in Security Prices . . ." (Wahba, 2012).

As one of the longest standing, and largest apparel and home furnishings retailers in America, the struggles for the company are concerning. JC Penney strategy, up until recent years, was recognized as one of the most successful in retail, keeping the business running for more than 100 years. James Cash Penney believed in good sales people and following the Golden Rule, which created a loyal customer following for his business (McInnis, n.d.). Penney's business model was even an inspiration for Sam Walton, the founder of the world's largest corporation, Wal-Mart (McInnis, n.d.). As successful as it was in the past, there are reasons why it no longer remains one of America's top retailers.

Johnson was viewed as a retail genius, so when the results of his efforts came through many were shocked. However, Ron Johnson had never been the CEO of a large retailer, had little experience with fashion or apparel, and his major successes were those of reworking already successful companies. With JC Penney Johnson was trying to raise up a sinking ship and was fighting against many of the factors that had worked for him before. Johnson had many transformative ideas to bring the department store back to the forefront of the retail industry, but none of them proved successful. Changes were made to brands carried, store layout, pricing strategy, the logo, and numerous other revisions to reposition JC Penney in the minds of consumers. Many now agree that his ideas were too bold and poorly

executed. Mark Cohen, former C.E.O. of Sears Canada was quoted saying, "There is nothing good to say about what he's done. Penney had been run into a ditch when he took it over. But, rather than getting it back on the road, he's essentially set it on fire" (qtd. in Surowiecki, 2013). Articles everywhere point the finger at Johnson and tear apart his strategy that he tried to implement at the "dowdiest dinosaur in American retail" (Tuttle, 2013). None of these innovations truly took hold as they yielded poor reviews from once faithful customers. The "Fair and Square" pricing strategy was the most negatively received by customers who were accustomed to traditional markdowns and sales. Johnson was confident that these new ideas reflected what the customer wanted, but he greatly missed the mark. Although Johnson certainly created numerous issues for JC Penney, the retailer was already in trouble. Deeper research is required to uncover the truth behind this retail giant's demise.

Statement of the Problem

How did one of America's greatest retailers reach this point? Although Ron Johnson is not innocent of the worsened situation at the company, it goes beyond him. There are several key factors that have contributed to the struggles of JC Penney in the past, and by extension, the department store retail format in general. These factors include: the changes in the retail industry, loss of resonation with target customers, and increased competition from new entrants in the market. The retail industry is a fast-paced, ever-changing landscape in which many companies are struggling to keep up. JC Penney is not the only middle-tier department store

that is struggling. Similar stories have been unfolded across the country. Sears was also held as one of the prominent competitors in the market, but now industry experts are putting a timeline on its demise. Some similar formats have already closed their doors, a prime example being Montgomery Ward. Between the three corporations mentioned, they were once considered the greatest of American retailers, but now they all fall on a list of lost causes or folded brands. One can see a trend of declining performance in middle-tier department stores. Many of these department stores have become laggards or have simply lost their luster with consumers. The department store sector is expected to see an annual decline in sales of 1.4% over the next five years (IBIS World "Department", n.d.). Department stores heavily rely on consumer demand and per capita disposable income. The decrease in market growth hints at lack of consumer interest in department stores. Customer interest has shifted to new business formats that are providing for their needs and creating a more compelling experience. JC Penney manages to diversify itself from the rest of the competition by remaining a standalone company. The department store industry has seen lots of acquisitions and consolidations over the last decade. Sears acquired Kmart, Bloomingdales and Macy's came together to create one large company, and Hudson Bay is lining up a fleet of department stores including Saks Fifth Avenue and Lord and Taylor. Larger companies have a harder time adapting to the fast paced fashion industry, which causes additional problems to the already struggling business format. Remaining smaller allows for faster response to customer wants and needs. By remaining its own company, JC Penney may be able to reposition itself in the saturated market and rejuvenate profits.

Currently, JC Penney is operating at a net loss with declining sales and increasing debt. Earlier in 2013 the company sold additional stock and received a loan from Goldman Sachs in order to remain afloat (Townsend, 2013). Mike Ullman, current CEO, is attempting to reverse the financial bleeding of the company by abandoning many of the innovations that Ron Johnson brought about. Analysts remain unsure about if this major retailer will be able to return the company to its former profitability. The New Yorker reported that efforts to get a retailer operating at a loss back to profitability only have a 30% success rate (Surowiecki, 2013). It's obvious that the odds are not in JC Penney's favor.

Through use of a case study format that analyzes factors that directly affect the decline in middle-tier department stores, this paper will examine the challenges that JC Penney and all department stores currently operating in the United States face. In recent years it has become evident that JC Penney and competitors, such as Sears, are failing as a retail format and are on the brink of extinction. The purpose of this thesis is to chart JC Penney's financial performance as competitors enter the market. The two types of financial data used for charting performance are net sales and net income as a percentage of net sales. Sales reflect the company's ability to perform in relation to its customers and net income allows for study of company strategy and effective use of revenues. Plotting this financial data will provide insight as to how JC Penney and other competitors performance changes over time, and as the market becomes more saturated. Data will cover all years from 1984 to 2013 and will be presented as annual totals. The goal of this case study is to analyze the collapse of middle-tier department stores and discover what is relevant in

today's retail industry. JC Penney's case can provide insight as to how retail is changing and where it will be in the near future. It is this information that can potentially rescue this business format from ultimate failure. If middle-tier department stores wish to survive, it is evident that they will have to change. The purpose of this study is to identify the necessary changes by looking at historical industry patterns and evidence of new trends. JC Penney, and many of its kind, depend on these realizations in order to remain pertinent companies in the retail industry. This thesis intends to provide a history of JC Penney from its founding to present day, analyze the problems associated with the Johnson era, and observe how his influence would have impacted the company. In addition, it will examine the current retail landscape, and lastly, discuss the implications the changing retail landscape and executive decisions have on companies, such as JC Penney.

Thesis Overview

History

In order to be able to properly examine the situation at JC Penney, as well as at other middle-tier department stores, this thesis will need to cover several areas of research. To begin, it will explore the history of department stores and follow their development over the last century. The timeline begins in the middle of the 19th century as dry goods stores began to arise in America and Europe. Department stores originated the concept of a retailer having everything under one roof. This retail institution had great influence on the development of the consumer culture

present in today's society. Retail revolutionized after department stores became prominent within the industry. It reflected a shift in consumer preferences as people urbanized and the change to a demand-pull economy. This thesis seeks to give an understanding as to how the department store developed from its beginnings to its modern version. Nowadays there are different types of department stores, such as discount and specialty. Department stores changed the way retail functions, and it will be important to cover what aspects of the industry were affected. They brought about a great amount of new technology, encouraged mass marketing, and forced other retailers to change in order to be able to compete with them.

In addition, this thesis will explore the history of JC Penney and how it developed into a revered, successful establishment. Starting at its founding in 1902, the discussion will encompass highlights from the company history. Examining Penney's history will provide insight into the evolution of the company. Business strategy is essential to understand, and historical research can reveal how executive decisions impacted the company throughout its lifespan. From its founding to present day, JC Penney has remained loyal to one specific target customer. They have continuously catered to the needs of middle class Americans with a classic sense of style. Their changes in business strategy can be compared to shifts in consumer tastes. This information will also indicate how well JC Penney has reacted to shifts within the industry in the past. As mentioned earlier, one of the factors playing a key role in the struggles at the company is the dynamic retail industry. As it changes, so must the company in order to satisfy customer needs. JC Penney has

had to innovate with the changes in order to still be in business today. It is important to analyze the past success of the company in order to gain an accurate understanding of the current dilemmas.

Department Store Challenges

Since JC Penney and similar competitors have come across significant obstacles, this thesis will also outline the challenges presented within the retail industry. A key element of research to this thesis is to construct an overview of the current retail landscape. Retail has not remained the same since the development and success of department stores. It is rapidly changing and has brought about hindrances for this sector of the industry. As aforementioned, other companies aside from JC Penney are struggling in similar ways. This indicates an issue that is within the industry as an entirety, rather than being applicable to solely one company. Thus it is important to have an accurate understanding of how the retail industry is operating. In order to be able to comprehend how the retail industry has developed to its current state, there also needs to be an analysis of how retail has evolved and what present day retailers must overcome in order to be successful.

In addition, it has also been observed that mergers and consolidations have influenced how the retail industry operates. JC Penney remains an independently owned company, which is becoming increasingly rare within the retail market. Companies, such as Macy's, or Hudson Bay, that have acquired other retail institutions operate differently, and on a larger scale of economies, than an

individual company. This thesis will examine the trend in merging and acquisition to be able to further the understanding of relevant business formats within retail.

Competition

An investigation into the industry needs to include a discussion on successful business formats within the marketplace. These new business formats are creating major challenges for department stores, since new entrants are continuously innovating the market. This thesis will offer an overview of major competitors in different sectors of the retail industry. During the financial analysis, these same companies will be used to create a comparison between JC Penney's performance and that of other retail formats. These brief discussions will include details of company history, what each retailer is known for, and how they are currently performing in today's market. Many of these notable retailers have established new business formats, such as off price retailing and online-only business platforms. These new business formats have an effect on how consumers prefer to shop. New consumer behaviors can have significant influence on the success of a company if they fail to adjust how they do business in order to satisfy customer needs. This examination of distinguished retailers will give further insight as to what business strategies are working in the industry and why each is significant in the industry.

Financial Analysis

Research on JC Penney and the marketplace provides qualitative information, but additional quantitative research from financial sources will be needed in order

to make proper conclusions on the state of middle-tier department stores. To gain perspective on both JC Penney's performance, as well as that of the retail industry as a whole, this thesis will chart financial performance of JC Penney as well as relevant competitors. The competitors to be studied include fellow department stores Sears and Kohl's. Sears is a direct competitor as a middle-tier department store, whereas Kohl's is positioned at a lower price point. Kohl's is still considered to be a competitor of JC Penney's as they often cater to similar customers. Target and Wal-Mart, known as big box discounters, are two other companies that will be charted. TJ Maxx will represent off price retailing, which puts significant pressure on other retailers in terms of profit margins. These retailers offer merchandise at discount prices, similar to the JC Penney pricing strategy. Lastly, the financial research will also include Amazon, which was chosen due to the increasingly dominant presence of e-commerce. Online retail has certainly caused a major shift in how consumers shop, thus Amazon is a suitable competitor to analyze.

Each competitor will be charted using Excel in order to follow the evolution of these companies since 1984 in terms of net sales and net income. As new entrants enter the market, observations can be made as to how it affected the marketplace, and certainly JC Penney. Particular focus will be placed on that of JC Penney and other middle-tier department store, Sears. After plotting all the points for net sales and net income as a percentage of net sales, conclusions can be drawn about the marketplace based on quantitative information. It is possible that as new business formats and entrants appear in the market, that JC Penney and similar

formats' financial success will drop. Plotting the financial information on charts will allow for a visual representation to either support or negate the thesis.

Statement of Conclusions and Observations

After having completed all the research necessary in order to be able to make accurate conclusions, the thesis will go into a discussion on what was observed through the research and data. It will serve to answer the questions posed in this thesis and the implications of the results. Conclusions will discuss which sectors of the retail market have been struggling the most, the factors involved in creating financial trouble at JC Penney and other companies, as well as the overall trends in the industry. The financial data will best reveal which portions of retail are succeeding, while others are beginning to fail. It is here that observations will be made as to whether or not the middle-tier department store is a successful retail business format. Additionally, after looking at the overall trends, it will be possible to create valid predictions on the direction retail is moving and how JC Penney should respond. Both of these conclusions will be able to help determine the future of JC Penney, and how it can change its business format to match the new world of retail.

The Future in Retail

This thesis seeks to illustrate the potential implications of a failing business format. JC Penney, and others, might be operating in an outdated fashion that ultimately, will lead to their undoing. It is a goal to be able to provide a series of

reasonable suggestions for JC Penney, based on the observations that will be made. The focus will be on broadd shifts in strategy, rather than offering specific solutions. Further research can be made after this work to provide more detailed proposals to improve JC Penney's business strategy. This thesis will also provide excellent insight to the current retail landscape, which can later be used to do further and deeper investigations into upcoming trends. The retail industry offers continuous avenues of research, since it is, by its own nature, extremely dynamic.

Middle-tier department stores are struggling to survive in retail. Does this mean that this business format will no longer be successful within the industry? This thesis seeks to answer that question by investigating the case of JC Penney. It will cover the overall state of the market, as well as analyze the issues within the company. At the end of this work the reader should have a basic knowledge of middle-tier department stores, how JC Penney reflects the current state of this format, and be able to formulate his or her own opinion on the future of JC Penney and its direct competitors.

CHAPTER TWO

Literature Review

History of the Department Store

To begin, there must be a definition of what truly constitutes a department store. Merriam-Webster simply defines the term as "a large store that has separate areas in which different kinds of products are sold" ("department", n.d.). For the purpose of this paper, a department store is considered a store in which multiple product categories of soft goods are carried under one roof and are merchandised in different departments. Typically, these retailers are located in regional or super regional shopping centers and average in size between 100,000 and 300,000 square feet (Showcase, n.d.). There are several price point categories which department stores can be placed into. At the highest level there are luxury and upscale department stores, such as Neiman Marcus or Nordstrom, that focus on selling designer merchandise. Aside from national chains, there are several standalone retailers, such as Bergdorf Goodman in New York City or Halls in Kansas City, which operate as luxury department stores. Budget department stores aim to sell discount merchandise that provides customers with basic or fashion items at low prices. A prime example of this particular type of department store is Kohl's. However, there are retailers that fall between these two extremes and seek to please a middle-income consumer by offering budget friendly items as well as a variety of best to

better goods. These "middle-tier" department stores are what this thesis examines more closely.

The American department store's origin begins in the late 19th century, following the Civil War. Many towns had local general stores, which provided customers with a variety of goods and set the foundation for the business format for department stores. Their development can be attributed to growth in city populations, advancements in transportation systems, higher standards of living, and technological innovations (Mayfield, p 28). Prior to large cities, most retailers specialized in only one product category. In order to support a large store, there must be an adequate number of potential customers. The Industrial Revolution brought about a surge in the population of cities, created more metropolitan areas across the United States, and also encouraged expansion to the West. Standards of living increased during this time, and people increased their demand for luxuries. The surge in popularity for a broader merchandise assortment and a means to distribute them to the masses arose. Department stores, with their large amount of retail space, could meet the new needs of consumers. (Mayfield, 1949).

The advancements in the transportation systems encouraged individuals within the city and at the outskirts to make the trip to these new destination stores. Without the transportation, it would not have created the convenience of going to one location for these goods, rather than shopping at local specialty retailers. Transportation systems helped create the accessibility that differentiated the department store from single-line vendors (Mayfield, 1949).

Advertising also played a great role in the founding of these immense retailers. As city populations grew, so did competition, as more merchants looked to capitalize on new markets and opportunities. Department stores had to advertise in order to persuade customers to bring their business to them, rather than go to specialty stores for their needs. Many of these advertisements were originally found in newspapers. Plate glass was invented after the Civil War, which allowed retailers to begin using window displays as a form of advertising. If there hadn't been adequate means of displaying their brand image and merchandise, department stores would not have been able to successfully establish themselves. (Mayfield, 1949).

Some of the first retailers to embrace this emerging business format in the United States include Macy's and Lord and Taylor (Mayfield, 1949). During the end of the 19th century department stores were opening their doors in cities across the United States, so many that an extensive list of pioneers in the industry could be compiled. Although each merchant conducted their business in a different manner, there were several characteristics of these new stores that connected them. First, as standards of living grew and people demanded more of life's luxuries, there was also a greater expectation for service. Department stores placed customer service as top priority, and certainly sought to help the communities that supported them. They also made great changes to the standard practices of buying and selling. Customers expected to be able to bargain for goods, but the department stores had buyers that set one price (Mayfield, 1949). The business owners were very innovative during their time, creating new policies like accepting returns and, as aforementioned, they

took advantage of new forms of advertising. Department stores rose to meet the changes arising in society, and thereby set new standards for retailers to come in the future.

Although many department stores only had one location in a particular city, certain companies decided to expand into other smaller, local regions. Sears and Roebuck Co. and Montgomery Wards were two of these establishments. The spread of these stores helped promote the popularity of department stores, as consumers began to realize their convenience. In the early 1900s department stores continued to innovate by developing more advanced distribution systems. Catalogs became the means to reach consumers who couldn't make the trip to the physical location of the department store. Greater distribution channels allowed retailers to reach more customers than the average small business, which in turn promoted growth (Mayfield, 1949). The well-established distribution systems and ability to sell quality products at low prices helped the new retail giants survive the economic downturn of the Great Depression.

As the economy recovered and experienced extreme growth following World War II department stores moved with customers to the suburbs. The once freestanding retailers began to anchor shopping centers. This is the setting in which many department stores still reside today. As consumers continued to gain purchasing power and desired more goods and services, larger markets became available. However, during this time, department stores had to start competing with specialty stores that were able to offer lower pricing due to generally lower cost structures. Most department stores were forced to cut operating costs in order to

avoid losing too much market share to the niche, specialized retailers. During the mid to late 20th century, department stores had to begin relinquishing some of their departments. Many of them stopped carrying products such as electronics, home appliances, and toys. As they shifted to be able to compete in the industry, department stores typically carried only soft goods and gave up some of the extra services and experiences for customers that made them so unique in previous decades. This is very similar to what department stores are today. (Lewis and Dart, 2010).

In an addition to anchoring major shopping malls, department stores also have some freestanding locations for "flagship" stores. The departments are now less about having a variety of product categories, but mostly focus around soft goods, such as clothing or shoes. Customer service is becoming a large part of their business model again, as it is one of the few competitive advantages they can keep over specialty stores or large, discount retailers. Later, this thesis will discuss the current state of the retail landscape, and how it applies to the middle-tier department stores.

History of JC Penney

Before JC Penney became an established business, James Cash Penney Jr. started thriving in the retail business at a young age. After graduating high school, he worked at several different general goods stores, but found the experiences dissatisfying due to his distaste for bartering with customers ("Penney", 2006). He came to work for the Golden Rule clothing store, a chain owned and operated by

Thomas Callahan. Callahan saw a great deal of potential in James, and offered him a position managing a store in Illinois, and then by 1902 James Penney became a partner in a new Golden Rule store that opened in Kemmerer, Wyoming ("Penney", 2006). Owning one store was not enough to satisfy Penney's entrepreneurial spirit. As his success continued, he purchased Callahan and his partner's shares of the other three Wyoming stores and began expansion into Idaho and Utah.

Thomas and Callahan and his business partner Guy Johnson dissolved their partnership, which gave James Penney the opportunity to purchase their shares in Wyoming. He continued expansion, following the same business model, and allowed store managers to have one-third share in the locations they opened. He established a central buying office for Golden Rule in Salt Lake City in 1909. James' next goal was to take the business national, and it was well on its way with 34 stores by the end of 1912. Golden Rule was incorporated the following year and the name changed to JC Penney Company. James made the decision to move the buying offices to New York City, so that it was within closer proximity to suppliers. Rapid expansion continued soon after, with the first store opening east of the Mississippi River in 1915 ("JC Penney", n.d.).

JC Penney was found to be successful, partially due to James Cash Penney's unique business practices for the time. As the name of the business suggests, the founding principle was to treat people fairly. Penney did this through pricing, by setting one fair price for each good, instead of bartering with individual customers. JC Penney also operated as a cash only business, refusing to accept customer purchases on credit. Penney once described his business philosophy by saying, "Our

idea was to make money and build business through serving the community with fair dealing and honest value..." (qtd. in Beaver, n.d.). At the company's first convention, following incorporation in 1913, these seven aspects of the Penney Idea were adopted:

1. "To serve the public, as nearly as we can, to its complete satisfaction."
2. "To expect for the service we render a fair renumeration and not all the profit the traffic will bear."
3. "To do all in our power to pack the customer's dollar full of value, quality, and satisfaction."
4. "To continue to train ourselves and our associates so that the service we give will be more and more intelligently performed."
5. "To improve constantly the human factor in our business."
6. "To reward men and women in our organization though participation in what the business produces."
7. "To test our every policy, method, and act in this wise: 'Does it square with what is right and just?" (qtd. in Beaver, n.d.)

JC Penney Company was created and kept this strong company culture as it continued to expand rapidly throughout the early 1900s. James Cash Penney expected his managers to operate their stores under these guidelines, thus the philosophy stayed well in tact even during the great times of change at the company.

James Cash Penney stepped down as company president and moved to a position on the board of directors in 1917. By this point in time JC Penney had 175 stores and the company was beginning to see extremely fast expansion across the nation. The retailer began to manufacture and carry private label brands, which customers preferred due to lower prices for the same quality goods ("JC Penney", n.d.). The company began to profit greatly during this period, and James Penney saw to it that the company continued to give back to the community through generous support of a variety of charities. During the 1920s many cattle farmers were affected by a poor beef market, so Mr. Penney purchased several farms in

order to help improve livestock ("JC Penney 1875-1971", n.d.). His continued desire to see good deeds would later develop into the JC Penney Foundation, which would serve to address major issues.

JC Penney was able to survive the Great Depression because of its low prices and wide assortment of basic goods. In fact, the company continued to see increases in sales during the Great Depression ("JC Penney", n.d.). The company sold a large number of war bonds during World War II and managed to keep profits rising even with scarcity of materials due to rationing. JC Penney continued to innovate by offering a company credit card to customers by the 1950s. This was mostly due to a study conducted by the company's vice president, William Batten, that indicated the retailer needed to adapt to changing consumer tastes. New product categories such as home appliances, furniture, electronics, and sporting goods were added to the company's product mix. The first "full-line" stores opened in Audubon, New Jersey and King of Prussia, Pennsylvania. These stores carried all of the new goods that the retailer had introduced and resembled the store format that was expected to move forward throughout the next two decades. JC Penney entered the mail order business much later than many of its competitors did. In 1963, JC Penney mailed out its first catalog, whereas companies like Sears had started as a mail order business and grew to have physical retail locations. In addition to diversifying their product offering, JC Penney began to give customers services such as portrait studios and beauty salons. ("JC Penney, n.d.)

With these changes at the company, accompanied by increasing disposable income of Americans, JC Penney reached the its greatest number of stores with 2053

locations. The recession in 1974 had a negative impact on JC Penney's performance, and they saw great losses in company stock. Shares plummeted from $51 to $17 and earnings went down by nearly $60 million. Investors blamed the lower margin product categories that the retailer added just two decades earlier. Specialty stores also began to pressure JC Penney in apparel categories. The retailer rebounded in 1975, just like many businesses, but executives knew the company would need to be restructured as the competition from specialty stores tightened. ("JC Penney", n.d.)

Up to this point, JC Penney was viewed by the public as a mass merchandiser, but the company goal was to be positioned as a department store. To begin the repositioning the company expanded their fashion product categories. The hard lines became less of a focus, and JC Penney attempted to identify itself with the other traditional department stores and grow farther from its roots as a general store. Customers were not as interested in the former retail formats where they could purchase everything from their clothing to home appliances. Under the direction of William Howell, JC Penney decided to create four merchandise groups to emphasize: women's, men's, children's, and home and leisure. With these changes to merchandise groupings, the company also decided to undergo renovations within the stores. The company also categorized its locations into either a metropolitan classification or geographic, which served smaller communities. ("JC Penney", n.d.)

Howell sent JC Penney down the right path to being repositioned as a department store. When the hard lines were removed from stores, the additional space was allocated to women's apparel. During the late 1980s individuals shopping in regional centers were primarily interested in shopping for clothing and

accessories. JC Penney had a great deal of retail space designated for those items in over 1000 regional locations across the nation. This put JC Penney in position for an amazing turnaround that even survived the recession of the early 90s. The private label brands saw immense success during this time period, and competitor's, such as Sears, attempted to follow suit. ("JC Penney", n.d.)

The newfound success eventually stalled in 1994, and the new CEO James Oesterreicher decided to use the profitable private label brands to keep sales on the rise. JC Penney made its name as the largest department store in the country, but long-standing competitors were rising closer to taking that title away. The retailer added several more private label brands and ventured into coffee, by adding JC Java to 800 locations. By 2002, the company reached 100 years of retailing, and remained one of the most formidable competitors in the industry.

Although JC Penney established itself as a department store, trouble eventually set in at the company towards the beginning of the Great Recession. Middle-income families had been shopping there for years, and JC Penney had prime retail space in over 1000 locations at malls around the country. However, the company started to lose its identity, as those customers started to shop for the same items at Wal-Mart, discounters, or even specialty retailers. Sales dropped between 2009 and 2011, significantly enough for JC Penney to bring in Ron Johnson as the new chief executive officer.

Johnson's strategy began with integrating newness into the stores. The JC Penney customer could find many of the same items at discount retailers or could purchase home goods at Target for a similar, if not better price. In order to

differentiate merchandise from these major competitors, Johnson created the "shop-within-a-shop" concept. Unique brands were offered a boutique space within JC Penney, creating a variety of experiences across the store. He changed the store layout to match that of a square, with services and registers in the center. The different brands no longer blended together, but would be confined to their own respective areas. Part of this strategy was due to the market share specialty stores were gaining. Ron Johnson spoke about how specialty stores had become JC Penney's main competitors and that's why the department store model was changing.

In addition to changing the store merchandising, Johnson completely restructured JC Penney's pricing. The company had fallen victim, like many other retailers, to promotional pricing. Consumers have become reliant on discounted merchandise, and frequently don't see the value in paying full price for an item. Not only has this hurt JC Penney profits, but it also has a negative effect on brand integrity. Since merchandise is so heavily discounted throughout the year, consumers believe that full retail price is unfair, or has been marked up too high. To combat this cycle, Johnson developed "Fair and Square Pricing", which involved three different parts. First, merchandise would be sold at a lower regular price, eliminating the constant clearance sales. The sales now would be held month long, and occur less frequently. Lastly, instead of offering coupons to customers, JC Penney would offer "the best price" on the first and third Fridays of every month. These changes tried to reposition the company as a retailer that always offered a

fair price for merchandise, attempting to break customers of the habit of needing a coupon or a sale to make a purchase.

In addition to pricing and store layout changes, Johnson revamped JC Penney's advertising strategy and logo. Marketing began to look more editorial and focused on the new fashion forward brands. To help launch the new pricing structure, JC Penney started a campaign saying, "Enough is enough" to all the sales and deals retailers barrage consumers with. The ads made it clear that the company was abandoning its tradition of past decades. Part of the reason for these changes to advertising was to speak to a new target audience. Johnson started to shift the JC Penney target market to a more affluent customer. This strayed away from the traditional middle-income family customer that had always shopped at the retailer.

The results of this turnaround strategy were not as positive as hoped. Ron Johnson had many innovative ideas that were supposed to reinvent the department store as people knew it. Jeff Macke for Yahoo Finance said, "To analysts and employees, Johnson was Willy Wonka asking us go with him on a trip through his retail imagination" (Macke, 2013). Many analysts agree that the first issue with the changes was that it was not under a staged roll-out, but rather Johnson implemented all of them at once. The retailer had lost its identity in the midst of the competitive retail industry, but had now abandoned everything that customers had understood about it as a brand. The traditional customers began to feel as though JC Penney was no longer interested in serving them. They looked to retailers that still offered discounts, budget pricing, and national brands. It became obvious that Johnson had misread what the bored JC Penney customers wanted.

Johnson also decided not to test the pricing structure. He assumed that customers would be happy to see lower prices, but in all actuality they were still attached to markdowns. The new pricing did so poorly that Johnson eventually brought back the sales, but by that time customers were still going to competitors, such as Macy's (Groth, 2013). Michelle Clark, a Morgan Stanley analyst gave this review of the everyday-low-pricing strategy:

> "Consumers' perception of JCP's new pricing regime is worse than we (and the market) thought. Looking at shoppers who have been to JCP since 2/1 (i.e. since the intro of new pricing), more cited higher prices (rather than lower) at the dept. store. In fact, only 16% of shoppers associated 'Best Prices' w/ JCP and cited prices as being lower. Furthermore, customers cited bargains as harder to find and fewer aisles w/ deals" (qtd in Edwards, 2012).

The confusion of all the rebranding combined with unmet desires pushed the company only farther into financial distress, until it finally arrived to its worst day in company history. As mentioned in the introduction, Ron Johnson was fired after seventeen months on the job.

At present, the company is still struggling financially, but has seen less significant decreases since Johnson left in April of 2013. Former CEO Mike Ullman, who will be succeeded by Marvin Ellison in 2015, is temporarily running the company. Many of the changes that Johnson made were either reversed or put on hold. The main focus for the company is to get customers back into stores. Once sales rise and consumers understand the company again, then the retailer can focus on being less out of date and work on revamping merchandising.

JC Penney has seen the many changes to the retail industry over the last 100 years, and has managed to remain a major competitor within the marketplace. It departed from its roots as The Golden Rule general merchandise store to become a

well-known department store with more than 1000 stores across the nation. It became the company that served middle class American families for decades, easily found in consumers' regional shopping centers. However, as the industry has changed, JC Penney has been presented with new struggles. As it sits in financial troubles, it will be essential that the company adapt accordingly.

Department Store Challenges

Any array of challenges has developed for department stores over the past several decades. New business models threaten profit margins and captivate what were once loyal customers' interests. It's been seen that department stores adapted to the past changes in the retail industry by moving to regional shopping centers and offering fewer product categories, but change in this dynamic industry is constant. Some of the main competition today is coming from online retailers, fast-fashion brands, category killers, and off price retailers. Another difficulty is the rise in mergers and acquisitions of retail companies, which have resulted in "mega-retailers" that are able to use economies of scale to help reduce costs and prices, but also have problems differentiating themselves from competition. This section will be dedicated to investigating and analyzing the effects of each on department stores.

As one might expect, the evolution of online retailing has had great impact on the way department stores must do business. Online retailing has benefitted consumers, as customers are able to compare retailers product offerings simultaneously, which adds additional pressure on the businesses to reduce margins as much as possible. Additionally, companies like Amazon that are solely

online are able to enjoy reduced operating costs by not having to pay for high rents for retail space, or for typical expenditures like utilities, security, maintenance and a sales force required for brick-and-mortar stores. Therefore, online retailers can pass the savings onto their customers in the form of lower prices. “Showrooming,” where customers shop in stores and then go to purchase online where they might find a lower price, has also become an issue for retailers. Consumer priorities have shifted, and are now dedicated to finding the best deal, rather than committing to a purchase at the first retailer they visit. Online shopping has certainly influenced the amount of traffic coming into stores as well. In 2013, customer traffic had dropped to 17.6 billion visits from a little over 30 billion visits just three years earlier (Banjo and Fitzgerald, 2014). If customers are not visiting the malls that department stores are primarily located in, then making sales becomes increasingly more difficult. Amazon alone had, on average, 164 million visits per month in 2013 (Gagan, 2013). This means that consumers would make nearly two billion visits to Amazon in the course of a year. With this many visits from consumers it is no surprise that online retailing is seeing exponential growth. Online sales are expected to grow to $491 billion by the year 2018 according to forecasts from eMarketer Projections (eMarketer, 2013). Over the past five years e-commerce has grown at an annualized rate of 10.3 percent (IBIS World “E-commerce”, n.d.). IBIS World also reports that over the next five years consumers are going to spend more time shopping online over more expensive options at department and specialty stores (IBIS World “E-commerce”, n.d.). According to research conducted by PwC, a business consulting firm, the top three reasons why shoppers purchase online are that they believe

there is a better deal online, they can shop at any time, and that there is no need to travel to a physical store (PwC, 2015). Although stores are still the preferred way to shop, the growth of online sales is slowly, but surely, taking away from store visits.

Another new business format that is adding pressure to the bottom line is fast fashion. Fast fashion refers to retailers who have extremely fast response times to new fashion trends and offer them at low prices. There are four characteristics that are evident at all fast fashion retailers: i) fashionable clothing targeted at a younger consumer; ii) affordable prices; iii) quick response times in the supply chain; iv) higher turnover of product assortment (Caro and Matinez-de-Albeniz, 2014). Fast fashion retailers practice what is known as "lean retailing", which is where the company's focus is to get the customer what they want as quickly as possible (Lamarca, et. al, 2014). Most traditional retailers respond to customer needs the following season by analyzing past sales, but fast fashion looks at that data during the current season and changes assortment based on what is selling at present (Lamarca, et. al, 2014). Lean retailing has reversed the discount mentality that plagued traditional retailers by training their own customers to buy instantly, knowing that the style they like will be gone the next time they visit the store. This is quite different from department stores, where many customers wait until the item is put on sale, and are more confident that the inventory will not turn over as rapidly. The quick turnaround time has also put pressure on other retailers as they try to keep up with fashion trends. Department stores find themselves chasing after H&M or Forever 21 for the hottest new style, which is something that restricts profit margins.

Harvard Business Review wrote an article in 1985 warning the industry about the rise of off-price retailers, acknowledging that their presence would change the face of the industry (Kaikati, 1985). This format began to arise in the late 1960s, but truly didn't take off until the 1980s. The introduction of fair-trade laws, poor economic conditions, consumer demand for name brands, as well as their disenchantment with traditional retailers enabled off-price merchants to surge in growth (Kaikati, 1985). Department stores found off price retailing to be formidable competition, as many of them were selling the same names brand at a discount of 20%-60% off retail price. There were three main strategies adopted by department to combat this new foe: to directly compete by slashing prices, avoid competing, or diversify by adding similar business formats (Kaikati, 1985). Major retailers began to introduce outlets underneath their name. Such examples include Saks Off Fifth, Nordstrom Rack, and countless specialty stores. Popularity of off price stores has once again seen a resurgence after the recession in 2009, making it one of the fastest growing sectors in the industry (Thau, 2015). Part of their success can be attributed to strong relationships with vendors and a flexible real estate strategy. Many of these retailers are willing to open in any location that will provide enough foot traffic. Shopping malls are looking to fill vacancies with off-price retailers such as T.J. Maxx and Ross. These "anchor" locations (stores at the ends of the mall, used to draw customers) were formerly held by JC Penney, Sears, or other department stores. Sales per square foot figures at off price retailers are nearly double that of department stores, attracting the attention of mall owners (Thau, 2015). As they

steal market share from department stores, off price retailers are filling in the vacant mall anchors where the traditional retailers once stood.

Category killers are yet another retail format that serves the lower to middle class American consumer. Evolving out of the same economic conditions that brought about off-price retailers, category killers are "retailers that specialize in a distinct classification of merchandise…while offering everyday low prices and wide and deep inventories" (Spector, 2005). An interchangeable term is "big-box" stores, referring to the enormous square footage that these retailers occupy. Recognizable names of this format include Lowes, Toys R Us, Barnes and Noble, and many more. With the ability to create efficiencies in inventory management and economies of scale, category killers undercut the prices of department stores, forcing them out of product categories like home electronics and appliances. It has also put a great deal of stress on home goods, which are still carried by a majority of department stores, including JC Penney. Over the last few years, category killers have started to shift their strategy with declining sales. There is a rising trend for these gigantic discounters to downsize new stores. A *Wall Street Journal* article explained the phenomenon by stating that, "as consumers trim their spending and shift their shopping to cyberspace, American retailers are acting on a realization that many of their stores are too big" (Bustillo, 2011). Although category killers are getting smaller, their presence still poses a challenge for department stores both in brick-and-mortar and online channels.

Merging and consolidations have changed the current retail format and ultimately have had a negative effect on department stores. The original purpose of

combining corporate forces was to create economies of scale. As discounters and fast fashion entered the industry, department stores needed a competitive way to lower prices. Many of the department stores shared similar supply chains and internal operations, prompting companies to merge, which in turn consolidated these functions and reduced costs. There are many drawbacks to mergers and acquisitions. Primarily, many of the brands begin to resemble one another. Robert Spector writes:

> "Consolidations and mergers have extinguished much of the excitement that was once a part of the department store experience. Shoppers are bored with what they see, which is often a sea of sameness, a lack of variety in merchandise, because buyers, under pressure to deliver margins, are not in a position to be adventurous" (Spector, 2005).

Companies may be able to reduce payroll costs by cutting down on the number of buyers, but this adds to the issue of merchandise assortment between brands or even store to store. Buyers are no longer able to accommodate for local needs and trends, which is driving consumers away to specialty stores. In addition, many consumers don't believe that they are receiving a benefit from reduced prices. In a survey conducted in 2005, only 24% of consumers thought that mergers would result in lower prices ("Study: consumers", 2005). If consumers are turned away by the merchandise, and don't perceive the prices to be better or equal to that of a discounter, then the goal of consolidations is inconsequential.

Competitors

As previously discussed, department stores are challenged by a variety of retail formats. Later, these competitors will be compared to JC Penney in a financial

analysis. The purpose of this section is to give a brief overview of some of the most prominent retailers in the categories of online retailing (Amazon), discount big-box stores (Wal-Mart and Target), off-price retailers (TJ Maxx), budget-priced department store (Kohl's), and another middle-tier department store direct competitor (Sears).

Amazon

Amazon first launched in 1995 and has become known as one of the most revolutionary retailers in the last several decades. What started out as an online bookseller, now offers consumers about anything they may need. Sales figures have grown exponentially. In 2013, the *Wall Street Journal* reported that Amazon's sales were more than its twelve biggest competitors made combined, including Staples and Wal-Mart (Worstall, 2013). Net sales in 2014 reached $89 billion, up from $74.5 billion the previous year (Amazon, 2015). However, with expansion into producing electronics, researching the possibility of using drones to ship goods, and other expansion strategies Amazon has overspent, placing itself at a $241 million loss. Operating at a loss does not cause much concern for the retailer, who considers many of these expenditures to be investments. Amazon executives see endless opportunities; however the chief financial officer Tom Szkutak cautiously stated that they would need to be selective in which they choose to pursue (Bensinger, 2014). The online retailer does plan to open its first physical location. The first store is expected to open in New York City in time for the 2015 holiday shopping season (Bensinger and Morris, 2014). Although this store will operate as

Americans know retail today, Amazon already has extraordinary ideas for what will come next. The concept for the new shopping experience remains true to Amazon's innovative roots. Amazon is envisioning a store that does not require payment, but allows customers to delay payment until later. Using RFID tags and cameras to identify customers and the merchandise that they select, after exiting the customer would receive digital confirmation and be charged (Baldwin, 2015). Growing sales may not be covering the growing ambitions at Amazon, but this online giant remains the top competitor in e-commerce.

Sears

Most comparable to JC Penney, Sears Roebuck and Co. began as a mail order business in 1893. It wasn't until 1925 that the first store opened in Chicago in order to cater to the new mobility brought to customers by cars. In 2005 Sears finalized the merger with Kmart, making them the third largest retailer in the nation (Hays, 2004). However, in more recent years Sears has seen a great decline both in financial performance and popularity with consumers. Year over year, Sears has been operating at a significant loss. By the end of 2014 net losses had reached $1.7 billion (Sears, 2015). Sales have also consistently declined, creating little room for a turnaround for the department store. The CEO, Eddie Lampert, has added much controversy to the retailer as many investors and financial analysts have struggled to identify what his strategy is for Sears, or if his endgame is to simply liquidate the retailer after it fails (Solomon, 2014). Lampert is frequently blamed for the downward spiral Sears is in, with one analyst saying, "With the supreme confidence

that only a billionaire hedge fund manager can bring, he has run Sears into the ground. From his perch in Florida, Mr. Lampert has failed to find a strategy to turn Sears around (Solomon, 2014). The future for this once prominent retailer appears to be unclear.

Wal-Mart

The behemoth of retail opened its first door in 1962. It would only take twenty years for the mass merchandiser to reach $1 billion in sales, the fastest company to reach the milestone at that time (Wal-Mart, n.d.). By 1990 Wal-Mart was the number-one retailer and in 2002 it reached the top of the Fortune 500 list for the first time (Wal-Mart, n.d.). Wal-Mart is no stranger to growth, but recently their mantra of expand, expand, expand has come to a halt in the United States. For six consecutive quarters there has been no growth in comparable store sales, a figure which excludes newly opened stores and shows how existing stores are performing (Wahba, 2014). Online retailing is where the massive retailer looks to expand in the near future, as well as open new Neighborhood Market stores, catering to smaller neighborhoods and shoppers who just want to quickly grab a few items (Wahba, 2014). Wal-Mart has started to see some troubles of their own, but this retail giant is not to be taken lightly, as by the end of 2013 it comprised 11.4% of total retail sales in the United States ("Retail", 2014).

TJ Maxx

The first two TJ Maxx stores opened in Massachusetts in 1977, and the company acquired Marshalls in 1995, vaulting the retailer to nearly 1000 stores at the time (TJ Maxx, n.d.). Between the two brands, the retailer is one of the best known off price retailers, with an outstanding recipe for success. Across the last six years, annuals sales have risen by 50%, and profits have almost tripled (Kowitt, 2014). During the same time frame many off price retailers floundered, but TJ Maxx has seen vast, expansive growth. Increased competition has caused some new challenges for this retailer, resulting in missed earnings estimates for the first time in five years (Kowitt, 2014). This is only a small shortcoming in comparison to the typically unhindered growth for this retailer. They are in a phase of expansion, as is evident from their long-term growth goal to reach 3000 stores in the United States alone (TJ Maxx, n.d.). Competition continues to rise in the off price sector, but it is expected the TJ Maxx and Marshalls will continue to be the largest competitor for this format for some time to come.

Target

Originating from Dayton's department stores, Target was first established in 1962 as an attempt for Dayton to diversify. The goal was to create a discount mass merchandiser that incorporated some qualities of department stores, such as fashion, quality, and service (Target, n.d.). Now it operates just under 1800 stores in the United States, and is still known as the stylish discounter. Over the last several years, growth has been slowed by a data breach incident and the failure of a venture

into Canada. The data breach cost Target approximately $148 million and dropped profit expectations (Abrams, 2014). A misstep in strategy at Target Canada resulted in the closure of all 124 stores and caused the company a $2 billion net loss on the venture (Wahba, 2015). After several years of disappointing financial performance, Target saw the largest increase in sales in three years at the end of the 2014 fiscal year (Ziobro and Dulaney, 2015). There is certainly still growth at the company, with the opening of smaller format Target Express stores in large cities, as well as evidence of a turnaround emerging. As the company continues to focus on its fashionable roots, it remains a serious competitor for apparel and general merchandise retailers alike.

Kohl's

Max Kohl opened his first department store in 1962 after operating a grocery store (Kohl's, 2010). Kohl's functions as a specialty department store dedicated to bringing national and private label brand merchandise at a budget friendly cost to consumers. Price points tend to be slightly lower and more budget driven than that of middle-tier department stores. Additionally, to attract customers, Kohl's frequently uses exclusive labels, such as Tony Hawk clothing, Lauren Conrad's fashion line, or Bobby Flay kitchenware. Although analysts aren't reporting exponential growth for Kohl's, many affirm its solid business performance over the last several years (Carnevale, 2013). For 2014, Kohl's reported a 3.9% year over year increase in sales and a 10% improvement for net income (Hoium, 2015). There are some, though, that warn that Kohl's is following a similar strategy that put JC

Penney in deep water only a little over a year ago (Duprey, 2014). Kohl's performance over the last year remains in line with other competitors, although it will certainly face many of the same challenges as fellow department stores.

Summary

It is easy to see that department stores, along with JC Penney and competitors, have a long-standing history in the retail industry. As time passes and consumer behavior changes, retailers are attempting to adjust to meet new expectations and desires in the marketplace. Even the most successful formats have struggles to overcome, making this industry one of the most difficult to navigate. However, even in the midst of troubling times, investors and consumers alike expect retailers to overcome such obstacles and improve performance. Success means adaptation and finding a strategy and format that resonates with consumers and matches the modern way in which they shop.

CHAPTER THREE

Methods

Hypothesis

An a priori hypothesis is an assumption made before conducting research. The a priori hypotheses for this thesis are as follows:

Hypothesis 1: That JC Penney's performance, as measured by net sales will be notably different in comparison to competitors in a similar price point over the period of time after 2001.

Hypothesis 2: JC Penney's performance, as measured by net income, will be notably different in comparison to competitors in a similar price point over the period of time after 2001.

Net sales represents revenues from sales after customer returns and allowances. Net income is profits made after taking out operating expenses and cost of goods sold from net sales. Net income is often represented as a percentage of net sales; this is done by taking the net income value divided by net sales, and then multiplying by one hundred. Retailers should expect to have a net income that is three to five percent of net sales. This is considered to be a healthy average for a company in the retail industry. Retailers that perform below this average are not efficiently managing expenses or costs of goods sold. If a company is able to hold a profit margin above five percent it is indicative of excellent financial performance.

If either hypothesis is found to be true, one possible conclusion is that JC Penney's corporate management has not been able to restore the company's competitive standing regardless of the implementation of multiple solutions. JC Penney had previously been a leading player in the middle price point tier of department stores, alongside Sears, and the demonstrated failure to effectively compete in the industry while others maintained their standing or improved it will be support that even top experienced management have, as of yet, been unable to meet the demands of their core consumers.

Methods

This particular thesis topic was selected as a result of several academic and personal factors. Primarily, I began to follow the struggles of JC Penney with a particular interest in their business strategy. Since 2012, as a student of the apparel industry at large, it has been fascinating to follow the story of JC Penney as it attempts to remain relevant in the rapidly changing retail industry. Much of my classwork at Baylor University gave me additional insight to this topic. During my FCS 3391 – Apparel Financial Control class, I began to avidly keep up with the headlines and financial performance of the company. I studied JC Penney in addition to other companies in class, and learned deeper meaning to their financial struggles. Many of my classes also enlightened me to the challenges that retailers face today. It became evident that the retail industry is extremely dynamic, and that the changes come quickly. I became particularly interested in business strategies and how retailers adapt to this shifting environment. Additionally, there is a certain

fascination with consumer behavior, and how brands cater to the needs and desires of their customers. The customer is also ever-changing, and can be difficult to please, which creates a challenge for retailers. Lastly, JC Penney is headquartered close to Baylor University, which has made it easy to follow the company and see the impacts of the financial issues first hand. The company also employs many alumni from the Apparel Merchandising discipline who have shared their own personal insights with faculty and students.

To begin the data collection, the online database *Mergent* was used to find all pertinent financial information used in this project. This is a subscription service held by Baylor University. *Mergent* online has all publicly available financial information collected in one place for researchers. This was found to be more efficient and complete than attempting to collect all data directly from company financial records. From this database, data were collected from the years 1984 to 2013. This period was selected because financial records began to be recorded online in 1983, however the majority of the companies studied did not have ample information available prior to 1984. The financial information was collected in the year 2014, thus 2013 was the most recent fiscal year that had been completed. A brief overview in the literature review and during conclusions gives insight into the most recent financial reports. Since corporations can operate using different fiscal years, it was found that it was more effective to use 2013 as an end point in data collection, when all of the retailers had officially reported performance sometime within 2014. Net income and net sales dollars figures were recorded and placed in an Excel workbook. After trying multiple methods of data collection, other forms of

financial information were rejected due to missing or incomplete data. Originally, the thought had been to include changes in stock price in the analysis, however after exploring this option, it was revealed that there is not enough data available online to get a comprehensive overview of stock performance. There is no data on yearly average stock prices, rather small change in price would need to be plotted. This practice was not efficient, and would not provide the reader with more insight than net sales or income. Net sales were used over same store sales because that information was not present for all the retailers in this study. For example, Amazon, an online-only company, would not have any data on changes in same store sales. It is the researcher's belief that analyzing net sales and net income as a percentage of net sales provided the most accurate and complete measurement of each company's financial performance. Using net income as a percentage of net sales allows the reader to evaluate performance without the numbers being skewed by the size of the company. For example, it would be expected that Amazon net sales and net income would be sizably more than that of JC Penney, but the percentage will show how much of sales was turned into profit.

A total of seven retailers were selected: JC Penney, Sears, Wal-Mart, Amazon, TJ Maxx, Kohl's, and Target. These companies were chosen to represent the lay of the retail industry today. The companies listed portray a variety of business formats. Middle-tier department stores, discounters, off price retailers, e-commerce, and budget priced department stores are all included within the financial research. Not only are multiple retail sectors covered by the study, but they also typify the competition in the marketplace for middle-tier department

stores, and specifically JC Penney. Specialty stores were not included due to the vast number present in the industry, as well as the high level of variance in performance and business strategy from brand to brand.

After gathering all of the necessary financial data, the net sales and net income as a percentage of sales figures were plotted on a line graph for the corresponding years. Using Microsoft Excel, the figures were plotted using the line graph function, with time on the x-axis and dollar amount or percentage plotted on the y-axis. The time span across the x-axis is from 1984 to 2013. Dollar values on the y-axis are represented in thousands due to the large values of net sales. Net income figures are shown as percentages. Line graphs were produced in order to create a visualization of the changes in financial performance over time. The visualization also made comparisons between retailers immediately evident.

The lines graphs allowed for observation of patterns in the data. All charts can be found in the appendix of this work. Chart 1 displays the net sales reported by JC Penney. This gives a visualization of the sales performance of solely JC Penney without any comparison to competitors. Chart 2 depicts the net sales of Amazon and Wal-Mart. The purpose of this chart is to show the performance of these companies aside from all other retailers in this research. These companies had significantly higher net sales values due to their scale of economy. When they are displayed with all other companies the graph is skewed and it is difficult to visualize other net sales lines. Chart 3 depicts the net sales of JC Penney, Sears, and Target. This comparison was also shown because these retailers have a similar economy of scale. Kohl's and TJ Maxx comprise the visualization in Chart 4. With similar net

sales values, this chart allows for a better view of net sales performance. The last net sales chart that was made, Chart 5, shows all competitors net sales together.

Net income charts begin with Chart 6, which like Chart 1, shows JC Penney's performance alone. The retailers were not placed together on charts based on economies of scale, rather with net income some were shown in the same chart because percentage values were similar. For example, Chart 7, which includes JC Penney, Sears, and Kohl's is able to show all department stores together because, for the most part, the percentages were similar enough to allow the reader to look more closely at each company. It also offers a comparison of how the department store competitors are performing against one another. Amazon, Sears, and JC Penney net income as a percentage of net sales is visible on Chart 8, both with significant losses at one point or another. It also allows for one visualization of middle-tier department stores against an online retailer. Chart 9 puts JC Penney against all other net incomes of retailers not previously charted, which include Wal-Mart, Target, Kohl's, and TJ Maxx. The purpose of having multiple net income as a percentage of net sales chart is to show JC Penney in a variety of comparisons, which can give the viewer a better understanding of overall performance relative to competitors. Additionally, placing fewer retailers on each chart makes the visualizations easier to read and understand. The last chart, Chart 10, shows the net income as a percentage of net sales values for all companies together.

CHAPTER FOUR

Results and Conclusions

Analysis

The visualizations created from the financial data allow for several observations. First, one can see from the JC Penney net sales shown in Chart 1 that, since 2003, the company has struggled in comparison to competitors. There has been a downward trend of sales over the last decade, indicating a persisting trend. When looking at JC Penney alongside other retailers of similar size, specifically in Chart 3 but also by looking at the Chart 2 and 4, JC Penney's performance in terms of net sales was feeble. The only other comparable sales data was found to be from Sears (Chart 3). After 2002, Sears also had a plummet in sales, and although they began to recover, they too have started to decline again since 2007. Chart 3 shows that JC Penney and Sears have very similar net sales trends. Both Wal-Mart and Amazon have extremely high volumes of sales that have continuously been increasing (Chart 2). There have been no significant losses in sales for either of these retailers. Kohl's and TJ Maxx, who are comparable in terms of economies of scale, show slow and steady increases in sales since their financial data went public (Chart 4). When analyzing the net sales data, two outliers become evident. First, Wal-Mart can be considered an outlier due to its ability to create continued growth, even during the economic downturn that affected most retailers (Chart 2). The second outlier is Sears, who showed a severe drop in comparison to the other

companies evaluated (Chart 3). This data was similar to JC Penney, in that both companies experienced a sharp decline in sales and have continued to struggle afterwards.

The net income charts reveal some of the same observations from net sales data. Looking at JC Penney (Chart 6), although there were points of increased income as a percentage of net sales, overall there is a downward trend. Especially in recent years, JC Penney is significantly below the retail industry average of net profits equaling three to five percent of net sales. They were able to maintain a profit during the Great Recession, however in the three years since then they have been operating at a loss (Chart 6). Amazon originally was doing very poorly in terms of turning sales into profits in the early years of the business, but they have continued on an upward trend, until just recently with the recession and extensive expansion plans (Chart 8). Sears shows many troubles with profitability as well. Although they have remained stable after the large decline in 2002, net income is currently less than two percent of net sales (Chart 8). This indicates that the company is below the industry average and not performing optimally. Wal-Mart is an outlier in this category as well because they have maintained a net income that is somewhere between three and five percent of net sales consistently (Chart 9). It was once again observed that they were not greatly impacted by the recession. Overall, we can see that in terms of profit maximization, JC Penney is performing below competitors in several areas of the retail industry. This is not to say that the other companies have been continuously successful, however JC Penney has shown

a lack of recovery, whereas competitors have been able to implement solutions or initiate a turnaround.

Conclusions

After analyzing the charts and making observations, it was concluded that the results provided support for the hypothesis. The expected outcome was that JC Penney would be significantly different in terms of financial performance, and that similar patterns could be observed for the other middle-tier competitor, Sears. In both sales and profitability, JC Penney was seen as underperforming. The data revealed that, not only was JC Penney's financial status worse than competitors, but it was severely different and has remained that way for a longer period than other retailers. Kohl's, TJ Maxx, Target, Wal-Mart, and Amazon had upward trends in their financial data or showed improvement in some manner. Other retailers have been able to recover and continue to prosper within the industry, whereas JC Penney has been declining.

The lack of recovery from the difficult economic times indicates that top management has not been able to develop a solution to maintain relevancy in today's industry. In the case of JC Penney, former CEO Ron Johnson attempted to make many changes to improve performance; however, none of them proved successful. The retailer has been distressed for several years, and executives have tried many temporary fixes. Instead of being able to establish a long-term strategy, they have thrown any new idea into action to see if anything would stifle the losses for investors and missed quarterly expectations. This rapid turnover of strategies points to a larger issue at hand.

Not only did JC Penney have subnormal financial data, but its close competitor, and middle-tier department store counterpart, also showed similar results. Sears, who has also been featured in news headlines for company troubles, had a net sales chart that looked very much like JC Penney's. The two had a significant drop in the early 2000s, and then saw continuous declines again since 2007. Neither of these retailers were able to increase sales after the Great Recession. Likewise, Sears has tried to find a way to remain one of the most recognizable department stores in American homes; however they are quickly on their way to no longer operating.

It is also safe to conclude that the decrease in sales for Sears and JC Penney can be partially attributed to the rise of new retailers, such as Amazon. Since its entrance to the market, Amazon has grown rapidly and attained sales of over $74 billion, a 22% increase over 2012. By comparison, Wal-Mart, who had one of the best financial performances out of the observed retailers, only increased sales by 1.6% year over year. Amazon's widespread success is naturally taking business away from other retailers, including JC Penney and Sears.

Wal-Mart will remain a formidable competitor, as it only continues to expand and gain market share. Their performance across thirty years signifies that the retailer has found a business format that works well for consumers, and the response is increasing sales, even during economic downturns. From 2008 to 2009 JC Penney sales dropped, whereas Wal-Mart saw an increase of nearly seven percent. It is very possible that consumers saw an opportunity to buy similar products at Wal-Mart for a lower price than at the middle-tier department stores,

where they normally would have made those purchases. There is also additional convenience, as consumers are able to buy everything from groceries to small household goods or clothing under one roof.

In addition to having consistent growth in sales, Wal-Mart also showed stable net income. Profit remained between 2.9% and 4.2% of net sales, thus holding within the healthy average of profit margins for retailers. Net income represents the retailer's ability to take sales and turn them into profit. It can be manipulated to an extent (for example, in order for companies to achieve a lower tax rate), but overall it is intended to show that a company can manage expenses and is operating efficiently, which benefits the corporate stock prices. JC Penney has not remained stable over the last three decades, and for the past three years has been operating at a loss. Part of this could be due to the decline in sales, however, JC Penney is then not adjusting business strategy in order to accommodate changes in the economy. Most of the competitors had a downturn in income during the recession, but the majority also recovered. The severe loss of profits for JC Penney in comparison to other retailers shows that they are battling to construct a sound operational strategy.

One conclusion as to why JC Penney has, and likewise Sears, been struggling financially in recent years is that their performance was greatly affected by top management, mainly the chief executive officer. At JC Penney, Ron Johnson created mayhem after new company policies offended customers. Sears' Eddie Lampert has been floundering since he merged Sears and Kmart a little over ten years ago. In order to try to keep the company afloat, he's been lending it money from some of his

affiliates, but refuses to cut back on cash expenditures. Chief executive officers, as previously discussed, hold a great deal of power at a company, and can certainly lead it to the desperate times that both JC Penney and Sears are seeing. However, it was also found that both retailers were experiencing problems prior to the hiring of either chief executive officer. In fact, they were sought out to fix issues already present at their respective companies. Unfortunately, these executives have not been able to find a way to turn their companies around with present day challenges, even though they are some of the most respected businessmen.

The challenges for department stores are only going to increase, and if they continue to perform similar to what the data have shown, they will not survive. It has been concluded that Amazon will continue to grow in terms of sales, along with the expansion of online retailing. Consumers will only use online shopping more frequently, continuously taking away from the brick and mortar department stores. Additionally, lower cost options such as fast fashion retailers and category killers, will add pressure onto department stores to lower prices. The data shows increasing sales at locations such as Kohl's, TJ Maxx, and Wal-Mart, all of which offer consumers goods at discount or budget prices. The compulsion to drive down prices will only further create the need to operate more efficiently, in order to maintain margins. JC Penney is already struggling to return to profitability, and the increasing competition will not make the challenge any simpler.

It is these factors, in addition to the data collected, that support the hypothesis that JC Penney is not performing to industry standards, and that top management has not been able to find a solution to the problem. This, in

congruence with the results from Sears, can lead one to conclude that middle-tier department stores are failing as a retail format. Other formats such as off price retailers, discounters, and online retailers have found ways to work through difficult financial times, and remain relevant and increasingly popular with consumers over time. The downward trends for middle-tier department stores Sears and JC Penney, shows that consumers are in disfavor of this format.

However, it is important to note that since this data were collected, JC Penney has been reported to show slow signs of recovery. According to the conference call transcript of the fourth quarter results, the retailer saw a 4.4% increase in comparable store sales for the year and that quarterly sales were up 2.9 percent (JC Penney, 2015). Overall, the talk about how the company is doing is positive, hinting that a turnaround is not entirely out of the question. This is certainly something to take into consideration; however, the true impacts of new leadership and strategy will not be able to be observed for at least five years. It would be effective to return to this data after that amount of time has passed and see if JC Penney has begun to recover, and thus disprove the hypothesis. It is safe to conclude, that with current data, that the hypothesis is supported.

Limitations

As with any study, there were several limitations to this research. One of the most constricting restraints was that data were limited to public information. Net sales and net income data could only be collected for the years made available online, and some of it was consolidated, or in some cases missing.

Conclusions could have been much more descriptive if there had been access to the companies internal data.

There were also limitations on the type of data available for analysis. Originally, it was a goal to follow stock prices for each company, however that data is not compiled or recorded in a yearly average. It is also difficult to be able to truly analyze the net income as a percentage of net sales data without further looking into financial reports or the economic trends that year. There are many factors that affect profits, and sales is just one of them. However, from data spanning across thirty years, one is able to see trends and make more generalized assumptions about how effectively a company is operating. If there had been time to look closely at each annual report, then more detailed results and thoughtful observations could have been made.

Time was another significant limitation for this study. With documents only made public since 1983, this allows for only a small glimpse into certain companies' histories. For example, JC Penney was incorporated in 1924, but documents could not be found any earlier than 1983, and important data was missing until the year 1984. Time not only influenced what data the researcher could find, but also how in depth the study could go. The researcher did not have ample time to delve into each financial report or exhaustively search through industry analyses. With more time, these resources could have been included, and the observations made more in depth.

Despite these limitations, the researcher believes that this study is an accurate depiction of financial performance of JC Penney and its competitors.

Although the study was not able to encompass all years, it was found that three decades was enough time to find trends and make observations. Overall, it was found that the results are still valid, even with time and data constraints.

The Future

As of August 1, 2015, Marvin Ellison will step up as the new CEO of JC Penney. Currently the vice president of Home Depot, Ellison is considered a safe bet for improving operations, but not known for having a merchandising skill set. The return of Myron Ullman brought stability back to the company as he reversed many of the radical changes Ron Johnson had put into place during his time at JC Penney. Now the retailer looks to someone who can find solutions to make operations more efficient, and stop the hemorrhaging of money flowing out of the company.

The news of Ellison's appointment as the successor of Myron Ullman initially caused JC Penney's stock to rise pre-trading by more than eight percent (McGrath, October 2014). It is considered a safe choice by both analysts and consumers alike. However, some people also share concerns that, without a background in apparel, Ellison won't be able to improve merchandising and promote a fashionable image for JC Penney. A *Forbes* magazine journalist said, "JC Penney's new pick for CEO reinforces the company's new stability but proves once again, the retailer lacks vision when it comes to putting a fashionable foot forward in attracting new, younger shoppers" (Heller, 2014). Regardless of his background and the goals of JC Penney, the industry will continue to change, and Marvin Ellison will need to be prepared to face the challenges ahead.

As online retailing continues to grow, department stores will need to embrace an omnichannel retailing strategy. This marketing strategy acknowledges all the ways the modern consumer shops: mobile, online, and brick and mortar. According to Marketo, a leading provider of marketing solutions, "marketers now need to provide a seamless experience, regardless of channel or device…. Each piece of the consumer's experience should be consistent and complementary" (Newman, 2014). A prime example of an omnichannel strategy is Nordstrom. This retailer uses mobile technology in stores to assist customers, allows them to shop online and pickup in store, and gives the most service possible across all channels. Customers are able to use multiple channels even when making one purchase. They are able to get a very similar experience no matter how they choose to shop. As more and more retailers turn to an omnichannel strategy, consumers are expecting the convenience of a seamless experience. There will become preference for retailers that offer these services, which could turn into brand loyalty over time. This creates the need for middle-tier department stores, like JC Penney, to implement an omnichannel approach to selling quickly, reducing the likelihood that their customers will develop new shopping habits. JC Penney's website allows shoppers to check in store availability, however there's no option to connect online shopping to the in-store experience. There is very little connection between mobile, online, and brick and mortar channels. In order to remain relevant in the retail industry as online shopping grows, it has become a precedent to initiate an omnichannel strategy. The first recommendation to JC Penney and middle-tier department stores is to focus on an engaging and seamless experience for customers

through the development and implementation of an omnichannel approach to retailing.

Another crucial response is making operations efficient in order to compete with the lower cost structures of fast fashion retailers, category killers, and even specialty stores. Middle-tier department stores target similar customers as these competitors, and with such substitutive products, it can quickly result in a price war. Having the lowest price can quickly cut into margins and result in high markdowns. Mergers may continue to occur within the industry as companies search for ways to create synergy in their operations. JC Penney has made itself unique by remaining an independent company; however this means that the retailer cannot afford to be lax with expenditures. Engaging the competition by attempting to have the lowest price is not the advocated response for middle-tier department stores. It would be better to improve basic business functions and regain focus on their core customers.

In addition to optimizing operations, middle-tier department stores will need to look to other customer experiences and services to bring traffic back into stores. For instance, JC Penney may consider what features to introduce through the brick and mortar channel that will differentiate it from competitors. Customer service and the ability to tailor the experience to an individual will increasingly become more important as retailers look for a competitive advantage. JC Penney is not necessarily known for outstanding service in comparison to other retailers who focus on providing convenience and a quality experience. According to research done by Temkin Group, a customer experience research group, JC Penney ranked 87th, whereas competitors such as Amazon or TJ Maxx were in the top fifty best

customer service companies. Sears was placed as 125th in ranking (Temkin Ratings, 2015). This indicates that middle-tier department stores are not ranking high in consumer's minds as having the best experience when they shop. If these retailers are to continue doing business, it should be a priority to learn how to better serve customers and create a compelling experience in stores.

Overall, customers will need to be the focus of middle-tier department stores. It is evident that consumer preferences are changing, and there must be a response to the shift. It is recommended that JC Penney, and similar retailers, conduct customer research and revaluate the needs and wants of their target market. JC Penney also needs to clearly define a target market. Recently they attempted to attract a new, younger customer during Ron Johnson's term, which alienated the traditional JC Penney shopper. A specific segmenting strategy will allow JC Penney to find a long-term strategy towards recovery.

The retail industry and consumer tastes will continue to be dynamic. Middle-tier department stores are currently in a state of decline, and desperately need to make changes if they are going to return to profitability. However, in crisis can be found opportunity. Currently, the needs of the upper-class are being met through luxury retailers such as Neiman Marcus, Saks Fifth Avenue, Bloomingdales and Barney's, while the needs of the working-class are amply met through discounters such as Target and of course, Wal-Mart. However, with an upcoming presidential election that will give the United States a new president, attention has turned to the middle class. Additionally, the company should recognize that many retailers are giving special notice to trendy, young consumers. This means that the average

American, who may be indifferent to fashion trends, is not being catered to. Although it is tempting to chase after the younger generations, JC Penney has the opportunity to capitalize on the older population that doesn't want to be barraged by fashionable items they have no use for in every day life. If JC Penney, and middle-tier department stores as a whole, can connect with this currently underserved market, it may be able not only to reverse its current situation, but has the potential to thrive for another 150 years. However, only time will tell.

APPENDIX: FINANCIAL GRAPHS

Chart 1:

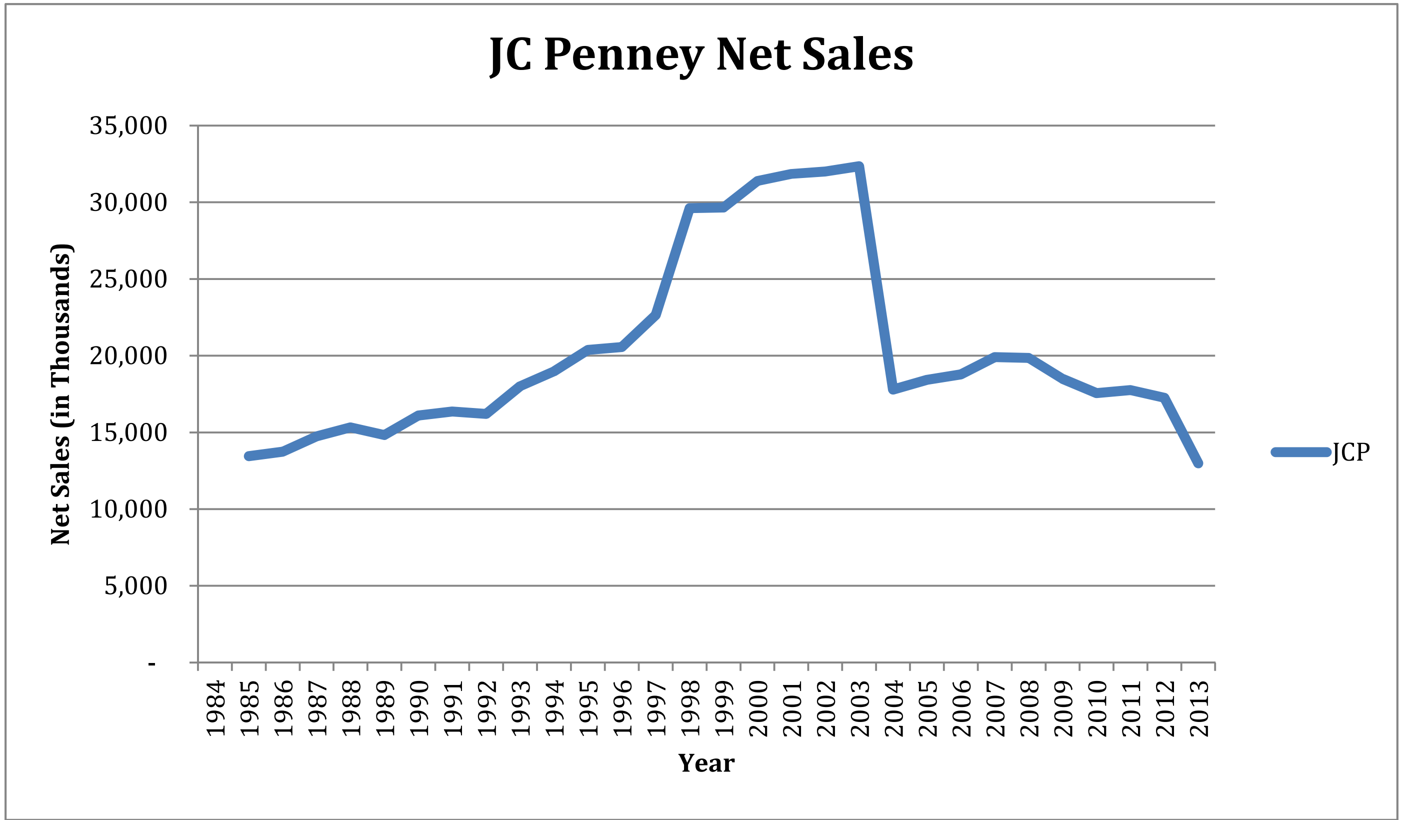
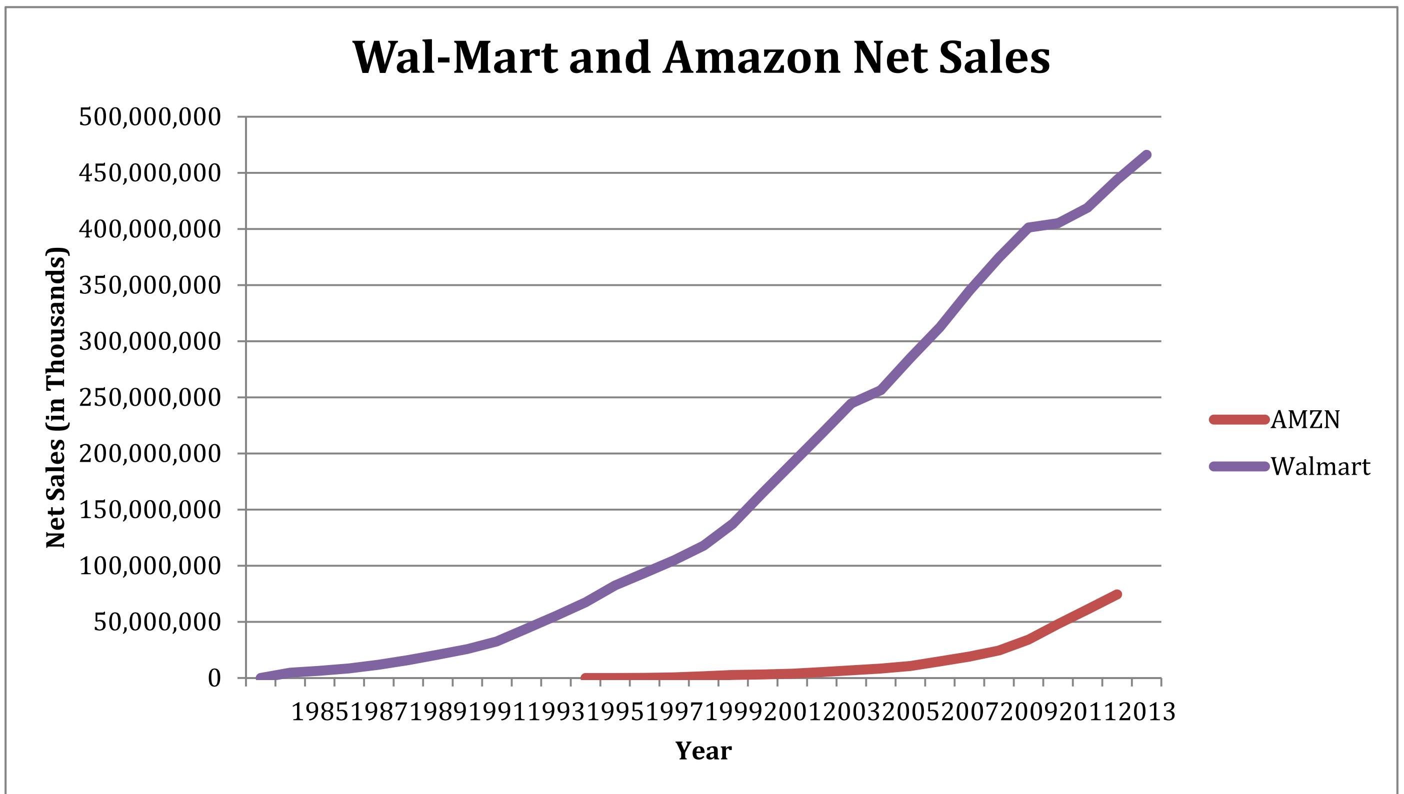


Chart 2:



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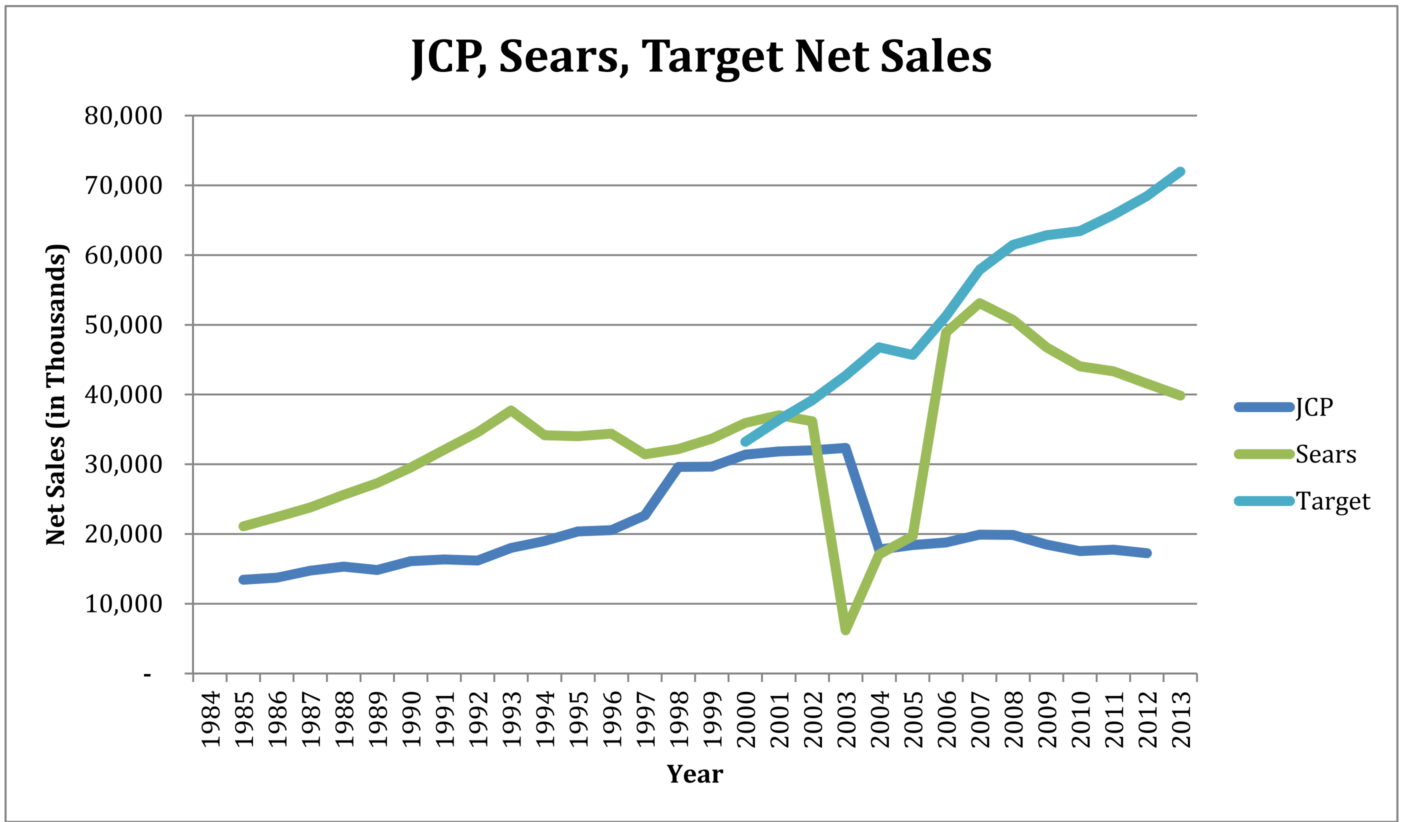

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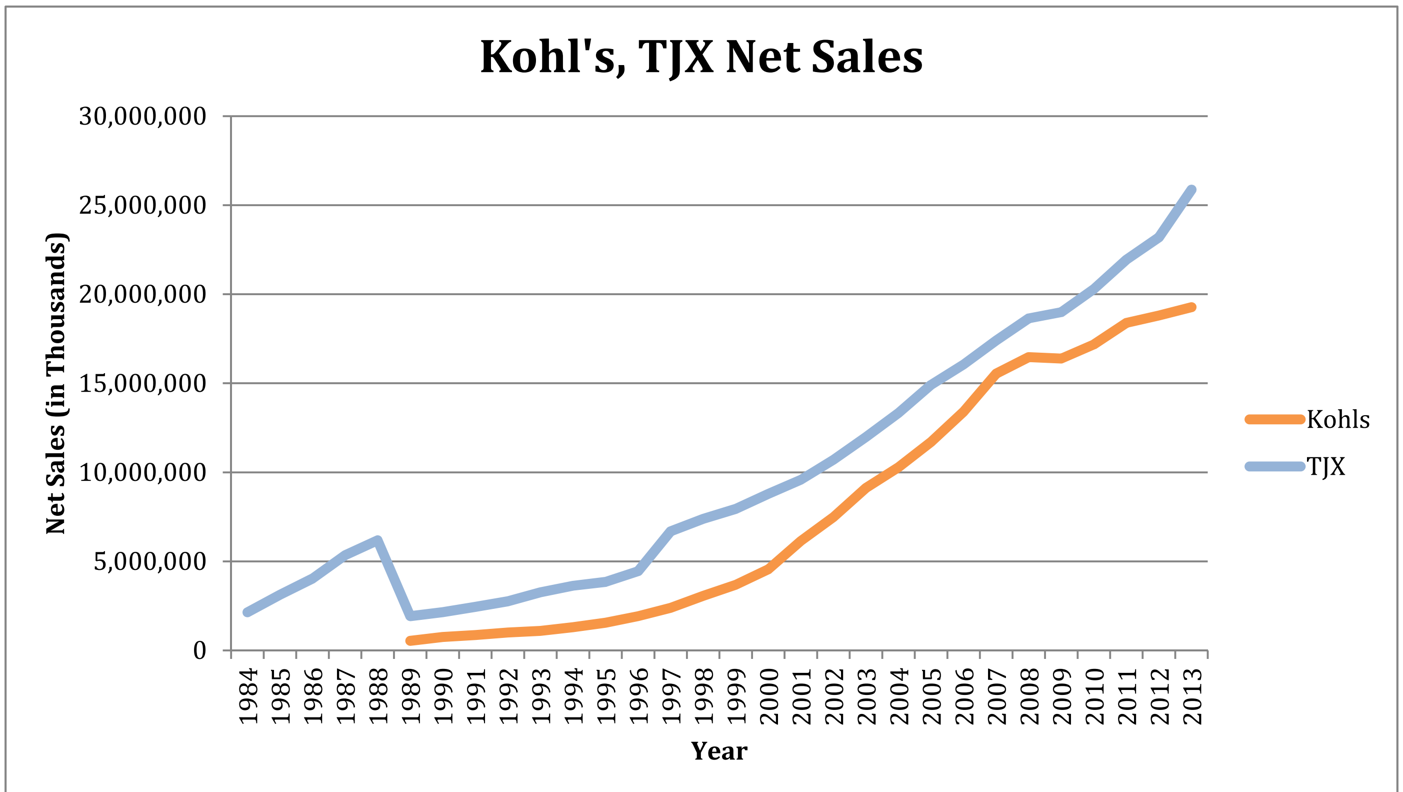

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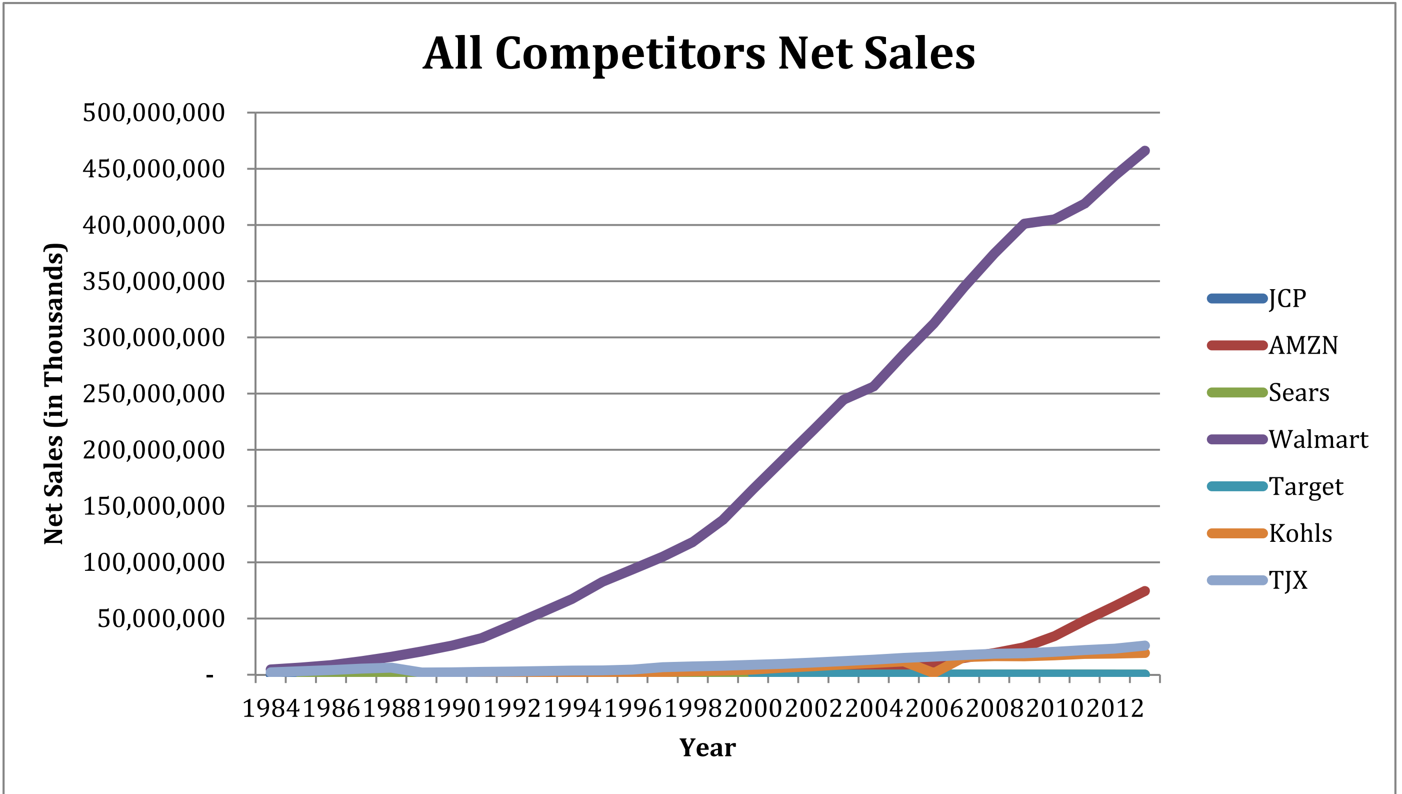

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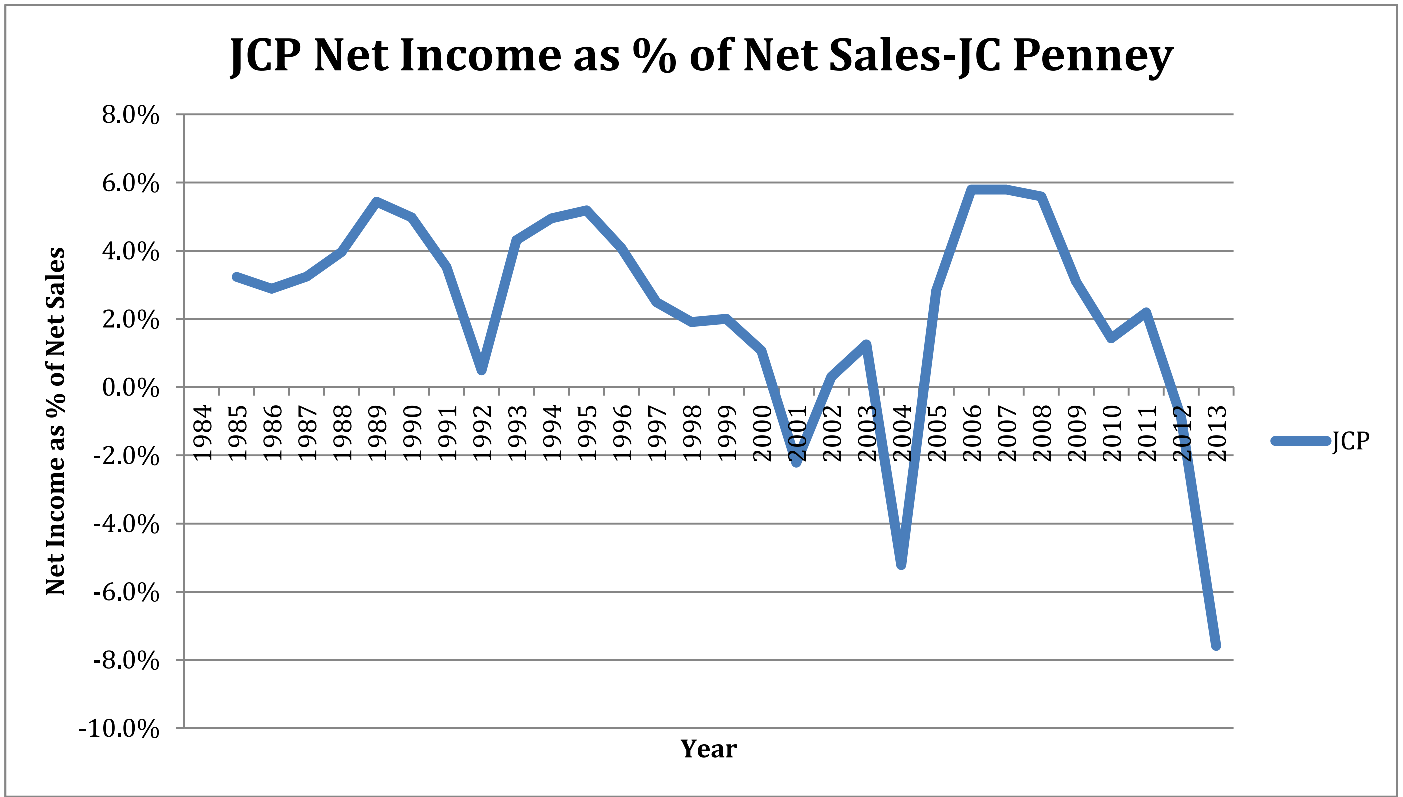


Chart 7:

Net Income as % of Net Sales- JC Penney, Sears, Kohl's

10.0%
5.0%
0.0%
-5.0%
-10.0%
-15.0%
-20.0%
-25.0%
-30.0%
-35.0%
-40.0%
-45.0%
-50.0%

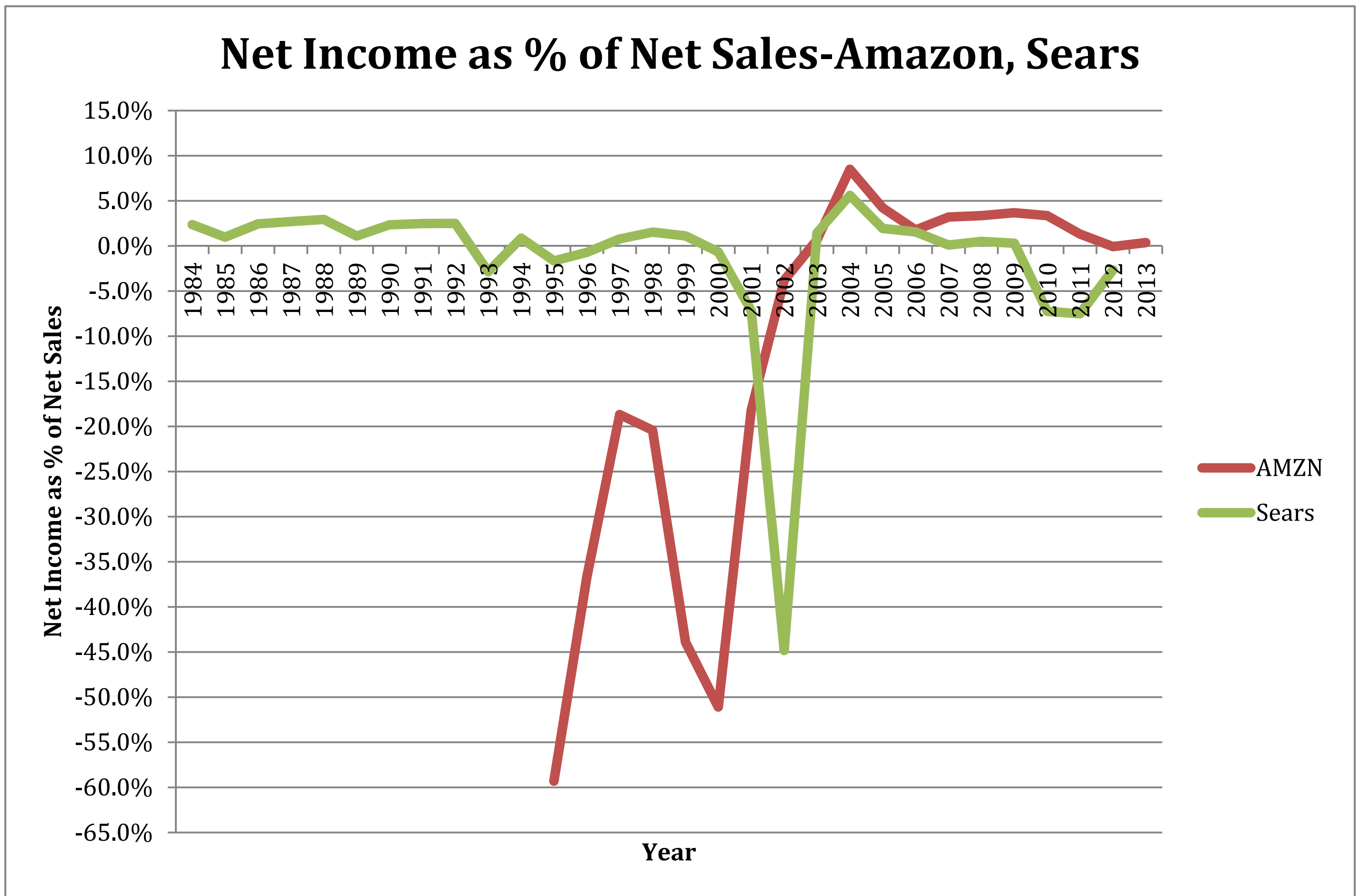
Net Income as % of Net Sales

1984 1985 1986 1987 1988 1989 1990 1991 1992 1993 1994 1995 1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013

Year

JCP
Sears
Kohls

Chart 8:



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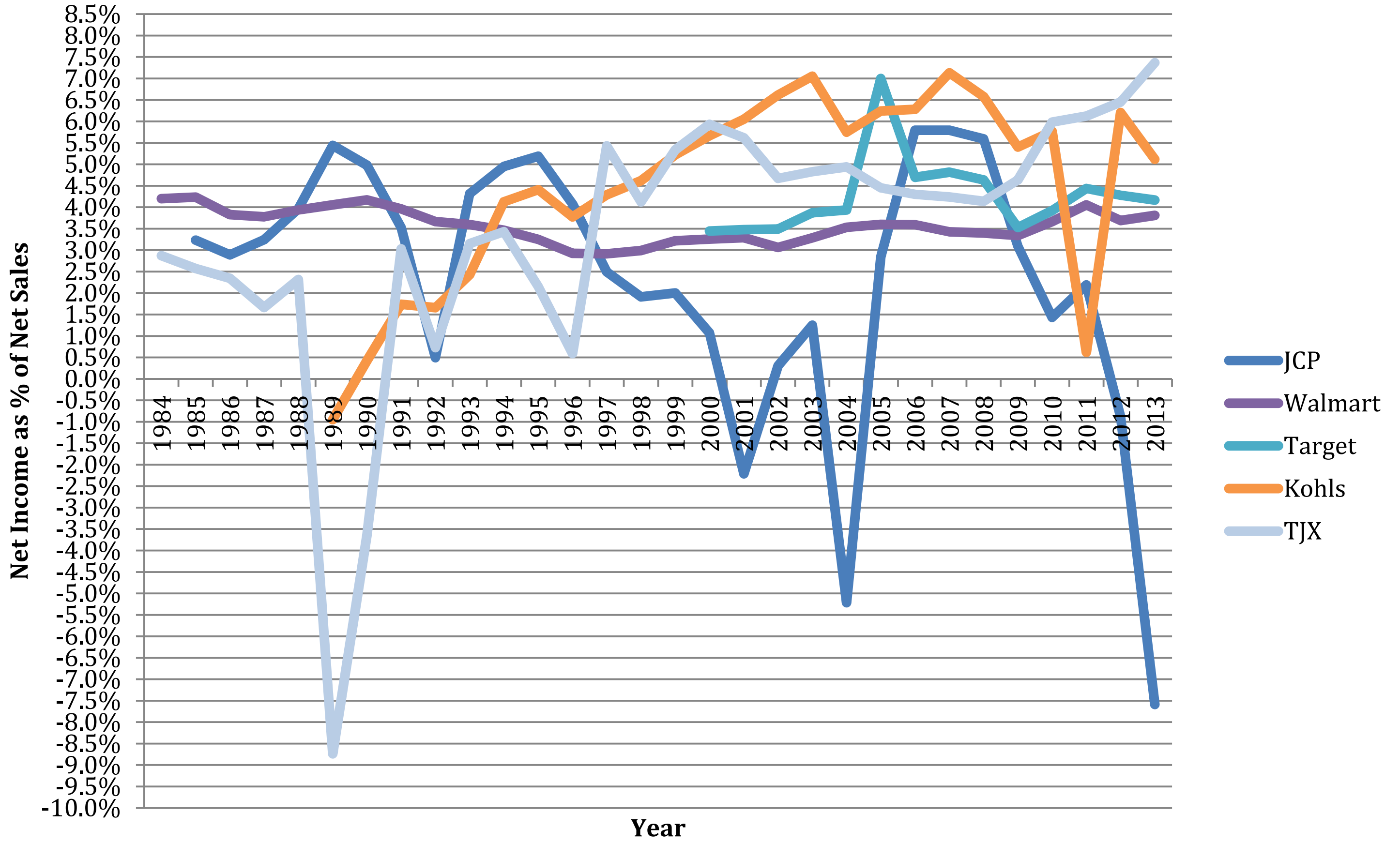
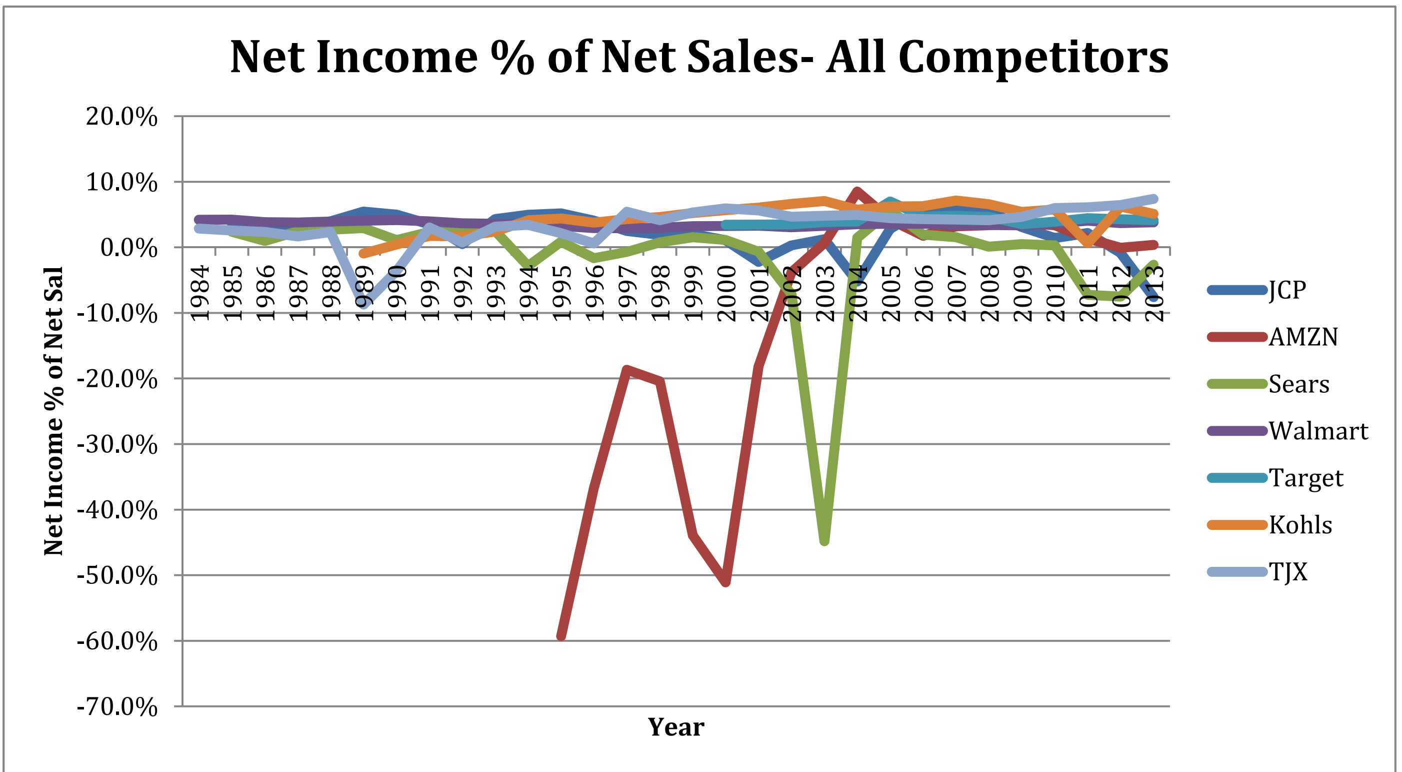


Chart 10:



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