

In The Press

Who Will Buy It?

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THE NATION'S LARGEST PURVEYOR OF CONSUMER GADGETS HOPES TO BUILD ITS BUSINESS BY TAPPING THE WALLETS OF JILL, BARRY, BUZZ AND RAY

By UNMESH KHER

Not everybody has the peculiar neurons needed to link a laptop to a wireless modem with ease, least of all Charlene Monzo. "I haven't made much progress with computers," she admits. "I'm paper generation." That's why Geek Squad double agent Cyrus Tavadia, decked out in his black-and-white uniform, with white socks and clip-on black tie, has dropped by her 35th-floor Manhattan apartment--to connect the technophobe wirelessly to the hyperlinked labyrinth of the World Wide Web. Under his polite tutelage, Monzo, 55, learns in a couple of hours how to use the computer mouse, launch Internet Explorer and--the main thing--look for jewelry and fashion sites on Google. The setup and an hour-long training session cost \$159 each, but when Tavadia's done, Monzo all but begs him to come back. "He's amazing," she exclaims. "He's fabulous. He explains everything."

That kind of reaction is music to the ears of Best Buy CEO Brad Anderson, who is on a campaign to reinvent the U.S.'s leading consumer-electronics retailer as not just a seller of digital TVs and portable electronics but also a provider of tech services for consumers and small businesses. With about 16% of the \$124 billion domestic consumer-electronics market, Best Buy offers Anderson a solid and profitable perch from which to begin. Morgan Stanley estimates that Best Buy had sales of \$27.5 billion in the fiscal year just ended, up from \$12.5 billion five years ago. Archrival Circuit City has seen sales decline from \$12.6 billion to an estimated \$10.3 billion over the same period. Research firm Retail Forward says Best Buy generates \$870 in sales per sq. ft. of retail space, in contrast to Circuit City's \$480. (Highfields Capital, a large Circuit City investor, offered to buy out the company for \$3.25 billion last month.)

But Best Buy's competition is far broader than Circuit City, from direct sellers like Amazon and Dell to the quintessential category killer, Wal-Mart, which analysts estimate sold \$17 billion in electronics in 2004. With challengers like those, Best Buy knows it cannot compete on price alone. Instead, CEO Anderson, a 32-year veteran at the company who began as an in-store salesman and ascended to the top job in 2002, wants Best Buy to differentiate itself by focusing on upscale customers and providing them with the hand holding and service that today's increasingly complex electronics invite but that the Wal-Mart's of the world, with their lean staffing, aren't equipped to provide.

The Geek Squad is one part of that effort. Best Buy bought the business--an independent computer-support firm based in Minneapolis, Minn.--from its founder, Robert Stephens, in 2002, after working with Geek behind the scenes for two years. Today there are 7,500 agents spread across all 668 of Best Buy's U.S. stores, led by "chief inspector" Stephens. So-called counterintelligence agents work inside the stores

to help befuddled shoppers select their wares, while badge-toting double agents like Tavadia make house calls in branded, black-and-white Volkswagen Beetles. "I'm trying to build an army," Stephens likes to say, "and my goal is complete world domination of the computer-support-services market."

But Geek is only one part of Anderson's integrated plan to refocus his company on its customers--from in-depth research that identifies what types of consumers contribute most to Best Buy's margins to specifically targeted storefront and marketing operations to boost their patronage. Best Buy calls that aspect of its strategy "customer centricity," and it is already in action in 67 "segmented stores" that have been rolled out in the West. In fact, the company has identified five customer types to target and conferred names on four of them: Jill, the soccer mom; Ray, the family man; Barry, the affluent, married male professional; and Buzz, the tech enthusiast. The unnamed group: small-business owners. "Best Buy wants to tailor each store's assortment [of products] to the customers that are actually going to shop at that store," explains Morgan Stanley analyst Gregory Melich. "In a way it sounds elementary. But, believe it or not, a lot of retailers don't do it." A store catering to Barrys, for instance, would promote high-end entertainment systems; a store for Jills would dedicate more real estate to things like learning software.

Anderson's bet is that the right kind of consumer experience can trump low prices, and there is evidence to back up that thinking. Darrell Rigby, head of the global retail practice at the consultancy Bain & Co., points out that Wal-Mart has yet to gain more than a 30% share of any of the regional markets it enters; two-thirds of consumers find the products it peddles to be of middling quality, and many dislike the long lines at the cashier. "People seem to be realizing that you get what you pay for at Wal-Mart," says Ryan Erickson, of Holt-Smith & Yates Advisors, which manages more than 1.6 million Best Buy shares.

Still, Anderson's customer centricity is a huge shift in focus for a company that came of age in the 1990s as a warehouse purveyor of affordable gadgetry. By the middle of that decade, in fact, its largely do-it-yourself model was growing so fast Best Buy nearly imploded. After building huge stores that didn't run well and focusing far too much on low-margin gadgets like PCs and CDs, Best Buy paid the price in 1996, disastrously miscalculating its PC inventory and essentially wiping out its profits. Facing a cash squeeze, the company was forced to violate its loan agreements and withhold payments to suppliers.

But Best Buy bounced back. Working with advisers from consulting firm Accenture, the company responded by cutting low-margin goods, tracking computer sales more closely and stocking merchandise more flexibly. By early 1998 it had improved the turnover of its PC inventories from a rate of 8.6 times a year to nearly 12 and begun working on a consistent operating platform. It didn't hurt that demand for new products like DVD players soon skyrocketed. When Anderson moved up from chief operating officer to CEO 21/2 years ago, Best Buy was a tightly run, revived retail juggernaut with 631 stores across the U.S. and 100 in Canada.

But Anderson was nagged by a concern--that Best Buy had somehow turned into a less innovative retailer, one that was so focused on efficiency that it had lost sight of its customers' needs and expectations. In the summer of 2002, he attended a lecture at Best Buy headquarters by Columbia University professor Larry Selden. Afterward, Selden--a proponent of the theory that companies that cater to their best customers while discouraging the worst tend to thrive--hitched a ride with the Best Buy marketing team on a flight to Memphis, Tenn., and wound up quizzing Brian Dunn, today president of the company's North American retail operations, about Best Buy's strategy. Dunn found himself unable to answer a disturbing number of those questions and told Anderson so when he returned. Not long after, Anderson hired Selden as a consultant to help the management team focus less on products and more on customers.

Not surprisingly, Best Buy now emphasizes research in a new way. Consider one of the segmented stores, the 58,000-sq.-ft. outpost in Santa Rosa, Calif. "We gathered information for years about customers," says Best Buy's Jeniece Knoblauch (whose title is "Jill segment manager"). The demographics suggested that Best Buy's most profitable customers in the area were primarily women and small-business owners. So the store was redesigned with those customers in mind, particularly the Jills, soccer moms who live in Sonoma County. The store is bright and airy and dotted with signs to make navigation easy. The Consultation Center for Small Business has its own section at the front of the store. The Geeks, ever ready to offer advice, and tech support for a fee, are a central fixture.

Each morning in Santa Rosa, the managers meet with the staff to go over the store's financial performance. They also prowl for ideas that can help propel sales, like sending gift coupons to customers' kids on their birthdays (an innovation now being considered for a roll-out in Best Buy stores across the country). The Santa Rosa team also helped boost sales of iPods and other hot items in December by displaying the devices at the entrance to the store and posting an employee there who talked to shoppers about the gadgets.

So far the experiment seems to be working. The company says its segmented stores generated sales last year that grew at twice the rate of those at other Best Buy stores. The Santa Rosa property has done especially well, earning \$70 million in revenues last year, vs. \$40 million to \$50 million pulled in by the average Best Buy store in the U.S.

That is not to say Anderson's strategy doesn't carry risks. By varying the merchandise at segmented stores, argues Geoff Wissman of researcher Retail Forward, Best Buy will become more complicated to run, and that could drive up costs. (Anderson says adjustments in inventory management will allow centricity to work efficiently on a large scale.) Best Buy must also read each of its local markets correctly and hire sales personnel carefully and effectively enough to make the murky area of service a distinguishing characteristic. Analyst David Ricci of William Blair says Best Buy was forced to scale back its segmented stores in Chicago in part because the staff was not sufficiently prepared. "We are still learning," says Michael Linton, Best Buy's chief marketing officer. "We've just scratched the surface from a marketing perspective."

Anderson admits there are pitfalls. "The biggest single risk," he says, "is that [centricity] is tremendously challenging to our employees." Meanwhile, the business skills that successful employees do pick up could make them tougher to retain. But with Wal-Mart bearing down on Best Buy's turf, the true risk might be to do nothing at all. As Bain's Rigby observes, "Growth is risky. But so is stagnation."

--With reporting by Sarah Sturmon Dale/ Minneapolis and Laura A. Locke/ Santa Rosa