

LEVI'S AT WAL-MART?

Introduction

In early 2002, Phil Marineau, CEO of Levi Strauss & Co., was thinking about whether he should direct his company to sell its product in the world's largest retail store, Wal-Mart. Levi Strauss had posted a decrease in sales for the past five years, and Marineau was eager to stem the decline. Since joining the company in 1999, Marineau had embarked on an aggressive plan to turn the company around by implementing new business strategies that included shuttering 16 North American manufacturing plants and moving the production to cheaper offshore sources. In the marketing area, Marineau had worked to revive the brand image by launching a series of new advertisements and product placements to broaden the appeal beyond the 15-to-19-year-old segment.

Marineau and his management team sensed that the Levi's brand was being challenged at all points along the spectrum. The high-end segment was dominated by trendy brands such as Tommy Hilfiger, Calvin Klein, Ralph Lauren Polo, and Diesel. In the middle segment, Levi Strauss competed with vertically integrated retailers such as the Gap, American Eagle Outfitters, and Abercrombie & Fitch. Meanwhile, retailers such as Wal-Mart, Target, JCPenney, and Sears had built their own private-label brands, offering comparable designs at significantly reduced prices. With Levi's selling in several chain and department stores, the company often found itself being used as a loss leader, with Levi's heavily discounted to the end consumer. Now Marineau and his management team had to decide whether to sell Levi's in Wal-Mart and, if so, what approach to use.

The company had maintained a 10-year relationship with Wal-Mart during the 1980s and 1990s by selling them a value brand called Britannia. Wal-Mart stopped dealing with Levi Strauss in 1994, however, after a dispute in Canada, when Levi Strauss executives refused to maintain a supply of Levi's Orange Tab jeans in Wal-Mart's newly purchased Canadian stores (previously Woolco stores).¹ With sales of Britannia dropping drastically thereafter, Levi Strauss sold the Britannia brand to a competitor, VF Corporation, in the mid-1990s.

¹ Louis Trager, "Wal-Mart, Levi's in Battle Over Jeans," *Los Angeles Daily News*, September 9, 1994, B2.

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As of early 2002, Levi Strauss was considering rekindling the Wal-Mart relationship by offering it a new value brand. Marineau and his management team had one central question: How should the brand be developed to preserve sales with existing customers in other channels? “There are 50 million pairs of jeans sold in discount stores,” Marineau said, “and we are in the business of making pants. We would be crazy not to be looking at other Levi’s brands that could be sold in those channels.”²

Apparel and Jeans Market in the United States

Approximately 569 million pairs of all types of jeans were sold in the United States in 2001, throughout all consumer segments, which represented an increase of 2.7% over 2000.³ Total jeans sales were estimated to be \$11.7 billion⁴ out of a total apparel market of \$166 billion. The apparel market had been steadily growing since 1998, but experienced its first decline in 2001, dropping 5.7% in dollars from the prior year.⁵ As an expert tracking the apparel industry stated, “2002 will be a very interesting year for the apparel industry and will see a slow road to recovery. Certain categories and consumer segments are expected to see slight increases, while most categories are expected to remain flat or decline in dollar sales.”⁶ **Exhibit 1** shows the market size of the entire apparel market and the breakdown of apparel sales by retail channel.

Within the apparel market, several categories of pants existed with casual pants, dress pants, and jeans being the largest. During the late 1990s, jean sales had leveled off as consumers’ tastes shifted to khaki, cargo, and other types of techno-fabric pants. By 2001, however, denim sales were rising as consumers migrated back to jeans. They were attracted by several innovations in fabric and in style. The jeans market was expected to grow by 2% to 3% in 2002.

The average price for a pair of jeans hovered around the \$20 mark for both men and women, with over 40% being sold (either as original or marked-down price) below \$20.⁷ The average price of jeans had dropped over the previous 10 years due to the proliferation of off-pricing and private-label brands. One study by Cotton Incorporated showed that none of the top-19 brands of jeans in both the women’s and men’s segments was able to increase its brand premium when compared to the average price of jeans in an eight-year period. In the men’s jeans segment, 11 of the 19 brands lost their premiums, and in the women’s segment, 14 of the 19 brands lost their premiums over the market’s average.⁸ The same study suggested the following to avoid losing price premiums:

² Sarah Butler, “Levi’s Rules Out Red Tab Sales to Value Sector,” *Drapers Record*, March 30, 2002, 3.

³ VF Corporation annual report, 2001.

⁴ VF Corporation annual report, 2003.

⁵ “Reports 2001 U.S. Apparel Industry Down for First Time in Three Years,” April 29, 2002, <http://www.fashionworld.com> (accessed March 3, 2005).

⁶ “Reports 2001 U.S. Apparel Industry Down for First Time in Three Years.”

⁷ Scott Malone, “Retail Revolution—Levi’s Considers Selling to Wal-Mart as Sales Slump,” *Women’s Wear Daily*, January 17, 2002, 1.

⁸ “Does Branding Combat Price Deflation?” Cotton Incorporated, Winter 2003, <http://www.cottoninc.com/TextileConsumer/TextileConsumerVolume31/?Pg=2> (accessed February 2, 2010).

One [solution] is for a brand to resist diluting its premium through discounting or marketing in too many different retail channels. Once consumers see a brand offered simultaneously at different channels, such as department stores and mass merchants, the ability to maintain a positive brand premium may be fatally compromised. A better strategy is to introduce a different brand name, perhaps affiliated with the original brand, but with enough independent brand identity so that consumers and retailers can differentiate products. Without differentiation, apparel products will compete largely on the basis of price. Another strategy for preserving brand premium focuses on emphasizing the non-price attributes of the brand. Attributes such as packaging, labeling, and customer service can enhance a brand image without compromising the brand's retail price.⁹

The largest and fastest-growing retail channel for jeans and apparel was the mass merchants channel made up of Wal-Mart, Target, Kmart, and several other smaller retailers. In January 2002, Kmart filed for bankruptcy protection after a soft holiday season and intense competition left it in a precarious financial situation.¹⁰ An industry analyst talked about the increasingly blurred lines separating the channels:

Retailers will be challenged in 2002 with the need to distinguish themselves from one another. With the melding of channels, department, chain, specialty, and mass merchant, retailers are looking for more of the same with similar merchandise. This allows the consumer to be able to switch channels for apparel shopping and seek the value experience, and find fashion value at lower prices. Department and specialty stores will really need to work hard to make themselves what they once were: special and different.¹¹

Jeans Consumers

Jeans were garments worn in a variety of settings—by people as diverse as manual laborers and models on the haute couture catwalks in London, Paris, and Milan. Denim jeans were considered truly egalitarian. As one academic wrote, “Jeans have the ability to conceal class distinction. When a person wears blue jeans—be it President Bill Clinton or a truck driver—the viewer is nebulous about the beholder's status.”¹²

Styles varied as much as settings. Jeans were inextricably linked with music, given that certain styles of jeans were often part of a group's costume—tight black jeans were an essential wardrobe item for Goth dressers, no-nonsense straight-leg blue jeans were worn by country and western musicians, and oversized, baggy styles were adopted by hip-hop artists. In younger age

⁹ “Does Branding Combat Price Deflation?”

¹⁰ “VF Corp. sees no material impact from Kmart,” Reuters, January 22, 2002.

¹¹ “Reports 2001 U.S. Apparel Industry Down for First Time in Three Years,” April 29, 2002.

¹² C. Magocsi, “The Gentrification of Blue Jeans,” University of Toronto, http://www.chass.utoronto.ca/history/material_culture/cynth/index.html (accessed February 2, 2010).

groups such as 15- to-19-year-olds, it was normal to own between five and eight pairs of jeans of a variety of brands. Men and women over 35 had between three and five pairs of two to three brands.¹³ In general, men and women over 35 spent half as much on jeans each year as members of the 15-to-19-year-old group. The over-35 group purchased fewer pairs per year, and they spent less on these purchases. The 15-to-19-year-old set purchased the more expensive brand names, while consumers over 35 preferred inexpensive brands and the availability of larger sizes and private labels.

Levi Strauss & Co. History

Levi Strauss was born in Buttenheim, Bavaria (modern-day Germany), in 1829, and moved to the United States in the 1847. After initially teaming up with his two half-brothers to run a dry goods business in New York, he relocated to San Francisco and started his own dry goods business in 1853. Nineteen years later, Strauss received a letter from Jacob Davis proposing that the two of them apply for a patent on a new invention: riveted denim pants. On May 20, 1873, the two men received U.S. patent no. 139,121 for men's riveted work pants and immediately started producing what were at that time called "waist overalls." They soon realized that they were filling an important niche with their sturdy, durable garment. By around 1890, "lot number 501" was being used to designate the copper-riveted overalls later known as jeans.

After the death of Levi Strauss in 1902, family members continued to run the business and developed Koveralls, one-piece play suits for children, in 1912, and Freedom-Alls, one-piece work suits for women. Around this time, the company established a relationship with Cone Mills to supply denim for key products—a relationship that still existed in 2002.

During the Great Depression of the 1930s, Levi Strauss avoided layoffs by giving workers shorter workweeks or assigning nonmanufacturing activities such as maintenance and improvement of the facilities to employees. Near the end of the decade, Levi's jeans were popularized by actor John Wayne's appearance in the movie *Stagecoach*—the jeans were a vital component of his wardrobe—and they became a common sight at dude ranches throughout the country. In the 1940s, Levi Strauss & Co. took the leadership position on social issues by being one of the first companies in the United States to promote integrated factories, with individuals from several cultures working side by side. The company also advertised in a number of languages to reach the burgeoning immigrant market within the United States.

Levi's took another marketing turn in the 1950s, when teenagers became the central focus in advertising for the brand. With movies such as *The Wild One*, featuring Marlon Brando in Levi's 501 jeans, the brand became associated with the rebellious "Beat Generation," the precursor of the 1960s countercultural revolution. Levi's jeans were becoming branded with the key attributes of rebellion and originality. (The "Right for School" campaign, however, drew responses to the contrary.) When Marilyn Monroe appeared in Levi's jeans in a photo shoot, the brand became sexier and appealing an alternative to skirts and other types of pants for women.

¹³ "Does Branding Combat Price Deflation?"

The company worked to expand the Levi's brand by moving into product lines such as Lighter Blues, Denim Family, and Casuals, the latter of which was adapted to meet the style of the 1960s with polyester blends and greater color variety.

Levi's expanded into international markets in the 1950s. In 1969, the brand received further recognition through a famous photograph of the jeans being worn at the legendary Woodstock music festival. The company set up a European division in 1965 and during the next decade expanded throughout the world and into Asia, with Japan becoming the first Asian affiliate in 1971.

The company's ability to create relevant and "cool" products for the teenage set as well as its progressive working conditions—such as being the first to offer benefits to the unmarried partners of their employees and one of the first companies to offer support to AIDS victims—made Levi Strauss a heralded and well-respected *Fortune* 500 enterprise.

By the 1980s, the company had several diverse interests ranging from dress-suit production to owning part of a hat manufacturer. In 1984, the company went through a major refocusing when it shed many of its noncore subsidiaries and based its marketing efforts on its star product—501 Levi's. The timing was ideal—the company rode the wave of Bruce Springsteen's multiplatinum album "Born in the USA," the cover of which showed Springsteen's backside clad in a trusty pair of 501s. The refocusing effort led by Strauss descendent Robert Haas put the company back on track as a profitable and focused organization.

Seeing an opportunity to open up a new segment in the pants market, the company launched Dockers pants in 1986, as a casual alternative to dress pants and jeans. The success of Dockers was unabated. From its launch in 1986 to 2002, when Dockers introduced a line of pants for women, the overall brand grew to over \$1 billion in annual sales.¹⁴ The company decided to offer styles for the discerning young consumer and launched its Silvertab jeans in 1988. By 1996, Levi Strauss was at the top of its game—it had built a truly global brand with efforts such as "Clayman," the company's first global commercial, and its iconic 501 jeans continued to grow. The company had become the world's largest apparel manufacturer, with sales reaching a record \$7.1 billion. **Exhibit 2** shows a sample of Levi Strauss & Co.'s historical advertising images.

Levi Strauss & Co.: 1997 to 2002

Coming off a record year of sales in 1996, the company's sales began to decline from \$7.1 billion and net income of \$465 million in 1996, to \$5.1 billion and net income of \$5 million in 1999. By the close of the 2001 fiscal year, the company's sales had eroded further to \$4.3 billion. During the same period, Levi Strauss restored net income to \$151 million. The company was carrying debt of \$2 billion, with some of the notes being graded as one category

¹⁴ Levi Strauss annual report, 2002.

away from junk status as of early 2002.¹⁵ **Exhibit 3** shows financial highlights from 1997 through 2001.

Levi's brand market share in men's and women's jeans fell from 18.7% in 1997 to 12.1% in early 2002.¹⁶ In the men's jeans market, the company's mainstay category, the brand held 48% market share in 1990, but had decreased to approximately 20% by 2002.¹⁷

Levi Strauss's decline was attributed to several factors, such as increased competition in both the high- and low-end segments of the market. On the high end, image-conscious consumers were reaching for designer brands such as Tommy Hilfiger, Ralph Lauren Polo, and Calvin Klein. Other smaller premium brands such as Miss Sixty, Diesel, and Guess were all gaining momentum by offering fashion-forward designs, finishes, fabrics, and fits. On the opposite end of the spectrum, major retailers such as JCPenney, Sears, Wal-Mart, Target, and Kmart were all realizing major market-share gains offering private-label jeans at under \$20 a pair.

Competing head-to-head in the same price category with Levi's jeans were vertical retailers such as the Gap, American Eagle Outfitters, Abercrombie & Fitch, J. Crew, and Eddie Bauer. These vertically integrated specialty stores controlled all aspects of product design, store design, and store operation. The Gap even had an in-house advertising department. These chains were credited with offering a consistent image across all formats and having the advantage of placing products directly in the stores instead of having to sell to independently owned retailers.

After being criticized for not being up to date with the shop-within-shop concept, the company invested heavily in education to learn more about in-store merchandising. One outcome was more than a dozen stores owned and operated by Levi Strauss & Co. in high-profile locations such as New York City. The company had a total of 3,300 retail customers at more than 20,000 locations.

Observers felt that the Levi's brand was caught in the middle. Priced between \$30 and \$50 a pair, the jeans did not offer the same image or design as the high-end brands or the complete wardrobe selection of the vertically integrated retailers. Also, they did not offer the inexpensive alternatives found through private labels. To offer the lower price points, pundits suggested that the company eliminate its costly overhead of maintaining its North American-based production sources. In 1997, the company started closing its North American production facilities and further developed offshore sources of production with third parties in Asia, the Caribbean basin, and Latin America.¹⁸ While it provided lower cost per unit, the company struggled to cover the costs of its restructuring charges for both manufacturing and non-

¹⁵ Levi Strauss annual report, 2002.

¹⁶ Louise Lee, "Why Levi's Still Look Faded," *Business Week*, July 22, 2002.

¹⁷ Ralph T. King Jr., "Infighting Rises, Productivity Falls, Employees Miss Piecework System," *Wall Street Journal*, May 20, 1998. Note: The 2002 share derives from a case writer estimate.

¹⁸ The company had used offshore suppliers since the 1980s and had created a groundbreaking Supplier Code of Conduct in 1991.

manufacturing staff. From 1996, the company reduced headcount by 33%, moving from a worldwide total of over 25,000 employees to 16,700 by the end of the 2001 fiscal year.¹⁹

In 1999 Robert Haas stepped down from the CEO post, handing control over to the second nonfamily leader in the company's history—Phil Marineau. Marineau had over 25 years of experience in consumer packaged goods companies, working for 23 years and later holding the president and COO positions at Quaker Oats. There, he was credited with leading the global growth of Gatorade. Later, Marineau worked for a short time at Dean Foods and then moved to Pepsi-Cola North America for two years before being recruited to head Levi Strauss & Co.

Levi's Product Lines

In 2002, Levi's brand represented 74% of the company's worldwide sales and 65% of sales in the Americas, with the remaining 9% derived from the Dockers brand and other smaller offshoots.²⁰ The brand comprised several product lines for men and women (see **Table 1**).

Industry observers frequently talked about Levi's product lines being arranged in a pyramid, with fashion-forward designs such as Levi's Vintage Line, Levi's Red, and Levi's Premium at the top, followed in order by Levi's Engineered Jeans, Levi's Silvertab, and Levi's Red Tab. The product lines at the top of the pyramid were intended to create a halo effect on the overall brand, enhancing its image and fashion relevance. The company did not allow all its retailers access to higher-image brands. For example JCPenney was not offered Levi's Vintage or Levi's Red, but was instead presented with the full range of Levi's Red Tab and Silvertab products. Each product line had a target consumer—the higher-end brands were aimed at trend-conscious buyers in the 15- to 24-year-old range, whereas the Levi's Red Tab line had jeans suitable for more than 10 to 12 different body shapes and styles that included straight-leg, relaxed, baggy, boot cut, and slim. The company used the combination of fit, fabric, and finish as key differentiators for its target consumer and price point. Prices for Levi's Red Tab line had historically been double the price of the average jean. In the past five years, the average price paid at retail for Levi's jeans had been dropping, and was approximately 1.5 to 1.75 times the market average.²¹

¹⁹ Levi Strauss annual report, 2001.

²⁰ Levi Strauss annual report, 2002.

²¹ Case writer estimates.

Table 1. Levi's product lines.²²

Product line	Description	Distribution Channel	Retail Price Point
Levi's Vintage Clothing and Levi's Red	Small group of premium tops and bottoms that were based on key heritage styles with premium fabrics.	High-end specialty stores Independent shops	Bottoms: over \$100
Levi's Engineered Jeans	Group of tops and bottoms that were engineered for special mobility	Specialty stores Independent shops Original Levi's stores	Bottoms: between \$50 and \$80
Levi's Premium Red Tab	Variations of Levi's Red Tab products with changes to fabrics and finishes	Specialty stores Independent shops Original Levi's stores	Bottoms: between \$50 and \$100
Levi's Red Tab Levi's Silvertab	The core of the Levi's brand including the classic 501 button-fly jean, as well as a series of models from the 505 through 579, featuring slim, baggy, straight-leg, boot-cut and superlow fits. The line also included tops and jackets. Urban-inspired denim fits and techno-fabrics such as slick cotton and nylon-blends	Department stores Chain stores Independent shops Original Levi's stores Department stores Chain stores Original Levi's stores	Bottoms: between \$30 and \$50 Bottoms: between \$25 and \$50
Other Levi's products	Included all other products such as additional tops, jackets, outerwear and licensed products such as hats, bags, belts, socks, underwear, and footwear	Department stores Chain stores Independent shops Original Levi's stores	All price ranges depending on product category

Source: Created by case writer.

Levi Strauss & Co. was constantly releasing new products that fell somewhere within the pyramid structure. For example, a refreshed design of Levi's 501 jeans was in process with a release date planned for 2003. Also scheduled to hit stores in 2003 was Levi's Type 1, a new product line, which accentuated the trademark Arcuate²³ stitching design.

Levi's new product releases had mixed results. For example, the release of Levi's Engineered Jeans in 2000 was highly successful in Europe and Asia but failed to prove viable in the United States. The design direction for Levi's Engineered Jeans was to start from zero and recreate a new jeans blueprint. The result of the new design was a reconstructed and re-engineered jean that had a twisted and bent pant leg for greater mobility. Fashion commentators believed that it was a breakthrough and soon many top-end brands such as G-Star and Diesel began their own designs based loosely on the Levi's pattern for Engineered Jeans. Despite this success with high-end brands, however, consumers of U.S. jeans did not adopt the innovation en masse.

²² Compiled by case writer based on information at retail locations and Levi Strauss annual report, 2001.

²³ Arcuate was the name given by Levi Strauss to the Levi's trademarked "V-like" stitching on the back pockets of a pair of Levi's jeans.

Advertising and Promotion

The Levi's brand was rated as the number-one apparel brand for brand awareness and brand retention.²⁴ U.S. advertising and marketing for the Levi's brand in 2002 was estimated at \$139 million. This budget included outlays for television advertising, billboard, print, and other media events and sponsorships.²⁵ By comparison, Nike, a company more than double the size of Levi Strauss & Co., invested \$998.2 million (10.5% in revenues) in advertising in 2001, and \$974.1 million (10.8% of revenues) in 2000.²⁶

As part of an integrated marketing approach, the company frequently promoted music and theatrical productions in exchange for brand advertising at the venue as well as product placement on the artists. Sponsored artists included tours by Lauryn Hill, Massive Attack, Jamiroquai, Christina Aguilera, Mariah Carey, De La Soul, Ben Folds Five, and the White Stripes. It used star talent such as Christina Aguilera and Mariah Carey in coordination with the release of Levi's Superlow jeans. For 2002, the brand was planning to tie in product with the World Cup soccer event in Korea by sponsoring Korean soccer star Song Chong Gug.²⁷ To augment traditional approaches, the Levi's brand also worked to get product placement on television shows, feature films, music videos, and on the pages of top fashion magazines.

Channels of Distribution

Jeans channels could be grouped into six main categories within the U.S. denim landscape:

1. Chain and department stores such as JCPenney, Macy's, Sears, May Department Stores Co., and Kohl's
2. Image department stores such as Bloomingdale's, Nordstrom, Neiman Marcus, and Saks International
3. Independent shops or "jeaneries"
4. Specialty stores such as the Gap, Old Navy, Abercrombie & Fitch, American Eagle Outfitters, and Original Levi's Stores (the only one of these to stock Levi's)
5. Mass merchants such as Wal-Mart, Target, and Kmart
6. Off-price channels such as Costco, Levi's Outlets, and TJ Maxx

²⁴ Levi Strauss annual report, 2002. Note: Brand retention was defined as the percentage of all past-12-month purchasers who planned on buying the brand in the future.

²⁵ The 2001 annual report indicated approximately 7% of sales was spent on various media. This figure was derived by multiplying 7.4% times \$4.1 billion in sales times 65% domestic sales times 74% of domestic sales for Levi's brand.

²⁶ Nike, Inc., annual report, 2002.

²⁷ Levi Strauss annual report, 2001.

The mass channel sold an estimated 31% of all jeans in the United States.²⁸ The breakdown of total jean sales and Levi's brand sales by channel is shown in **Tables 2 and 3**.

Table 2. Jean sales in the United States by channel (percent).

Mass	31
Specialty	23
Chain	18
Department stores	16
Other	12
Total	100

Data source: Levi Strauss annual report, 2001.

Table 3. Levi's brand sales in the United States by channel (percent).

Chain and department stores	58
Independent	8
Specialty	3
Image department stores	2
Mass	0
Other	29
Total	100

Data source: Levi Strauss annual report, 2001.

The Levi's brand was not present in the mass merchant channel in the United States. The single largest customer for Levi's brand sales was JCPenney, which accounted for over 10% of the company's overall sales.²⁹ In 2002, along with JCPenney, the top 10 customers in alphabetical order were Costco, Casual Male Retail Group (formerly Designs, Inc.), Dillard's, Federated Department Stores (owners of Macy's and Bloomingdales), Goody's, JCPenney, Kohl's, May Department Stores Co., the Mervyn's unit of Target Corporation, and Sears.³⁰

Competition

Given the fragmented nature of the fashion industry and the jeans market, the Levi's brand competed across a wide spectrum of brands. Competitors chose to either fight for market share based on price or sought consumers willing to pay a premium for image, design, fit, and finish. The first category was dominated by mass-market private labels from Wal-Mart, Target, Kmart, Sears, JCPenney, and Macy's. The second category was rife with examples from high-

²⁸ Levi Strauss annual report, 2001.

²⁹ Levi Strauss annual report, 2001.

³⁰ Levi Strauss annual report, 2001.

end brands such as Ralph Lauren Polo, Calvin Klein, and Guess, through to fashion-forward styles such as Fubu, L.E.I., Mudd, and Diesel. One consistent competitor in the last 50 years had been Wrangler and Lee Jeans, both of which were owned by VF Corporation.

VF Corporation: Wrangler, Lee, and Rustler

VF Corporation, established in 1899, produced and marketed a large portfolio of brands including outdoor names such as JanSport, The North Face, and Eastpak as well as intimates labels such as Vanity Fair, Vassarette, and Bestform. VF's largest customer was Wal-Mart, which made up 15.1% of VF's total sales in 2001 and 14.8% of VF's sales in 2000.³¹ Total advertising for all VF brands was \$244 million (4.4% of sales) in 2001, \$252 million (4.4% of sales) in 2000, and \$258 million (4.6% of sales) in 1999.³²

VF Corporation jeanswear brands included Riders, Chic, Britannia, and Rustler, and a number of product-line offshoots from their stable of Wrangler and Lee offerings. Riders, Chic, Britannia, and Rustler were sold in the mass channel at stores like Wal-Mart, Target, and Kmart and were typically priced between \$9.99 and \$19.99. All three of the brands were targeted largely at value-conscious mothers who made buying decisions for the rest of the family.

Wrangler jeans were also available at the mass-merchant channel with some product extensions being available at chain and department stores. Wrangler jeans retailed between \$14.99 and \$24.99, and were designed for durability, reliability, and fit. Wrangler imaging revolved around western-inspired themes and the spirit of the American cowboy. Its consumer base was mostly males ages 25 to 50 and appealed largely to men seeking comfortable jeans for work or pleasure activities.

Lee Jeans were largely a chain and department store brand, commanding price points between \$29.99 and \$49.99, depending on the style, cut, and finish. In promotions, Lee Jeans used a character called Buddy Lee, a miniature cowboy doll that had gained a cult following in the United States. Lee Jeans were targeted toward the 15-to-25 age group, although the company did offer the Lee brand to children. The brand image projected original fits with up-to-date variations on vintage offerings.

Designer and fashion-forward jeans

Hundreds of brands competed in the designer and fashion-forward denim market. While the majority of brands commanded small market share, each attempted to find a niche with its style. The larger designer labels such as Ralph Lauren Polo, Calvin Klein, and Tommy Hilfiger were supported by ready-to-wear collections shown regularly in fashion havens such as New York, London, Paris, and Milan. All three brands had distinct jean collections, which they sold at high-end and regular department stores. All three brands invested heavily in in-store displays at

³¹ VF Corporation annual report, 2003.

³² VF Corporation annual report, 1999 through 2001 (see **Exhibit 13**).

department stores, refreshing the design and refurbishing every three years. The average price of jeans for these three labels was between \$49.99 and \$99.99.

Other brands such as Guess (\$49.99 to \$79.99) and Diesel (\$69.99 to over \$100) had built a strong image using provocative out-of-home advertising. Guess chose to sell at a combination of department, independent, and Guess stores. Diesel products were found at higher-end department stores, image-conscious independents, and a small worldwide network of corporate-owned locations in select urban centers. Guess chose to control all of its advertising efforts in-house and spent \$17.5 million (2.6% of total revenues) in 2001, \$29.7 million (3.8% of total revenues) in 2000, and \$24.5 million (4.0% of total revenues) on advertising in 1999.³³

A number of other brands such as L.E.I. (Life Energy Intelligence), Mudd, FUBU, and Lucky all attempted to establish a niche in the jean marketplace whether it be with quirky designs or baggy fits that responded to America's rap idiom. These brands were located at a combination of department stores and independent shops at price points ranging from \$39.99 to \$89.99.

Vertically integrated specialty-store brands

The Gap sprung up in 1969 in San Francisco and carried Levi's jeans until the company began focusing on building its own jeans brand in the late 1980s and early 1990s. The Gap offered a wide range of casual products with a penchant for offering fashion-relevant basics supplemented by seasonal changes in colors, fits, and fabrics. An average pair of Gap jeans cost between \$35.99 and \$59.99, although the Gap frequently discounted its seasonal line of goods every eight weeks as new products were released into the stores. The Gap controlled all aspects of product and store design as well as consumer communications, which in recent years had featured a mix of well-known and unknown individuals involved in either music or dance. Notable TV spots for the 2001 holiday season included musical stars such as Dwight Yoakum, Macy Gray, Sheryl Crow, Shaggy, and Alanis Morissette. The Gap's target audience was fairly broad, although industry observers generally felt that the store was targeted to individuals in their 20s. The Gap also owned and operated Old Navy, which offered lower price points aimed at teenagers. An average pair of jeans at Old Navy cost between \$19.99 and \$29.99.

Abercrombie & Fitch, American Eagle Outfitters, and J. Crew all competed for wardrobe dollars, offering a complete line of casual clothing for men, women, and children. They targeted consumers between 15 and 25 years of age, with each brand saluting the American classic styles frequently associated with campus and country club images. Prices points for a pair of jeans varied between \$39.99 and \$69.99.

Private-label brands

Private labels were developed by retailers to offer consumers a similar product to branded alternatives at 50% to 60% of the retail price. JCPenney had developed the Arizona brand, which

³³ Guess Inc. annual report, 2001.

commanded about 7% of the men's jeans market, and Sears had a similar share of the market with their Canyon River Blues private label.

Mass merchants had realized tremendous growth in private-label sales. Wal-Mart ,with its Faded Glory and No Boundaries private labels, had gained nearly 6% of the overall jeans market, while Kmart retained approximately 5% of the overall market. Target had taken a different approach by licensing the Cherokee brand, which became its captive label. With Cherokee jeans, Target had posted yearly growth to command nearly 8% of the overall jeans market in units. All private-label offerings by mass merchants were priced below \$20.

Wal-Mart

Founded in 1962 in Arkansas, Wal-Mart became the world's largest retailer. For the year ending January 31, 2002, Wal-Mart posted revenues of \$220 billion and net income of \$6.7 billion.³⁴ **Exhibit 5** shows Wal-Mart's financials. It had over 2,700 U.S. outlets, split between its regular discount stores and supercenters that sold groceries and offered additional services. The company also operated another 500 discount outlets under the Sam's Club name and controlled nearly 1,200 outlets on international soil under names such as ASDA in the United Kingdom. **Exhibit 6** indicates the growth of Wal-Mart's discount stores and supercenters.

Wal-Mart's average store size ranged from 90,000 square feet to over 200,000 square feet for supercenters. The company's slogan was, "Everyday low prices," and it guaranteed maximum selection at the lowest prices. Wal-Mart carried a mix of both private-label and branded merchandise with private-label sales accounting for approximately 20% of overall sales (in contrast, Target's private-label sales represented 50%).³⁵

Table 4. Wal-Mart sales categories (percent).

22	Grocery, candy, and tobacco
21	Hard goods
18	Soft goods/domestics
9	Pharmaceuticals
9	Electronics
7	Sporting goods and toys
7	Health and beauty aids
3	Stationery
2	One-hour photo
1	Jewelry
1	Shoes
100	Total

Data source: Wal-Mart annual report, 2002.

³⁴ Wal-Mart annual report, 2002.

³⁵ Pankaj Ghemawat, Ken A. Mark, and Stephen P. Bradley, "Wal-Mart Stores in 2003," 9-704-430 (Cambridge, MA: Harvard Business School Publishing, 2004).

Apparel sales were included in soft goods/domestics and represented approximately \$23 billion in sales, or 11% of Wal-Mart's total revenues.³⁶ It was estimated that Wal-Mart held 12.6% of the entire apparel market compared with the 3.6% held by rival Target.³⁷ Wal-Mart's most successful apparel categories were in the ladies' plus sizes and men's work wear with both consumer sets typically being 35 to 60 years old. Unlike higher-end designer brands that did not come in large sizes, Wal-Mart offered a range of sizes in men's pants with waist sizes that went as large as 48 inches. The predominant positioning for the Wal-Mart private labels was a focus on offering the basics at everyday low prices. As one analyst commented, "The only thing Wal-Mart really develops is low prices."³⁸ Another analyst explained that Wal-Mart used a low-risk strategy in its apparel division by playing down disposable fashion. "They can usually hold pricing at fairly stable and comfortable levels. They do some markdowns, but you won't see a whole category on sale," he said.³⁹

Some onlookers believed that Wal-Mart had substantial room in which to grow their apparel line and cited the retailer's attempt to develop one of its star brands, George, as well as other fashion-forward brands such as No Boundaries, Organize Your Life, and Mary-Kate & Ashley that were aimed at junior customers.⁴⁰ As a Wal-Mart spokesperson said, "Over the past five years we've stepped up our efforts to focus on apparel, in terms of fashion and quality. George demonstrates that commitment. It offers high quality, great value and styling at everyday low prices."⁴¹

While looking to grow its own brands, Wal-Mart also purchased a specially designed assortment from work wear marketer Dickies, which developed a line specifically for Wal-Mart. Other branded apparel manufacturers such as VF Corporation sold Wal-Mart multiple lines, including the Wrangler, Riders, and Rustler brands. The president of VF Jeanswear, Mass Market, said:

The potential for Wal-Mart's apparel is endless. They already turn merchandise well, but the numbers of people who walk into stores and don't buy apparel or only buy a small percentage is huge. It comes back to what products they showcase and how they customize the assortment.⁴²

Wal-Mart organized its offerings along the good, better, and best spectrum, with private labels filling the good position and national brands occupying the best spot. VF's Wrangler jeans were priced from \$14.99 to \$24.99, while Wal-Mart's Faded Glory brand was priced regularly at

³⁶ Debby Garbato Stankevich, "Expanding Upon a Basic Appeal: Micromarketing and Other Initiatives Are Likely to Drive Wal-Mart's Clothing Sales to New Heights," *Retail Merchandiser*, March 1, 2002: 34.

³⁷ Emily Scardino, "Is Target's Wardrobe in Wal-Mart's Sights? The Mossimoization of Mass Catches On," *Discount Store News*, April 7, 2003, S1.

³⁸ Stankevich.

³⁹ Stankevich.

⁴⁰ Stankevich.

⁴¹ A. Scott Walton, "Low-Cost, High-Fashion," Cox News Service, November 25, 2002.

⁴² Stankevich.

\$10.77.⁴³ In women's jeans, the main national brand was Riders jeans, which sold between \$14.99 and \$24.99; No Boundaries, Faded Glory, and White Stag carrying price tags between \$9 and \$20. Wal-Mart's No Boundaries brand offered greater variation in styles and coloring. The collection was largely based on prevailing fashions such as capri pants and low-rise jeans for girls, as well as carpenter pants and baggy fit for boys. Faded Glory offered customers a sturdy and relaxed basic jean. One fashion source even claimed that Faded Glory jeans were one of the most comfortable jeans in the U.S. market.⁴⁴ **Exhibit 7** shows a list of Wal-Mart's main brands by consumer category.

The central incident involving the weakening of the Levi Strauss & Co. and Wal-Mart relationship was the dispute over selling Levi's Orange Tab jeans (a line of products that was phased out in the United States but still existed in Canada) to Wal-Mart stores in 1994, when it purchased the Woolco chain in Canada. Levi's decision to not sell Orange Tab at Wal-Mart in Canada cost the U.S. business the entire Wal-Mart sales of the Britannia brand—approximately 1.2 million units, or \$10 million in revenue, for the Levi's brand.⁴⁵

The Question for Levi's: What to Do and How to Do It?

Levi Strauss & Co. management believed that its competitive advantage was based on the worldwide recognition of the Levi's brand name, its commitment to ethical conduct and social responsibility, and its focus on product innovation, quality, and value. Management thought that the Levi's brand was able to work across several channels of distribution because of its long-standing relationships with top retailers.⁴⁶

To remain competitive, Phil Marineau realized the company needed to continue innovating fits, finishes, fabrics, and other product features. The necessity of maintaining strong brand imaging and advertising was believed to help Levi's maintain the number-one position as the most recognized jeans brand in the world. To strengthen retail partnerships, Marineau had to provide products for retailers to reach their overall blended margin, while backing up all brand extensions with strong consumer messaging and the necessary investment to create an in-store experience complementary to the brand and the retail space.

In mid-January 2002, Marineau told the press:

One point where we don't sell is obviously the mass merchants: Wal-Mart, Kmart, Target. We'd be crazy not to be studying that and trying to understand what the opportunities are in the marketplace. We've talked to these people, we've tried to understand how they do business, what they do. We have studies

⁴³ "Retail Industry Update," Credit Suisse First Boston, July 18, 2003, 1.

⁴⁴ "Cheap Jeans Beat Designer Once Again," <http://www.fashionunited.co.uk/news/archive/jeans1.htm> (accessed February 2, 2010).

⁴⁵ Trager.

⁴⁶ Levi Strauss annual report, 2001.

going on about what their consumers want. But we have no announcement to make about any plans or any approach that we have finalized or decided on. The first person we will tell if we do this is our current customers.⁴⁷

Marineau was well aware of the potential reaction from customers. In its past, Levi's had upset existing customers on a few occasions when it made the decision to withdraw a product line or to sell to other customers. One such incident was in 1982, when Levi's made the decision to sell to chain stores JC Penney and Sears, which caused a dearth of orders from department stores such as Macy's.⁴⁸ Eleven years later, Macy's began purchasing Levi's jeans again.

The Decision

While some insiders were convinced that selling a brand to Wal-Mart was necessary, many executives within the company were divided on the subject. One article from an apparel industry magazine read:

According to sources, there are intense disagreements within Levi's as to whether the company should make a move toward the mass market. In particular, the executives who have worked to build the company's profile in the premium jeans market—on the strength of directional lines including Levi's Red Tab and Levi's Vintage Clothing, which carry triple-digit price tags—are said to be reluctant to see the brand sold in Wal-Mart.⁴⁹

Marineau and his executive team needed to decide on whether—and if so, how—to sell to Wal-Mart. Levi's formidable competitor VF maintained the top spot among national competitors at Wal-Mart—Wrangler in men's jeans and Riders in women's jeans. One analyst said Levi Strauss & Co. was going to have “a tough time taking on the presence that Wrangler has in this niche.”⁵⁰ The other main pressure was explaining the rationale to existing customers.

An industry insider said:

[Selling to Wal-Mart] creates more pressure for the Kohl's and Penney's of the world. What are they going to do—just roll over and play dead? [Some retailers may say] “You have mass distribution now, we can't make money on you, you're gone.” [Levi Strauss & Co. has not] had one effective strategy yet. This one will prop up short-term earnings, but it's a bad long-term strategy.⁵¹

⁴⁷ Scott Malone, “Retail Revolution—Levi's Considers Selling Wal-Mart as Sales Slump,” *Women's Wear Daily*, January 17, 2002, 1.

⁴⁸ Malone.

⁴⁹ Malone.

⁵⁰ Thomas Cunningham, “Levi Strauss Rolls the Dice...,” *Daily News Record*, November 4, 2002.

⁵¹ Cunningham.

On the other hand, another analyst said, “The total volume of traditional department stores is so insufficient right now that if Levi Strauss was totally dependent on department stores, they would go out of business.”⁵²

Marineau wondered about how he could leverage the celebrated Levi’s brand name while remaining competitive and not affecting consumers’ propensity to purchase other Levi’s product lines at higher price points. “Around the world,” Marineau said, “we’re making sure we have the opportunity to sell at the right price point, from the \$250 level to the \$25 level. That’s a unique opportunity for the Levi’s brand, and it’s one we’ll continue to explore as we move forward.”⁵³

⁵² Cunningham.

⁵³ Malone.

Exhibit 1

LEVI'S AT WAL-MART?

Apparel Market Information

U.S. Annual Apparel Dollar Sales (1998-2001)

1998	1999	2000	2001
168	173	176	166
	3.0%	1.7%	-5.7%

2001 U.S. Apparel Sales by Market Segment (billions)

	Dollar Volume	% Chg 00/01	Dollar Share %
Total Apparel	166	-5.9%	100.0%
Men's	51	-7.0%	30.7%
Women's	89.3	-6.7%	53.9%
Boys'	7.3	-5.6%	4.4%
Girls'	7.5	-4.1%	4.5%
Infants' & Toddlers'	10.6	5.7%	6.4%

2001 U.S. Apparel Sales by Channel Distribution (billions)

Channel	Dollar Volume	% Chg 00/01	Dollar Share %
All Channels	166	-5.9%	100.0%
Department Stores	32.7	-6.3%	19.7%
National Chain	22.4	-10.2%	13.5%
Mass Merchants	34.9	-0.6%	21.0%
Specialty Stores	41.2	-6.4%	24.9%
All Other	34.5	-7.0%	20.8%

Data source: "Reports 2001 U.S. Apparel Industry Down for First Time in Three Years," April 29, 2002, <http://www.npdfashionworld.com> (accessed March 3, 2005).

Exhibit 2

LEVI'S AT WAL-MART?

Images of Levi's throughout the Ages



Levi's Ad: 1966



Levi's Sta-Prest Ad: 1970



Levi's for Women: 1992

Source: Levi Strauss and Co. Used with permission.

Exhibit 3

LEVI'S AT WAL-MART?

Levi Strauss & Co. Financial Highlights

	Nov 30 1997	Nov 29 1998	Nov 28 1999	Nov 26 2000	Nov 25 2001
Statement of Income Data:					
Net Sales	6,861,482	5,958,635	5,139,458	4,645,126	4,258,674
Cost of goods sold	3,962,719	3,433,081	3,180,845	2,690,170	2,461,191
Gross profit	2,898,763	2,525,554	1,958,613	1,954,956	1,797,479
Marketing, general and administrative	2,045,938	1,834,058	1,629,845	1,481,718	1,355,881
Other operating (income)	(26,769)	(25,310)	(24,387)	(32,380)	(33,421)
Excess capacity/restructuring charge	386,792	250,658	497,683	(33,144)	(4,281)
Global Success Sharing Plan	114,833	90,564	(343,873)	-	-
Operating income	377,969	375,584	199,345	538,762	479,297
Interest expense	212,358	178,035	182,978	234,098	230,771
Other (income) expense, net	(18,670)	34,849	7,868	(39,016)	8,831
Income before taxes	184,281	162,700	8,499	343,680	239,687
Income tax expense	46,070	60,198	3,144	120,288	88,681
Net income	138,211	102,502	5,355	223,392	151,006
Statement of cash flow:					
Cash flows from operating activities	573,890	223,769	(173,772)	305,926	141,901
Cash flows from investing activities	(76,895)	(82,707)	62,357	154,223	(17,231)
Cash flows from financing activities	(530,302)	(194,489)	224,219	(527,062)	(139,891)
Balance Sheet Data:					
Cash and cash equivalents	144,484	84,565	192,816	117,058	102,831
Working capital	701,535	637,801	770,130	555,062	651,251
Total assets	4,012,314	3,867,757	3,670,014	3,205,728	2,983,481
Total debt	2,631,696	2,415,330	2,664,609	2,126,430	1,958,431
Stockholders' deficit	(1,370,262)	(1,313,747)	(1,288,562)	(1,098,573)	(935,941)

Data source: Levi Strauss & Co. annual report, 2001.

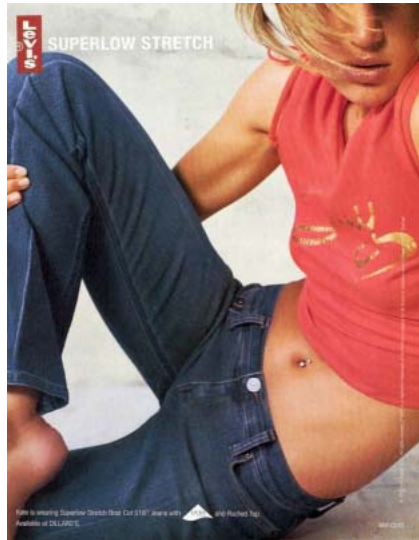
Explanation of Stockholders' Deficit from annual report: "The stockholders' deficit resulted from a 1996 transaction in which the company's stockholders created new long-term governance arrangements, including a voting trust and stockholders' agreement. As a result, shares of stock of a former parent company, Levi Strauss Associates Inc., including shares held under several employee benefit and compensation plans, were converted into the right to receive cash. The funding for the cash payments in this transaction was provided in part by cash on hand and in part from proceeds of approximately \$3.3 billion of borrowings under bank credit facilities. The company's ability to satisfy its obligations and to reduce its total debt depends on the company's future operating performance and on economic, financial, competitive, and other factors, many of which are beyond the company's control."¹

¹ Levi Strauss annual report, 2001.

Exhibit 4

LEVI'S AT WAL-MART?

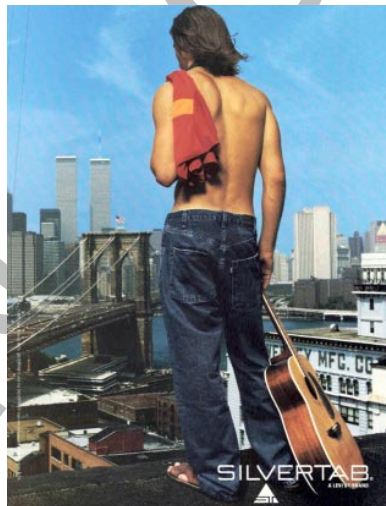
Pictures of Levi's Product Lines



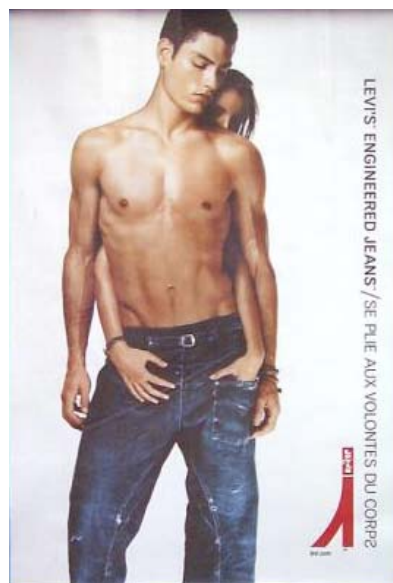
Levi's Superlow: 2002



Levi's Red Tab Cords: 2000



Levi's Silvertab: 2002



Levi's Engineered Jeans: 2002

Source: Levi Strauss and Co. Used with permission.

Exhibit 5

LEVI'S AT WAL-MART?

Wal-Mart Financials
(dollars in billions)

	2000	2001	2002
Net Sales	165,013	191,329	217,799
Net sales increase	20.0%	16.0%	14.0%
Domestic comparative store sales increase	8.0%	5.0%	6.0%
Other income net	1,796	1,966	2,013
Cost of sales	129,664	150,255	171,562
Operating, selling and general and admin expenses	27,040	31,550	36,173
Interest costs:			
Debt	756	1,095	1,052
Capital Leases	266	279	274
Provision for income taxes	3,338	3,692	3,897
Minority interest and equity in unconsolidate subsidiaries	(170)	(129)	(183)
Cumulative effect of accounting change, net of tax	(198)		
Net income	5,377	6,295	6,671
Per share of common stock:			
Basic net income	1.21	1.41	1.49
Diluted net income	1.20	1.40	1.49
Dividends	0.20	0.24	0.28
Current Assets	24,356	26,555	28,246
Inventories at replacement cost	20,171	21,644	22,749
Less LIFO reserve	378	202	135
Inventories at LIFO cost	19,793	21,442	22,614
Net property, plant and equipment and capital leases	35,969	40,934	45,750
Total assets	70,349	78,130	83,451
Current liabilities	25,803	28,949	27,282
Long-term debt	13,672	12,501	15,687
Long-term obligations under capital leases	3,002	3,154	3,045
Shareholders' equity	25,834	31,343	35,102
Current ratio	0.9	0.9	1
Inventories/working capital	-13.7	-9	23.5
Return on assets*	9.5%	8.7%	8.5%
Return on shareholders' equity**	22.9%	22.0%	20.1%
Number of U.S. Wal-Mart stores	1,801	1,736	1,647
Number of U.S. Supercentres	721	888	1,066
Number of U.S. SAM'S CLUBS	463	475	500
Number of U.S. Neighborhood Markets	7	19	31
International Units	1,004	1,071	1,170
Number of Associates	1,140,000	1,244,000	1,383,000
Number of Shareholders of record (as of March 31)	307,000	317,000	324,000

* Net income before minority interest, equity in unconsolidated subsidiaries and cumulative effect of accounting change/average assets

** Net income/average shareholders' equity

*** Calculated giving effect to the amount by which a lawsuit settlement exceeded established reserves. If this settlement were not considered, the return would have been 9.8% for 2000 Return on Assets.

Exhibit 6

LEVI'S AT WAL-MART?

Wal-Mart Number of Doors

STORE COUNT

Year Ending January 31	Wal-Mart Discount Stores			Total	Wal-Mart Supercenters	
	<u>Opened</u>	<u>Closed</u>	<u>Conversions</u>		<u>Opened</u>	<u>Total</u>
Balance Forward				1,995		239
1997	59	2	92	1,960	105	344
1998	37	1	75	1,921	97	441
1999	37	1	88	1,869	123	564
2000	29	1	96	1,801	157	721
2001	41	2	104	1,736	167	888
2002	33	1	121	1,647	178	1,066

Source: Wal-Mart annual report, 2002.

Exhibit 7

LEVI'S AT WAL-MART?

Wal-Mart Jeans Selection in 2002
(retail price in dollars)

	Wal-Mart's private label/ captive brands		National brands available	
Men	No Boundaries	\$15–20	Wrangler	\$15–20
	Faded Glory	9–11	Rustler	9–15
	George	15–20	Dickies	15–25
Women	White Stag	15–20	Riders	15–20
	Faded Glory	9–11		
	George	15–25		
Juniors	No Boundaries	10–20	Jordache	15–20
Girls	Faded Glory	8–11	mary-kate and ashley	15–25
	No Boundaries	15–20	Riders	15–20
Boys	Faded Glory	8–11	Wrangler	\$15–20
	No Boundaries	15–20		
	George	\$15–25		

Source: Created by case writer.