



Marks and Spencer, Ltd. (B)

When he assumed the chairmanship of Marks & Spencer (M&S) in July 1984, Lord Rayner outlined the following priorities:

1. A rapid increase in selling space in the United Kingdom.
2. A comprehensive program to modernize the appearance of stores and the efficiency of operations.
3. The development of existing merchandise ranges and the expansion into new product areas.
4. The improvement of information systems, warehousing, and transport.
5. The launch of charge-card and associated financial services.
6. The expansion of international business, including securing a foothold in two large overseas markets—the United States and the Far East.

By 1987, Lord Rayner had made progress in the first five areas, but had not established M&S in the United States and the Far East. The chairman, who was determined to enter these markets, argued, “The world is what it’s about, not little Europe. We’ve got to be entrepreneurs and take some risks. This retailing field is becoming crowded.”¹ Alan Smith, director of the business development group, characterized M&S’s expansion plans as a defensive-offensive move: “Unless we learned to trade globally, others would. We had to get on that learning curve.”²

Good results in the mid-1980s for Europe gave M&S confidence that it could make a profit abroad. However, the firm’s experiences convinced Lord Rayner that M&S “had to learn its trade on the streets.”³ In March 1987, the chairman sent a team of executives to the United States to study the clothing and food markets and assess the firm’s opportunities. Smith headed the six-member group that included Mike Goldstone from store operations, Saeed Hatteea from merchandising, Joan Smith from human resources, Paddy Walker-Taylor from finance, and Gareth Williams from retail systems.

¹ Personal interview, December 11, 1990.

² Ibid., December 12, 1990.

Research Associate Dianna Magnani prepared this case under the supervision of Professor Cynthia A. Montgomery as the basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation.

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The study team divided its work into two stages: it had to determine whether M&S should move into the United States and if so, how. It hired McKinsey & Co., an internationally recognized management consulting firm, to do a broad study of American retailing.

When Smith's group reviewed McKinsey's results, it decided that the U.S. market did present opportunities. After determining that M&S lacked the merchandise and store style to compete successfully in the United States, it set out to find a clothing chain and a food chain, intending to develop an M&S-type store in the long run.

The team concentrated on the Northeast market because it was roughly the same size as the U.K. market and because management believed it understood the customers. Paying close attention to reputation, brand, and location, the group members talked with executives, suppliers, and real estate people. Another important part of their evaluation was looking in store windows.

After seven months of study, Marks and Spencer concluded that it should purchase Brooks Brothers, an upscale specialty clothing chain with a small joint venture in Japan, and Kings Super Markets, a high-quality supermarket chain in New Jersey. Smith described both organizations as "quality-driven in the widest sense—in relation to people, merchandise, and suppliers."⁴

Brooks Brothers

The Acquisition Agreement

In January 1988, Robert Campeau, Brooks Brothers's owner, refused to sell the chain when Lord Rayner approached him. Campeau was expanding his retailing empire that comprised over 20 chains including Jordan Marsh, Stern's, Joske's, and Pomeroy's department stores, and Bonwit Teller, Ann Taylor, Garfinckel's, and Plymouth specialty stores. It was not until the Canadian real estate developer and retailing magnate was strapped for cash while acquiring Federated Department Stores that he agreed to sell Brooks Brothers.

As part of the due-diligence procedure, Smith's team was able to get an insider's view of Brooks Brothers. In six days, they, along with another group from M&S, spoke with all the store managers as well as some of their own U.S. and Far East suppliers who were familiar with Brooks Brothers's operations. In April 1988, M&S and Campeau came to a \$750 million agreement that included the following:

1. The Brooks Brothers chain, including its 51% share of the Japanese joint venture.
2. Preferential rights for five years to set up food outlets in any of Campeau's 60 malls.
3. Preferential rights for three years to set up food outlets in over 700 U.S. and Canadian Campeau department stores that did not already sell food.
4. A noncompetition agreement whereby Campeau would not set up a specialty menswear chain in the United States or Japan for five years.

³ Ibid., December 11, 1990.

⁴ Ibid., December 12, 1990.

Keith Oates, M&S executive director of finance, stated that 300 of Campeau's 740 department stores were prime possibilities for M&S food outlets.⁵ Marks and Spencer valued the preferential rights at \$30 million and the noncompetition agreement at \$50 million. Thus the firm viewed the acquisition price of Brooks Brothers to be \$670 million.

Description

At the time of acquisition by M&S in 1988, Brooks Brothers owned 47 U.S. stores, primarily in the financial districts of large cities in the Northeast (19) and the Midwest (16). About two-thirds of the stores had been added in the early 1980s. Company headquarters and the flagship store were located on Madison Avenue in New York and occupied 140,000 square feet. Most Brooks Brothers stores had selling areas of 5,000 to 15,000 square feet (**Exhibit 1**).

Founded in 1818, Brooks Brothers had a long-standing reputation for high-quality, classic tailored menswear. The chain carried only private-label merchandise that changed little in style from year to year. One Brooks Brothers executive offered the following rationale for selling traditional merchandise: "This is not a retail store, it's an American institution, and anything remotely revolutionary will destroy it."⁶ At Brooks, men could always find "sack suits" with single vents and unpadded shoulders, button-down collar shirts (invented by the firm), and conservative striped ties. The stores did carry a narrow selection of women's clothing, but it accounted for only a small fraction of total sales (**Exhibit 2**).

Prices were high and customers were primarily upper-middle class businessmen and professionals. The *Wall Street Journal Book of Chief Executive Style* found that about three-quarters of chief executives in the United States bought suits off the rack and preferred to buy them at Brooks Brothers.⁷ The firm counted several presidents among its customers: Bush, Grant, Kennedy, Lincoln, Wilson, and both Roosevelts.

Over half of the firm's retail sales were made with Brooks Brothers charge cards. Well-made merchandise and courteous, attentive salespeople ensured that customers returned to the stores. Employee retention was well above the industry average. Alan Smith commented, "Even Brooks's employees are like ours: they're tree huggers."⁸

Display, promotional, and advertising programs reflected Brooks Brothers's conservatism. Customers viewed display merchandise through enclosed glass cases, and clearance sales lasted only one week. The chain handled its own advertising and ran the same handful of simply drawn advertisements in the *New York Times* for several years (**Exhibit 3**).

Three company-owned factories produced 40% of the chain's retail sales. U.S. and Far Eastern suppliers accounted for the remaining 60%. Frank Reilly, CEO of the firm, described the relationship with suppliers, "We have done business with [many of our suppliers] for 40 or 50 years. We're demanding, but we're fair. We don't try to take undue advantage."⁹

Brooks Brothers owned a 51% stake in a joint venture with Daido Worsted Mills Ltd., a Japanese textile business. M&S viewed this investment as an opportunity to learn about the Japanese retailing market and as an important step in developing a global supply base.

⁵ *Financial Times*, May 4, 1988, p. 46.

⁶ *Forbes*, July 9, 1990, p. 76.

⁷ *Ibid.*, p. 42.

⁸ "Flying in the Face of Fashion," *Business (U.K.)*, December 1989, p. 45.

⁹ *Chain Store Age Executive*, December 1988, p. 21.

In 1988, the Japanese joint venture comprised 18 shops of less than 2,000 square feet that were within department stores. There were also three freestanding units of 4,000–7,500 square feet. The chain sold Brooks Brothers merchandise sourced from the United States and the Far East. Brooks received a share of the profits and a royalty on sales.

Performance

Brooks Brothers produced \$290.1 million in turnover and \$20.3 million in profits in 1988 (**Exhibit 4**). However, the chain lagged competitors in terms of infrastructure and store modernization. Inventory and distribution systems were archaic, and stores were old-fashioned in appearance. M&S realized that without sizable investment Brooks Brothers could not maintain its high profit margins. Smith described Marks and Spencer's outlook as long-term, "If you're expecting to get 25% in the first year, then go into another business. . . . We're in a five-year time frame here! Anyone can go in and gut a business and get a return out of it. But you're not growing a business, you're playing financier."¹⁰

Kings Super Markets

The Acquisition Agreement

Like Brooks Brothers, Kings Super Markets was not for sale when M&S proposed to buy it. Allen Bildner, the chain's owner, was interested in selling only part of his stake when Lord Rayner first approached him. Eventually, M&S made an offer that Bildner could not refuse—\$110 million for the 15 stores.

Description

Kings Super Markets was an upmarket New Jersey chain well regarded for its service-oriented staff and high-quality products. It had a loyal following of upper-middle class customers who were willing to pay a premium for top-quality offerings.

Stores totaled 265,000 square feet, and no two outlets were more than 40 miles apart. The chain's competitors included Grand Union, Pathmark, and Shop Rite. Kings focused on variety, quality, cleanliness, and good customer service. It was not and did not intend to be a "price operator."¹¹ Compared to its competitors, Kings drew customers from a larger radius and attracted more split shoppers who purchased groceries at more than one store.

Many customers stopped at the stores on their way home from work to buy fresh foods prepared daily on the premises. They ordered at the service counter, and Kings associates packaged the food immediately. Customers could choose from a wide range of entrees and talk to the store chefs about how to serve the dishes.

¹⁰"Flying in the Face of Fashion," *Business (U.K.)*, December 1989, p. 42.

¹¹Jim Meister, personal interview, March 13, 1991.

Performance

Kings stores generated sales of \$258 million and pre-tax profits of \$4.9 million in 1988. Their 2% profit margin was quite good for the American market, although significantly lower than the margin of M&S's food division in the United Kingdom.

M&S intended to introduce to Kings customers the prepackaged, refrigerated (nonfrozen) foods it had pioneered in the United Kingdom. The parent company realized that it would have to prove that American customers would be willing to serve themselves while paying for the quality of freshly prepared food.

Building a solid supply base was critical for M&S's long-range expansion plans in the United States. Richard Greenbury, who had become CEO of M&S in 1986, realized that "If you want to build a really dynamic food business, [it must] be based on local retail expertise and, even more so, local procurement across the entire range."¹² Since the existing U.S. supply and distribution network was incapable of handling foods that perished in less than 10 days, M&S had to introduce cold chain techniques to the U.S. market.¹³

The structure of the U.S. retail food market presented a tough environment for M&S. Manufacturers' brands dominated the industry, and a customer's choice of supermarket was based primarily on location and prices. In contrast, in the United Kingdom, customers selected stores based on their house brands, which were perceived to be superior to manufacturers' brands. The intensely competitive U.S. market and the widening range of deli offerings made M&S's position even more risky (**Exhibits 5 and 6**).

¹² "Marks & Spencer Retailing Presentation," *Goldman, Sachs & Co.*, May 12, 1989, p. 15.

¹³ Prepared food was transported in refrigerated trucks, and its temperature varied little throughout the shipping process.

Exhibit 1 Brooks Brothers U.S. Stores

# of stores	average selling area (square feet)
1	51,000
5	15–21,000
21	10–15,000
19	5–10,000
1	under 5,000

Source: Marks and Spencer

Exhibit 2 Brooks Brothers Sales Mix

	1988 Sales
Menswear:	
formal	27%
shirts/ties/knitwear	25%
sportswear	12%
leisurewear	12%
accessories (including shoes)	10%
Women's wear	12%

Source: *Charterhouse Tilney*, May 5, 1988, p. 3

Exhibit 3 Brooks Brothers Advertisement

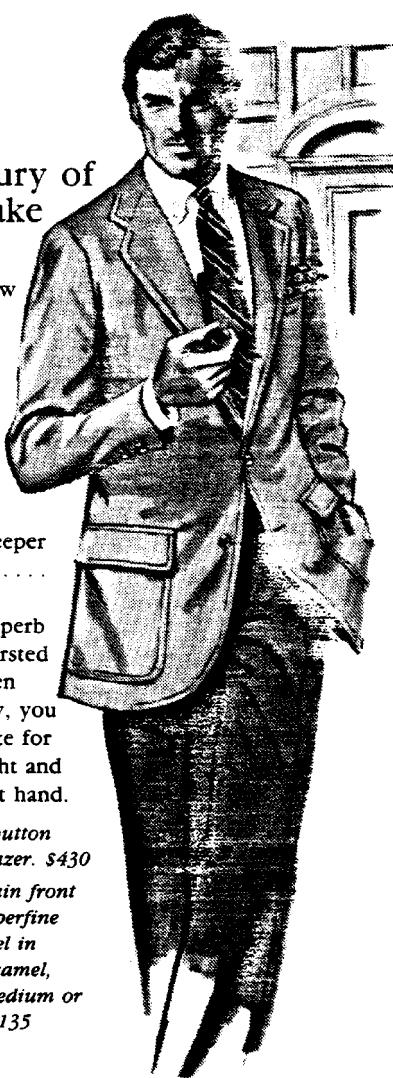


**The luxury of
Own Make**

Here are two handsome new sportswear choices expertly tailored in our own workrooms. Our rich camel hair blazer in a deeper honey shade And for our trousers, a superb Superfine worsted flannel, woven for us in Italy, you will appreciate for its light weight and unusually soft hand.

Own Make 3-button camel hair blazer. \$430

Own Make plain front trousers of Superfine worsted flannel in brown, blue, camel, olive; light, medium or oxford grey. \$135



Third Floor

Use your Brooks Brothers card, American Express, Diners Club, MasterCard or Visa

346 MADISON AVENUE • LIBERTY PLAZA • MANHASSET
PARAMUS • SCARSDALE • SHORT HILLS • STAMFORD

Exhibit 4 Brooks Brothers Profit and Loss Account (\$ millions)

Year to 31 January /1 March ¹	1984	1985	1986	1987	1988
Total Sales	216.2	236.1	247.1	267.9	290.1
United States	203.6	221.7	231.1	244.4	256.5
Japan	12.6	14.4	16.0	23.5	33.6
Cost of Sales	108.0	117.8	122.0	130.3	141.5
Gross Profit	108.0	118.3	125.1	137.6	148.6
Operating Expenses					
Selling & Distribution	36.6	40.9	44.1	46.1	53.2
Administration	42.3	45.7	50.1	53.7	56.9
Trading Profit	29.3	31.7	30.9	37.8	38.5
Other Income	3.0	3.1	3.2	3.9	3.3
Pre-Tax Profit	32.3	34.8	34.1	41.7	41.8
United States	30.5	32.6	31.9	37.9	36.3
Japan	1.8	2.2	2.2	3.8	5.5
Taxation	14.6	15.7	14.8	18.4	20.1
Post-Tax Profit	17.7	19.1	19.3	23.3	21.7
Minorities	0.4	0.5	0.5	0.9	1.4
Net Profit	17.3	18.6	18.8	22.4	20.3

Source: *Goldman, Sachs & Co.*: Investment Research, "Marks & Spencer," May 12, 1989

1. Brooks Brothers's fiscal year changed from January 31 to March 1 upon acquisition.

Exhibit 5 U.S. Grocery Stores

1984	Number	%	Sales (\$b)	%
Chain Supermarkets	17500	11.2	136.9	49.0
Independent Supermarkets	12675	8.1	63.1	22.6
Convenience Stores	42950	27.6	19.0	6.8
Other Stores	82875	53.1	60.4	21.6
Total	156000	100.0	279.4	100.0

Source: *County NatWest Woodmac*, "Topic of the Month: Lord Rayner and the Golden Fleece"

Exhibit 6 Deli Services in U.S. Chain Supermarkets

1986	
Percentage of US Chain Supermarkets with Deli Services	81%
Special Deli Services	
Catering/Party Trays	63%
Custom Cooking	43%
Home Economist/Food Consultant	7%
On premise preparation	
Cold Food	60%
Hot Food	58%
Types of Food	
Hot Poultry	56%
Cold Sandwiches	52%
Hot Ribs	39%
Cold Fish/Seafood	31%
Cold Poultry	31%
Cold Casseroles	28%
Hot Casseroles	28%
Hot prepared sandwiches	26%
Hot Fish/Seafood	19%
Cold Ribs	11%
Percentage of U.S. Chain Supermarkets with:	
Salad Bar	22%
Soup Bar	19%
Taco Bar	4%

Source: *County NatWest Woodmac*, "Topic of the Month: Lord Rayner and the Golden Fleece"