Schlecker...

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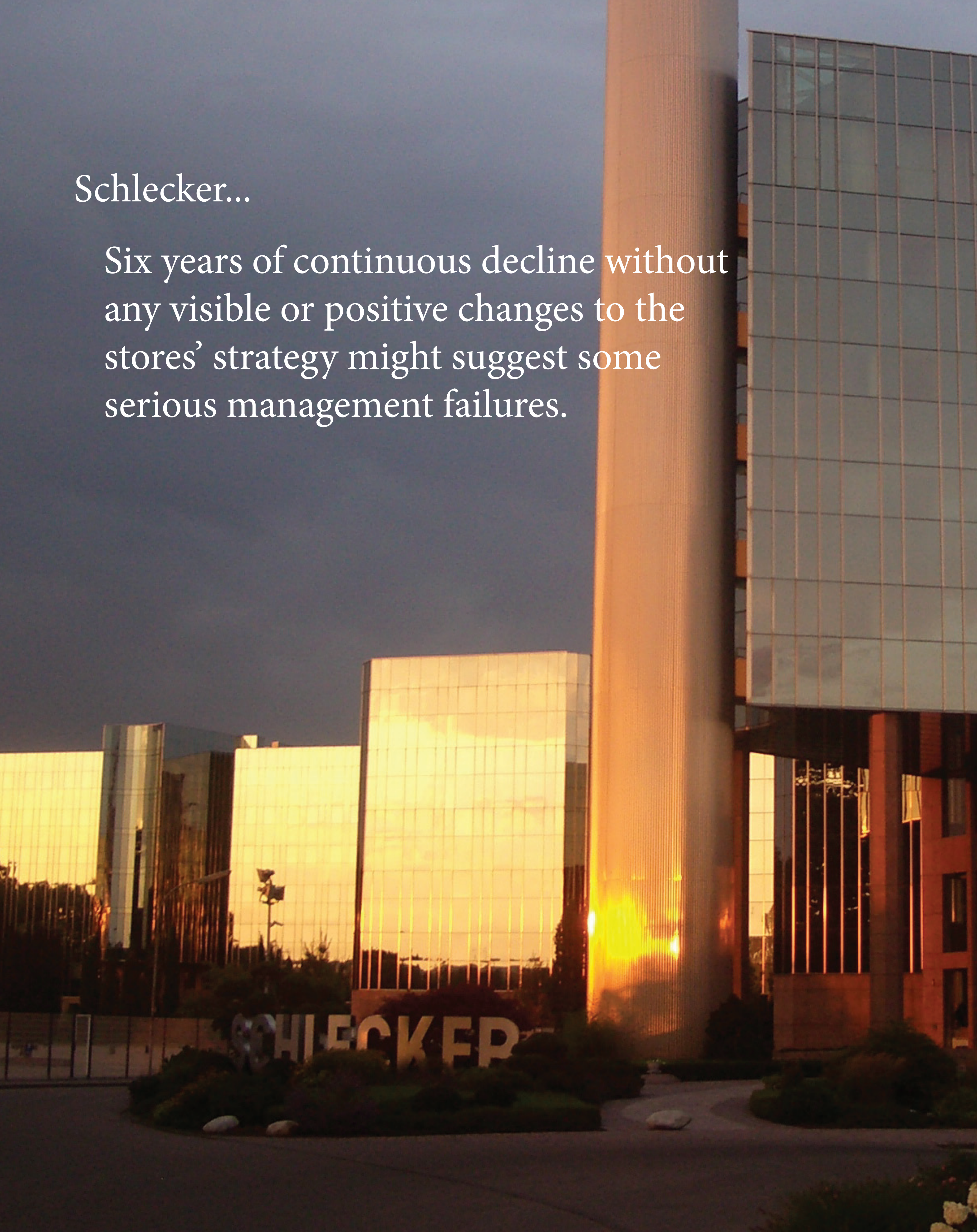

available online at www.turnaround-management.com

Turnaround Management Journal

Turnaround Management Journal (1) 2012 Special Issue

Rescuing Schlecker: The fall of an empire and ways to turn the company around

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This is the story of the fall of Anton Schlecker's empire of seven thousand shops with thirty thousand employees. There is no question about the urgency of a rescue plan: currently, Schlecker loses about €20 million every month, so deep cuts will have to be made, as it is too late to adopt a strategy that simply avoids further declines in profits or market share. It is also too late for heavy investments and higher credit lines. It is time to determine what went wrong, what can be rescued, and what makes economic sense.

In 1975, Anton Schlecker founded a new kind of store in Germany, a shop system that was revolutionary at that time: the drug store chain Schlecker. Two years later, Schlecker had a hundred stores, and seven years after that, Schlecker opend its one thousandth store in Germany. The rapid expansion was due in part to the stinginess of Anton Schlecker, who saved every penny he could and reinvested it into the business. This financial strategy led him to greate success but also eroded his empire from within, even though it was expanding at great speed.

This is the story of the fall of Anton Schlecker's empire of seven thousand shops with thirty thousand employees, but I would not write this article if I did not believe that Schlecker's empire could be rescued. There is no question about the urgency of a rescue plan: currently, Schlecker loses about €20 million every month, so deep cuts will have to be made, as it is too late to adopt a strategy that simply avoids further declines in profits or market share. It is also too late for heavy investments and higher credit lines. It is time to determine what went wrong, what can be rescued, and what makes economic sense.

From 2006 to 2011, Schlecker lost about 6 million customers and then lost another 2 million in 2011 (Wirtschaftswoche and GfK). This was not because the customers of what was once the biggest drug store chain in Europe suddenly didn't need shampoo, toothpaste, or soap; rather, many chose to shop at the competition's much nicer shops (Rossmann and Mueller), while about 25 percent went to Germany's discount grocery stores Aldi and Lidl. Germany's discount grocery stores are famous for their extremely low prices and good management.

How did Schlecker's decline develop? What led Anton Schlecker to watch his empire run straight into insolvency? Schlecker's stores were once the friendly neighbourhood drugstores where people went after work because they could not get what they needed at the discounters or because it was on their way home. This customer model explains why Schlecker was the drug store with the smallest shopping carts (Hamburger Abendblatt 30.01.2012). However, Schlecker's stores today are very small stores with half empty shelves. The lighting is poor, cardboard boxes lie about on the floor, and many of the stores are dirty.

Six years of continuous decline without any visible or positive changes to the stores' strategy might suggest some serious management failures. Either the management was incapable of taking countermeasures when the decline first appeared, or the measures they did take were the wrong ones. Let's take a look at what happened during the last six years.

The crisis' roots lay in Anton Schlecker's determination to increase the number of shops and to lower the prices. Even while Schlecker was losing millions, he opened more and more stores. Many Schlecker Stores were so close to each other that they cannibalized each other's sales.

Lowering prices makes sense, and Schlecker's buyers have a reputation of being very aggressive with vendors, which is part of their job. However, while prices received primary attention, other important details went lacking. Dark, crowded shops with very tight aisles mean customers who come in, finds what they need, and leave as soon as possible. While other discounters and chains increased their focus on the customer over the last ten years, Schlecker did not. Other stores tripled the number of lights in their stores, widened their aisles, painted their ceilings white, and added music. As a result, customers sometimes spent hours in the store. No one would voluntarily spend hours in a small Schlecker store. They focused only on convenience and price and fell behind when the competition created a pleasant shopping experience.

News about low salaries and mistreatment of employees also damaged Schlecker's once positive image. Some shops did not have toilets for the employees or a telephone for emergencies. The union Verdi sued Anton Schlecker for paying his employees less than they where supposed to be paid (FAZ 26.03.2012) (FAZ 14.03.2012) or failing to pay employees for sick days. These policies had to have a negative effect on the motivation of Schlecker's employees, but even the customers aligned with the already underpaid workforce by avoiding the stores.

Despite the efforts of aggressive buyers, Schlecker's goods were often more expansive than the competition, which, in combination with the "customer-unfriendly" stores, further eroded sales. A DVD rental store or a gas station might sell ice cream for three times the price of a grocery store, but their sales are driven by the convenience attendant to combining the ice cream purchase with a gas purchase. Schlecker's pricing strategy led to some products' being extremely unprofitable while other rarely sold at all (FAZ 29.02.2012). Unprofitable products were not discontinued or were discontinued too late. Aldi and Lidl have a very experienced product management team that puts together only what is profitable and replaces unprofitable products very quickly. Hiring some experienced managers could be a solution to the problem but only if top management gives the product management the freedom to decide on its own. This strategy would have addressed another issue, which was that many commonly needed goods were not available in Schlecker's stores, resulting in unhappy customers who are less likely to return than they would be if the store stocked what they needed. Schlecker had a serious problem with not enough useful goods on the shelves, too many goods that were not useful, and too many empty shelves (FAZ 14.03.2012). Not having the goods customers need erodes the convenience strategy, as the last thing a customer who is on the way home from work wants is to have to make two stops for one item.

Many Schlecker shops are in small villages, and these shops are often not very profitable or barely break even. In these villages, Schlecker is sometimes the only store, and it is important that it supply the most necessary items for the community. It is also the center of communication for the villagers, so it has the potential to increase shopping time if the store is comfortable. However, these shops have very small shopping carts and a limited selection. The customers, often older people who cannot go very far, buy small amounts but regularly. By driving out to these villages and asking customers their views, a Turnaround Management Society employee found out that the customers would buy more if Schlecker would supply other goods besides drugs, such as basic groceries, books, wine, drinks, and DVDs. If Schlecker provided these goods in country regions, they could be more profitable, gain customers, and provide an important service to these communities. To accommodate for the communities' need to exchange information, they could even offer fresh coffee.

Another reason for the crisis is very high rent in some areas; in this case, Schlecker can benefit from the struggling economy, as it may have an opportunity to renegotiate rents. According to the German law, the insolvency administrator can cancel rental agreements with three months' notice even when the period of the original contract has not expired.

The primary issue—the source of the myriad issues listed so far—is the top management of the company, Anton Schlecker. Schlecker has a reputation for not taking criticism well or seriously. He and his wife Christa tend to run the empire using an imperial management style, and the good intentions and fresh view of employees were not regarded as constructive or taken seriously (Manager Magazin 4|12). Schlecker managed the company autocratically and did not accept many questions or suggestions from middle management. In the end, (which it seems the company is nearing), Schlecker lost millions.

It is interesting that the Schlecker subsidiaries in countries other than Germany are profitable, which could open a discussion about cultural influences or differences in how the subsidiaries are run. However, my suggestion, in keeping with the International Turnaround Management Standard (ITMS), a guided system for steering a company out of a crisis, is that, since the company is well on the way to insolvency, selling the profitable parts of the business to finance the restructuring of the crisis-shaken parts of the business may be a last resort . The ITMS shows that this strategy can lead to a successful turnaround.

In March 2012, the auditors from PricewaterhouseCoopers (PwC) came to the conclusion that it will be difficult for Schlecker to find investors since too many shops are unprofitable. The insolvency administrator closed down 40 percent—2200—of the shops and laid off eleven thousand employees. However, PwC does not believe that the company can make the turnaround by this means alone.

Schlecker is far from a risk-free investment because of the need for change with an owner who avoids change. The shops need to be lifted to a higher standard through investments in furnishings and advertising. A name change, considering the badly damaged image of the company, would cost additional millions. However, I believe that a name change is not necessary. While Schlecker has a heavily damaged image, an investor that replaces the management, sets new standards for the employees, makes significant changes to the store design, and focuses on the customer can use the current public awareness to make these changes visible to the public. The press is currently closely watching Schlecker, and this attention can be used to market positive changes and change customers' perceptions of the company. In addition, as long as they see these changes themselves, the employees will communicate the changes. Still, it all comes down to how much the investor wants to invest. If the investor has enough money to pay for the name change and position the company, a name change can be considered, but limited funds should be invested first in changes that the employees and customers can see and feel."

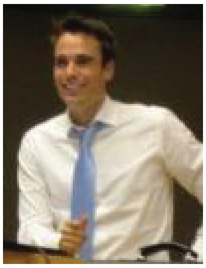
Another problem for a possible investor are the employees that are not needed anymore. While laying off eleven thousand employees would save the company money immediately, dismissals protection claims would mar the company's balance sheet for years to come.

There is one way to make the investment for outside investors more lucrative. A transfer company funded by the sixteen German states could save investors from these claims and allow positive cash flow right away. However, such a transfer company would require about €70 million to pay the employees 80 percent of their salaries for six months, in addition to job training to prepare them for other job opportunities. In Germany, as in other countries that bailed out banks in the 2009 financial crisis, the government is sensitive to the need to support failing businesses, although taking this action is up to the German states. Schlecker is present in all of the German states, so all of them could share the burden of raisubg the €70 million. However, the likelihood of this kind of coordinated action's occurring is questionable.

It is the way of a free economy to let companies fail if they are not staying competitive and to let other companies take over their market share. In order to serve that market share, the surviving companies hire more people, so jobs are not lost as long as the market does not shrink or technological advances does not render the jobs unnecessary. Still, an efficient company can serve a bigger market share with fewer employees than a failing company can.

It is my opinion that Schlecker can be rescued, although it is already too late for any but drastic changes to the business, and the company will have to make use of the law to have a fair chance of survival in the long term. The ideas outlined in this article are starting points. There is little doubt that this case is a perfect example of a company run by a stubborn founder who was once swimming in success but who is not the right person to lead the company out of its crisis. No single top manager, no matter how initially successful, can handle every situation perfectly, but there is an experienced expert who can address any situation. Having such a consultant look at the business, get feedback, and help on an operational level is not a sign of weakness; it is good management.

About the Author:



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