Robert Campeau and Innovation in the Internal and Industrial Organization of Department Store Retailing: Are the '80s and '90s the '20s and '30s All Over Again (and Why Does It Matter)?

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There has been a substantial reorganization of department store retailing in the United States, the largest home market in the world, in the course of the last rough decade. It appeared to come to a symbolic climax in 1987 and 1988 when a Canadian developer and entrepreneur, Robert Campeau, bought two of the largest American department store holding companies, Allied Stores and Federated Department Stores. The combined entity operated over a thousand establishments. It employed nearly two hundred thousand people. Its operations included such department stores as Jordan Marsh, Filene's, Garfinkle's, Abraham and Straus, Foley's, Rich's, Burdine's, Bullock's, and even Bloomingdale's, widely thought to be the crown jewel of the business. Related enterprises included Brooks Brothers and Ann Taylor. These were prominent properties, and many had been prominent for many years. The Federated transaction was the second-largest corporate takeover in history.

Campeau was not a merchant, nor was he personally immensely wealthy. He borrowed almost all of the purchase prices on the strength of some ideas drawn from outside of retailing about how he would reorganize the properties to make them more profitable. Economies of scale were central to his strategies. It appears not to have been lost on the lenders that the most prominent department store holding companies of the 1980s--Dillard's, the closely held firm headquartered in Bentonville, Arkansas, and the May Company, headquartered in St. Louis and famously dominated by its

[1]This essay is largely background for joint research with my colleague Walter Salmon. We hope to complete a book manuscript, tentatively entitled *Campeau, Federated, and the Fate of Department Stores*, in 1991. I am grateful to Salmon for ongoing discussions and to Adam Brandenburger, Timothy Bresnahan, Robert Fogel, Alvin Silk, Peter Temin, and Robert Zevin for illuminating conversations and seminar interventions. Margaret Levenstein and Carl Ryant gave valuable formal comments at the Business History Conference meetings. The Division of Research of the Harvard Business School and the National Science Foundation have supported the primary research drawn upon here. The usual disclaimer applies.

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chairman, David Farrell--were very large by historical standards and seemed to have relatively highly centralized decision-making.

Department stores were originally local enterprises. At the beginning of the interwar years, almost all of the most famous names in the business operated a single store. Most of the exceptions involved merely financial, rather than operational, relationships between the stores; they also appear to have involved a tiny handful of stores. In the course of the 1920s and early 1930s, there were many consolidations. Some involved substantial numbers of stores; others, stores doing a very substantial volume. Commentators spoke and wrote--generally addressing trade audiences, but sometimes ranging as far afield as the annual meetings of the American Economic Association (AEA) about potential huge economies of scale. The chain stores offered some competition and a dramatic example. Edward Filene told the AEA that chain department stores, in the sense of stores of chains of departments, were beyond doubt the wave of the future [12].

The selection of goods sold in these institutions has not changed much over the intervening years. The vertical boundaries of department store firms are quite similar. In the core apparel businesses upstream, even production methods have not changed radically. Yet fifty years separate these two periods. Has nothing fundamental changed?

In the essay that follows, I will address this question. I believe that something important has changed, but that scale economies are not at the heart of it. The change in size is only one consequence among many of a far deeper development. This development is a radical decline in the cost of transmitting and processing information.

My argument will raise a methodological point that I think is of far broader import in business history. Size is not necessarily a reliable guide to profitability, and it is certainly not a reliable signpost to profitable new ideas. Particularly where innovation requires inframarginal reorganization and expense, large incumbent enterprises may well--perhaps for reasons of sociology or perhaps for reasons of simple economics--act conservatively and so be unrepresentative of a changing population [17, p. 336; 16]. To understand critically the history of business practices and institutions, one needs to identify the innovative possibilities and to study their diffusion and consequences moving forward in time. Any other procedure introduces what statisticians call sample selection bias. Bresnahan and I have recently demonstrated that this sort of bias can be substantial in understanding the history of business.[2] Narrative built around the implications of structural changes is likelier to be a sound description of a changing reality than

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[2]See [4], for example, especially Table 2 and the accompanying text. A pair of statistics summarizes the point vividly. In 1929, the Big Three auto manufacturers produced two-thirds of the motor vehicles industry output. But they operated only one-quarter of the establishments. To a first approximation, the other three-quarters were running a different production process. These establishments closed down disproportionately. The Depression in this industry was thus a shakeout, not simply a contraction. On the short- and long-term dynamic implications of this, see [5]. To study industry-level indices of production or input usage as if they were nothing but the behavior of average surviving plants writ large is to miss the watershed completely.

narrative that simply studies the traits and strategies of prominent survivors. (Put otherwise, there is information in failures as well as successes.) This method of analysis is also more susceptible to testing and refutation, another an important virtue.

Then

The broad history of department store retailing in the 1920s and early 1930s has several themes [24]. One is the vigorous and relatively steady growth of the business from its inception to the 1920s, followed by a notable tapering off. A second is intrastore managerial innovation, which includes the development of retail expense accounting, planned merchandising (i.e., systematic methods for stock control), and formal personnel management. Corporate reorganization on a substantial scale is a third.

There were many consolidations among department stores during this time [6]. But the scale of operating units and the span of control within them do not appear to have changed much. It is difficult to cite statistical data to establish this absolutely: the first Census of Distribution was conducted only in 1930. Yet most consolidations appear to have been reported in the *New York Times* and discussed in adequate detail; articles in the early years of the *Harvard Business Review* and in other contemporary trade journals give a further crude time series of glimpses of the underlying situation in operating terms.[3]

It may be worth summarizing in a little more detail what these sources say about size. There were clearly some groups of six, eight, and eventually even twenty-odd stores [1, 6, 9]. These were quite unusual.[4] The commentary usually suggests either that they were simply holding companies or that the central control and decision-making did not extend far down into operations [1, 7, 13, 18]. The representative situation was thus either a single store, (or, occasionally, a center city store operating one of a very small number of satellite branches) or a quasi-holding company owning widely dispersed properties under essentially local management.[5]

The scope for profitable coordination, consolidated buying, and similar activities do not appear to have risen at all to judge from the actions of those closest to the profit consequences. The first major consolidation was in 1914. Others occurred fairly steadily throughout the next two decades. Yet

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[3] The *HBR* articles derive from one of the earliest research ventures of the Harvard Business School, the collection of a long time series on department store financial and operating data. For a long run of the data and a retrospective, see [21]. See also [2].

[4] It is a measure of how unusual these were that a company operating only two was noteworthy enough to make a table of examples in a textbook on department store operations published in 1927. (The largest operated eight.) See [9, p. 20].

[5] These suburban branches were first opened in the 1920's [24, p. 1]. In October 1929, only about a dozen stores operated them, and none operated many [3].

Edward Filene's tone in 1927 was that of Cassandra. A Harvard authority, probably Malcolm McNair, wrote that "combinations have failed to provide one of the great advantages of chain stores, namely large-scale central buying" [8, p. 89]. Stanford Business School professor Boris Emmet, writing in 1930, discussed sourly a series of examples and concludes that "[t]hese illustrations may be considered typical of the limited extent of pooled buying in store mergers. Probably less than ten percent of the total volume is bought centrally or in a group way" [10, p. 57]. An authoritative study in the *Harvard Business Review* at the end of the 1920s concluded that "an examination of a number of organizations, each operating several department stores, reveals that central buying is being applied to a very limited extent" [11, p. 265]. Coordination was not occurring.

Filene's view about what needed doing thus seems to have been widely shared. The wolves of the chain stores and mail-order operations appear to have been baying at the doors.[6] Yet apparently nothing was done. Clearly, the department store operators resisted change by allowing their profit margins to erode [19]. This cannot be a complete answer, of course; it only raises the question of why the capital markets let this happen. The snappy and superficially obvious answer is that the capital markets did not come into it: the companies were relatively closely held (see, for example, [6, p. 466]). This is not satisfactory either. The owners could have invested their money elsewhere. They may have received some nonpecuniary pleasure from owning the stores regardless of the extent to which this ownership might diminish their fortunes. So perhaps--and this is how matters are described in the oral tradition of the industry's past--this was simply a mistake, a little like the purported entrepreneurial failure in Victorian England. But as with Victorian England, it is at least worth considering what the decision-maker's choices actually were. The English entrepreneurs and the American merchant families may have had good reason for behaving as they did. There is a plausible line of explanation that fits the facts of the industry and opportunities and does not rely on completely untestable hypotheses.

The key part of stores' internal organization was as follows. Unlike in a general merchandise store, accounts were kept on the basis of broad groupings of merchandise categories (i.e. departments). A major urban department store would have well over a hundred. Each department was headed by an individual--sometimes referred to as a department manager, but more commonly called a buyer--who was responsible for both procurement and sales. These individuals dealt directly with the manufacturers or the manufacturers' sales representatives, committing to product lines and particulars with apparel, (for example, to the selection of sizes, cuts, and colors) as well as hiring and managing their own sales force and having primary responsibility for pricing decisions. The owners monitored buyers'

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[6]On the baying, see [11]. The reliance of the chains on scale economies is obvious. The mail-order house, as a commercial proposition, relied for its viability almost entirely on stock turns and upstream scale economies as well: department stores had generous returns policies. The mail-order houses could not compete on service even in theory.

performance by monitoring the departmental profits. It might seem reasonable to speculate that the owners did not monitor decisions directly because they were ignorant of the details concerning what wise choices were. But the owners directly trained the buyers in their duties. Thus owners knew this key information at least once. One must presume that the owners had grounds for believing that these managers, being close to demand, had the best information about what people were buying. The owners' reluctance to replace decentralized buying with a more centralized function was not passivity in the face of skilled labor: it was recognition of the real impact of information [28]. The two activities--buying and selling--were bundled together because the owners recognized that the two were interdependent; having a means of measuring efficient execution for only the two together, they also wanted to give control commensurate with responsibility. It would have been unfair as well as counterproductive to hold responsible for profits those who did not really control all the decisions that influenced them.

The stores may also have been shifting their focus toward fashionability in response to the threat of the chains [22]. This is certainly a familiar pattern in the history of retailing [20, pp. 17-18]. It would in itself have subverted coordination: central buying was most common in staple rather than fashion goods [15].

One finds some confirmation of this line of argument in exploring the period's organizational innovation. Almost all consolidations were merely financial and involved no major operating changes or altereations in job scope. But a number of groups of department stores and department store holding companies set up cooperative organizations, many of which survive to this day and whose purposes and *ex post* activities bear examining [6; 18, pp. 4-5].

The official purposes of these new organizations were generally two: cooperative buying and figure exchange. Cooperative buying is the pooling of orders with common manufacturers to achieve and share out scale economies in production. Traditionally, the cooperative fixes designs, and the members commit to quantities. From the start, cooperative members have been relatively unenthusiastic about doing this for any other than staple goods. Even there, they have often insisted upon retaining some independent choice and supply. From the start, commentators remarked caustically about opportunities missed since maximal scale economies would only come from broad and rigid commitments to uniform styles and colors. The figure exchange activity had more or less the opposite reception. It was enthusiastically taken up at the time, and the enthusiasm and appreciation have persisted to the present day. Statistics on sales, inventory turnover, and other aspects of the business operation were collected with relatively standardized definitions on a store-by-store basis. These were circulated among cooperative members (i.e., the owners). Previously, the owners could assess department manager performance only via the crude instrument of comparing departmental profit rates with a hurdle rate or with the performance of other departments that sold different merchandise. The statistics gave owners a vastly more reliable means for telling whether the department heads were doing their jobs well [23].

One hears a further echo of this theme in commentary about the foundation of Federated Department Stores in 1929. Decision-making was to remain decentralized.[7] But the consolidation would bring a common set of accounting definitions and procedures.[8] Given that the owners did not also want to centralize decision-making, this was nothing but the figure comparison scheme internalized.

The Shift in Relative Costs and Its Expectable Consequences

In terms of the economist's usual primitive categories of endowments, tastes, and technology, the change between the two periods that I want to focus on concerns technology.[9] By technology, I mean all the exogenous elements in the process of stores deciding what goods they want to stock, acquiring, displaying, and selling them, and actually getting control of the money. In the period in question, there was little radical change in this process. By comparison, the relative costs of anything to do with gathering, processing, analyzing, or transmitting information did drop radically. IBM began producing the products for which it is now famous well after the second World War. As the interwar period ended, the most sophisticated and swiftest computing machine was an electrified version of a hand calculator. The only means of moving coded information from one place to another other than by hand were telephones, telexes, and telegraphs, and there were no widely used means of running their inputs directly into calculators. (Indeed, there would have been no point. Calculators did not run programs.) "Manual unit control"--sales ledgers with information entered and subsequently transferred to inventory accounting systems by hand--was still commonplace in the early 1950s. One would expect the subsequent rise of mainframes and then distributed data collection and processing to have consequences for profit-maximizing (and thus durable) organizational strategies.

One setting in which responses might occur concerns the division of labor discussed above. Cheap information gathering--for example, from point-of-sale input--meant that one central buyer could learn a great deal (and very quickly) about what was being bought. Cheap data processing and analysis enabled the buyer to discern subtle patterns by holding constant the influences that varied across stores. For parallel reasons, monitoring and comparing the performance of individual buyers and sales people became vastly more

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[7]Indeed, this was a very long time in changing. Sixty years later, Federated was still known in the trade as a collection of baronies rather than a single integrated company. It seems that only the exigencies of bankruptcy have any chance of changing the situation.

[8]See also the discussion of the motives behind the consolidation that ultimately became Allied in [26]. The motive behind the Federated consolidation (and others, for that matter) may not have been efficiency at all. Desires for liquidity, orderly management succession, or geographical diversification are all plausible motives.

[9]For a preliminary discussion of the others, see [25].

effective, lessening the need to bundle the functions together. Thus buyers (whose salaries represented fixed costs to their firms) could be freed to buy intelligently for many more stores than before. That constraint of the earlier period was relaxed.

A second setting concerns relationships with upstream suppliers. Traditionally, orders are placed a season in advance--six to nine months before the goods go on the shelf. This is not very attractive for two distinct reasons. It ties up money for a long time. It also requires the buyer to commit on the basis of very little information concerning what people are buying in the season in question, how real incomes are evolving, and how acquisitive customers are feeling. With cheaper information gathering and processing, the precision with which sales can be forecast in a more timely manner increases. This increases the value of being able to commit closer to the date of expected sale.

The first of these makes seizing all possible economies of scale more attractive. The second makes shorter production runs and more variety in general more attractive. There are, of course, other consequences to the changing information costs that I have not mentioned. The point is that the balance of advantages between them all is an empirical matter. It is one of history as it has emerged, not one of theory. But in principle, it is possible that the advantages of scale, of profit through volume, no longer dominate other advantages and sources of profit, that is, of customer value.

Now

If one looks at prominent department store retailing firms circa 1990, Filene's program seems to have been realized. The groups are obviously much larger. It is far commoner for buying and selling to be separate responsibilities. In the largest groups, there is a substantial amount of centralization of merchandising. Those groups appear to regard it as a central source of their competitive advantage. The coming to power of these centralizers is generally thought to have been one of the two main developments in department store retailing in the past ten to fifteen years.

For some time those groups have been doing distinctly better than their less centralized department store competitors. It would be fair to say, however, that the whole category of department stores has not looked like an attractive investment over the period in question. In particular, their franchise has been under attack from a number of directions. Some of these, in their methods of doing business, may suggest the central strategy of the prominent department store operators: the most obvious examples of these are the mass merchandisers and discount stores. The others--the so-called narrow-and-deep-selection specialty stores such as the Gap and the Limited--are about something different. Strategically speaking, their focus is not on price. It is on offering to customers selections of relatively fashionable goods and basing use selections on extremely up-to-date information about what consumers are buying. They often make final commitments on a 30-to-45-day basis rather than the six to nine month one.

The other major event in recent years concerned Allied and Federated. Among the large traditional department store groups, these had performed in a notably lackluster way in the 1980s. When takeover attention turned to department stores, it was not surprising that the attention focused on them.

Campeau, at the time a Canadian developer with ideas about building malls, first purchased Allied in a hostile takeover. The transaction was financed by junk bonds and paid for in significant measure by subsequent sales of the company's assets. A year and a half later, while the effort to reorganize the shrunken Allied into a stable and profitable enterprise was still under way, Campeau bid for Federated. The stock had been trading for $33 a share in the period following the October 1987 stock market crash. Campeau opened the bidding at $47 a share. Federated's investment bank shopped for bidders, and an auction followed. Campeau eventually bought the company for $72.50 a share.

Among the rationales offered to investors--those who were contemplating buying the bonds--were a number of species of scale economies and bigger-is-better arguments. It is not clear precisely what the market believed; but Campeau certainly believed the rationales and he succeeded in borrowing enough to buy Federated. Once he owned it, he proceeded to operational measures: ruthlessly cutting most categories of overhead expenditure, attempting to radically restrict the number of vendors the stores bought from, negotiating for lower prices from those among whom business was to be concentrated, and so on.

Within a year and a half, however, it emerged that Campeau had paid too much for the company. Federated ran out of money and declared bankruptcy in January of 1990. A year later, it seems clear that shareholders and bondholders, among others, have lost a great deal of wealth. But it is not clear that the new management team reorganizing the company will sell off businesses or adopt a radically different operating strategy. They are respected traditional department store merchants and the main innovations they have proposed are in the way of increasing centralization of operating decisions.

Fate and Opportunities

Someone who believes that the way to follow an industry is to look at practice and strategy by studying cross-sections of the largest companies would conclude that bigger department store groups have a brighter future. Someone who thinks that the right method is to follow practice and strategy in successful firms that seemed to stay successful would conclude the same. The fate of department stores would seem clear to them. The trend is remarkably consistent over a long period and is even visible through the haze of occasional entrepreneurial missteps. Recent changes in relative costs certainly might improve the benefits of scale.

Such analysts would be surprised to discover that the most prosperous businesses sharing a customer base with traditional department stores are roundly out-competing the department stores and have a very different view of why they are able to do so. Their scale is in fact bigger, but they think the

economies central to their success concern timeliness rather than scale; and they think nothing of leaving on the table large fractions of the scale-related cost advantages that their custom offers their suppliers in exchange for being able to order at the last possible moment. Salmon and I have calculated, in a first pass, that in the comparable departments, the overall cost advantages vis-a-vis the department stores are on the order of 60 to 70% of operating income stated as a percentage of sales [25].

This has two implications. In terms of department store practice, it says that in retrospect the 1980s and 1990s will not look like the 1920s and 1930s all over again. Size will confer advantages in bargaining with upstream suppliers, but scale will not be the key to competitive success. It might have been otherwise; but the evidence through 1991 suggests that increasingly heterogeneous and fashion-conscious customers will value selection over price and will reward stockholders accordingly. Decision-making may or may not emerge more centralized. This will depend upon the extent to which data analyzed by computers supplants the on-site observations of buyers. However many people make the decisions, the decisions will be much more provisional. Cheap information is central to this, but not perhaps in the most obvious way. If distribution and manufacturing are becoming more closely linked and department stores are thus becoming more like factories, the factories in question are in Toyota City, not the environs of the River Rouge. And there is no particular reason to believe any of this will prove to be a distinctively American phenomenon. The management techniques are not subject to patents; and the computers that do much of the implementation are available internationally.

I also see a methodological implication for business historians. (That is, I think the moral is global rather than local in the mathematical sense as well as the geographic one.) To study the trade of only the leading firms at a time when the population of firms--and thus of competitive strategies--serving traditional customer needs is changing gives a biased view. If one is committed to a longitudinal approach--that is, to narrative--one needs to ground one's story in a context that is not changing. The right approach would be to study not the fortunes of the department stores but rather the opportunities and behavior of the people who might shop there and the evolution of the means of meeting their needs. One would need to begin with detailed studies of innovations and their economic or otherwise evolutionary implications. This method can lead to rich descriptions of institutions and their growth, and it can do so in a way that gives real explanations rather than mere descriptions.

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