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J.C. Penney's "Fair and Square" Strategy (Abridged)

Retailing is hard, and that's what Steve [Jobs] said to me when we started stores at Apple.

— Ron Johnson, CEO, J.C. Penney[1]

It was August 2012 and the release of second-quarter earnings was looming for Ron Johnson, the chief executive officer of J.C. Penney, one of America's first department stores. Johnson, HBS '84, had intimated to Wall Street that the retailer's second-quarter results were likely to miss expectations again, following dismal first-quarter results that revealed a $163 million loss, same-store revenue down by 19%, and the number of customers shopping in J.C. Penney stores down by 10%. These results were particularly disheartening given the company's radical repositioning of its business model and its brand in February 2012.

The centerpiece of the repositioning initiative was a switch from J.C. Penney's existing high-low pricing strategy, in which the retailer ran frequent sales to offer customers deep discounts off its higher list prices, to a new strategy the company dubbed "Fair and Square" pricing. Fair and Square was meant to simplify the pricing structure by offering great prices every day, with less frequent promotions. The company touted that its new pricing strategy offered "no games, no gimmicks" and invited consumers to "do the math" to see how it regularly offered them cheaper prices with less hassle. Moving away from high-low pricing was a massive shift for J.C. Penney. In 2011, the year prior to the shift, the retailer spent $1.2 billion to execute 590 different sales events and promotions[2] and generated 72% of its $17.3 billion in annual revenue from products sold at steep discounts of more than 50% off the initial list price.[3] Wall Street initially supported the company's plans for change. Investors, who sent J.C. Penney's stock soaring up 24% following the announcement of the new pricing plan, viewed it as a way for J.C. Penney to escape the ruthless downward spiral of escalating price promotions that gripped America's retailers struggling to survive the economic recession.

But by mid-2012 Johnson was under enormous pressure to turn things around quickly as the all-important back-to-school and holiday shopping seasons were imminent. Was Johnson's new pricing strategy misguided or was it just a matter of time before customers fully embraced it?

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Company Background

Once the largest department store chain in the country with over 2,000 stores, as of 2012, the 110-year-old retailer operated 1,100 stores, claiming to serve more than half of America's households with 41 million square feet of retail space. Founded by James Cash Penney in 1902, the company's first outlet was opened in a Wyoming mining town under the name "The Golden Rule," which signified its philosophy of treating customers the way Penney himself wished to be treated.

But by its 100th anniversary, the company appeared to be running out of steam. Price-oriented mass merchandisers, such as Walmart and Target, had garnered the lower end of the market, while higher-end department stores, such as Macy's and Nordstrom, were catering to the upwardly mobile middle class. Although the economic recession of 2008 was difficult for all retailers due to consumers' increasing frugality, middle-market retailers, like J.C. Penney and Sears, were hit the hardest. J.C. Penney's stores were old, often disorganized, and faded, and the brand and its merchandise were starting to feel dated. About 400 of its stores were located in small towns with a population of roughly 10,000 people. In such towns, there were often only few, if any, other department stores. The remaining 700 or so stores were located in major metropolitan areas.

Following years of store closings, declining market share, slumping earnings, and weak stock market performance, activist investor and hedge fund manager William Ackman (HBS '92) obtained an 18% majority shareholder position in the company in 2010–2011. He was determined to turn J.C Penney around and extract its value, much of which was locked up in its vast real estate holdings that were estimated to be worth $11 billion.[4] J.C. Penney owned 400 of its retail stores and paid low rents (an average of less than $5 per square foot) for the remainder. Specialty stores like Gap paid much higher rents (around $40 per square foot) for their retail space.[5] Looking to shake up the company, Ackman was instrumental in luring Johnson to take the CEO position.

In the 1990s, Johnson was vice president of merchandising at Target where he helped transform the mass merchandiser into a hot retail brand selling stylish yet affordable products. During his time there, Johnson negotiated a contract with architect Michael Graves, beginning Target's profitable partnerships with high-end designers, which enhanced its brand image as a chic, fashion-forward retailer. Starting in 2000, he worked with Steve Jobs to develop the wildly successful Apple retail stores. Johnson was the brainchild behind the "Genius Bars" concept, a free technical help and support area staffed by knowledgeable customer service representatives, widely touted as one of the most innovative retail concepts of the last decade. Johnson's deep retail experience combined with his wholesome charisma and boyish enthusiasm made him the perfect change agent. The media dubbed him the "Steve Jobs of the retail industry," and on the day his appointment was announced, J.C. Penney's stock jumped 18%. (See **Exhibit 1** for J.C. Penney's stock market performance.)

An Industry under Pressure

J.C. Penney's 2011 sales were lower than they were in the 1990s, and the retail landscape was getting more competitive. Big box retailers like Walmart, which operated free-standing supercenters selling mass merchandise, and small specialty stores like Gap and J. Crew, which were located in shopping malls and offered specialized items, were squeezing department stores out of the market (department stores went from a high of 10% of total retail sales in 1985 to 5% in 2000 and under 3% by 2011). An emerging challenge came from international clothing retailers, such as H&M and ZARA, which were aggressively entering the U.S. market. These retailers relied on short product life cycles and partnerships with top designers to offer fast-fashion merchandise at relatively low prices.

Department stores were once the most popular places for Americans to shop, offering distinctive merchandise in elegant settings that provided special services, such as tearooms, salons, and on-site tailoring, and served as social hubs. Johnson reminisced, "In the golden age of department stores, America's families came for more than just to shop. They were able to have fun experiences and were offered a range of useful services."[6] Johnson believed that department stores could be revived. "They can be people's favorite place to shop. They've got all these strategic advantages—the lowest cost of real estate, exceptional access to merchandise, scale to create enormous marketing power, colocation with specialty stores. And people like stores with huge assortments and one-stop shopping."[7]

J.C. Penney's performance had been lackluster for quite some time, and the retailer was losing market share even within the shrinking department store channel. (See **Exhibits 2** and **3** for company financials and sales.) Competitors Macy's and Kohl's were nipping at J.C. Penney's business. The average J.C. Penney customer visited a store only four times per year, and sales per square foot ($156) were low compared to those of its competitors and the specialty stores Johnson hoped to emulate (e.g., Gap, $300[8]). Department stores and big box stores had increased their promotional budgets since the outbreak of the Great Recession in 2007, and most used blockbuster sales, coupons, and frequent price promotion to drive purchases. According to consulting firm A.T. Kearney, more than 40% of the items Americans purchased in 2011 were bought on sale, up from 10% in 1990.[9]

Competition from online retailing was also increasing. Yet Johnson believed brick-and-mortar stores were still relevant. "Physical stores are still the primary way people acquire merchandise and I think that will be true 50 years from now. . . . A store has got to be much more than a place to acquire merchandise. It's got to help people enrich their lives. If the store just fulfills a specific product need, it's not creating new types of value for the consumer. It's transacting. Any website can do that."[10]

Many of J.C. Penney's largest competitors, such as Macy's, seemed to have a different view and were investing heavily in their e-commerce operations and in catering to what they called the "omni-channel" consumer who accessed the retailer through the web, on mobile devices, or in physical stores. Although it had been a pioneer in multichannel commerce, with 2001 combined catalog and web sales of nearly $3.4 billion, J.C. Penney's e-commerce sales had stagnated over the last three years while those of Macy's and Kohl's had grown substantially.[11] (See **Exhibit 4** for a comparison.)

J.C. Penney's Radical Makeover

Upon his appointment in November 2011, Johnson determined that nothing short of a complete overhaul would solve J.C. Penney's problems. Just two months after taking the helm, he and his newly recruited leadership team, culled largely from Apple and Target, announced a radical repositioning of the J.C. Penney business model and brand. *Forbes* magazine proclaimed, "This week, Johnson took a sledgehammer to the J.C. Penney way of doing business. It's the most exciting thing I've seen in retail since Apple opened stores, again with Johnson at the helm."[12]

The four-year radical plan would touch every part of the business. As Johnson explained, "We are going to rethink every aspect of our business, boldly pursue change, and create long-term shareholder value, as we become America's favorite store. Every initiative we pursue will be guided by our core value to treat customers as we would like to be treated—fair and square."[13]

New Logo

J.C. Penney had been tinkering with its logo, changing it three times in three years. In 2011, in a crowd-sourcing experiment, the company had asked the public for help in redesigning the logo. The winning design, submitted by a university student, was unveiled with much fanfare via social media.

In 2012, Johnson scrapped this design and hired an agency to redesign the logo yet again. The new logo evoked the American flag, with red, white, and blue colors and the letters "jcp" in lower-case font within a square that represented the new "Fair and Square" mantra. J.C. Penney, which many affectionately called "Penney's" would now be known as "jcp." (See **Exhibit 5** for the new logo.)

New Brand Spokesperson

One of the most exciting and controversial developments of the plan was the announcement of comedian and talk show host Ellen DeGeneres as the new brand spokesperson. Johnson proclaimed DeGeneres to be "one of the most fun and vibrant people in entertainment today, with great warmth and a down-to-earth attitude."[14]

Shortly after DeGeneres's debut in J.C. Penney's advertising campaign, the conservative Christian group One Million Moms took offense, citing DeGeneres's homosexuality as problematic for the brand's image and its traditional family-shopper demographic. The group asked its members to boycott J.C. Penney and to call their local store manager to ask for DeGeneres's removal as spokesperson. DeGeneres went on the offensive to defend her personal values and to reassert her relationship with her fans and with J.C. Penney, producing a witty, yet heartfelt response delivered on her talk show that quickly went viral on the social web. A firestorm erupted and played out on J.C. Penney's Facebook page, where both pro- and anti-gay individuals pledged their support for and/or rejection of the retailer.

J.C. Penney survived the controversy by standing behind its choice of spokesperson. The protest generated significant positive press for the company, and Facebook feedback was, on balance, positive.

New Store Design

While the new logo and spokesperson were short-term fixes that could be executed quickly, Johnson knew from his experience at Apple that, to really make a difference, he had to institute significant changes to the product offering, a longer-term proposition. He embarked on a multiyear plan to re-energize and redesign J.C. Penney's product offering and its merchandising at retail.

He began by forging new relationships with top brands like Martha Stewart and hot designers like Nanette Lepore to create J.C. Penney–specific merchandise lines, a strategy reminiscent of Target's. He then went to work to improve the quality of J.C. Penney's dated private-label brands, Worthington, St. John's Bay, The Original Arizona Jeans Co, and Stafford. These efforts could also build on J.C. Penney's recent purchase of the Liz Claiborne brands and the ongoing opening of about 300 Sephora locations inside J.C. Penney stores, which offered a select set of Sephora beauty-care products.[15]

He envisioned the in-store retail environment as a series of specialty "Shops" along a visually engaging and vibrant "Street," with a central "Square" that would serve as the social hub of the store. J.C. Penney's vast array of merchandise, currently hung on crowded racks and shelves, would be regrouped in 80–100 stores-within-a-store, each meant to simulate the buying experience of a specialty shop. The first shop to appear was devoted to jeans and featured a denim bar, trained fit specialists, and Levi's innovative Curve ID program that helped women find the right jeans for their body type. Plans for future shops included Joe Fresh and Mango. The company planned to install two to three new shops each month, beginning in August 2012, over a four-year period. Many of the shops were designed to pull in younger shoppers, a deficit in J.C. Penney's current customer base.

The Street would consist of wider aisles with a fresh, clean look, with less signage and bold, colorful, upscale graphics featuring the square from the new logo. (See **Exhibit 6** for the layout and store design.) Each month would have its own unique personality and color-coded signage that changed the look of the store to freshen its appeal. Ten thousand square feet at the center of the store would be designated for the Town Square. In this area, J.C. Penney planned to offer complimentary services, such as gift wrapping, and special promotional events to create fun and excitement. During the summer of 2012, the company offered free hot dogs and ice cream, free "Go USA" Olympic T-shirts during the Summer Olympics, and free back-to-school haircuts for children. Johnson summarized his vision for the new environment: "We are going to make the store a place people love to come—just to come."[16]

New Sales Structure

To support the new retail environment, Johnson wanted to create a team of specialists who were product experts, much like those at Apple's Genius Bars. J.C. Penney salesclerks had always been paid commissions based on how much they sold, which encouraged salesclerks to sell aggressively to customers. Johnson felt that this culture did not fit with the new "Fair and Square" positioning and decided to eliminate all sales commissions. The decision was controversial, especially among employees, some of whom expressed dissatisfaction. "I must take offense at Ron Johnson's reason for eliminating commission. Ron Johnson should remember that J.C. Penney is not Target, we are better. When people come into our store they expect to be greeted, they expect someone to be available to help, they expect good service," said a sales associate. Another associate claimed, "I lost about $250 per pay period and Mr. Johnson thinks this is FAIR and SQUARE. From all of J.C. Penney's little workers, this stinks." Another lamented, "Ron Johnson may have a grand plan, and it may work, but we feel like he is destroying 'us' in the process of implementation."[17]

The New Pricing Strategy

Without a doubt, the cornerstone of Johnson's change program was a new pricing scheme. Looking at the numbers, Johnson believed that he needed to revamp the existing high-low pricing structure. J.C. Penney's customers had become hooked on the deals; over the past 10 years, the average discount to get customers to buy went from 38% to 60%.[18] "J.C. Penney spent over $1 billion [on price promotions], and the customer didn't even pay attention," he agonized.[19] In his first report to shareholders, he spoke about the detrimental long-term effects of excessive price promotions: "Plagued by the 'games' of the industry over the last several decades, retailers—including J.C. Penney—barraged customers with a constant stream of promotions that proved to be ineffective. Each time we participated in this pricing war, we were discounting our brand."[20]

The company announced its Fair and Square pricing plan in January 2012. The plan had three pricing tiers. First, the company reduced prices by an average of 40% to offer consumers an "Every Day Fair and Square" price. Second, every month the company ran a "Month Long Values Event" with special pricing on seasonal items, marked down an additional 20%–29%, meant to coincide with events such as Back-to-School and Father's Day. Third, every first and third Friday of each month were designated "Best Price Fridays," where J.C. Penney would offer special deals on items it was looking to liquidate, about 20% of the store's stock, at deals of about one-third off the everyday price. Each price point was supported by unique signage at retail. J.C. Penney eliminated its famous "doorbuster" sales, such as those that it traditionally held on Black Friday, the day after Thanksgiving, that featured outrageously low prices on over 500 items from 4:00 a.m. to 1:00 p.m. (**Exhibit 7** shows an example of the new price tiers.)

J.C. Penney would avoid using the words "sale" and "clearance" in its messaging. Said Johnson, "Sale is not in our vocabulary. . . . Every item in the store is priced to be its best price every day."[21] The Fair and Square price was the only price listed on the price tag, moving J.C. Penney away from the practice of listing the manufacturer's suggested retail price (MSRP) and the sale price, which was intended to show customers how much they were saving relative to a somewhat fictitious list price. In the highly competitive world of retailing, almost no one priced goods at the MSRP. Breaking with another common retailing practice, J.C. Penney ended all of its Fair and Square prices with .00 instead of .99, rounding up to the nearest dollar. Johnson also instituted a no-restrictions "Happy Returns" return policy, designed to take the hassle out of returning items, even without a receipt.

In effect, the new plan combined elements of two traditional pricing strategies: everyday low pricing (EDLP) and high-low pricing.

High-low pricing strategies were intended to allow retailers to use price discrimination to maximize the average price paid by customers who differed in their willingness to pay. Customers who were highly price sensitive waited for sale days to purchase, used coupons and rebates, scoured the crowded clearance racks to find a bargain, and took advantage of retailer's doorbuster specials. Customers who were less price sensitive bought when it was convenient for them, tended not to use coupons and rebates, and rarely joined in on doorbuster or clearance sales. However, the predominance of high-low pricing strategies in today's marketplace caused even less-price-sensitive consumers to become savvy about waiting for sales or to compare across retailers to find the store offering the best prices. And instantaneous price comparisons were getting easier with the rise of mobile smart phone applications.

Marketing consultant Jonathan Salem Baskin offered his thoughts on the high-low practice: "When no price is 'the' price for an item, it means that instead retailers engage customers in a constant cat-and-mouse game in pursuit of the truth. . . . [E]ach simply participates in a round-robin of discounted offers that its competitors have and/or will again match."[22] In Johnson's view, "The customer knows the right price. To think you can fool a customer is kind of crazy."[23]

EDLP pricing strategies, on the other hand, such as that offered by Walmart, promised consumers that they would pay the same low price every day. This freed customers from waiting for sale periods to purchase and eliminated the need for retailers to offer coupons or to engage in constant advertising of price promotions via weekly newspaper circulars. Most department store retailers used high/low pricing strategies. Macy's and Sears had flirted with EDLP pricing in the past, but both had largely abandoned it once they realized how addicted their customers were to sales, coupons, and other discount programs.

The new pricing strategy was a big shift for J.C. Penney, a company known and loved for its JCP Cash coupons distributed to customers via direct mail and e-mail, its RedZone Clearance aisles, and its weekly circulars advertising that week's price specials. The Fair and Square pricing program eliminated all coupons and weekly circulars; instead, the company distributed a high-quality, editorial content–heavy glossy magazine each month to highlight its Monthly Values. Each Monthly Value event was supported by $80 million in promotional funding.

Johnson hailed the strategy for its appeal to customers: "People are disgusted with the lack of integrity on pricing."[24] Johnson intimated that "[b]y setting our store monthly and maintaining our best prices for an entire month, we feel confident that customers will love shopping when it is convenient for them, rather than when it is expedient for us."[25] Michael Francis, J.C. Penney's new president, concurred, "Our objective is to make our customers love to shop again."[26] Francis was recruited by Johnson from Target and was charged with the marketing and merchandising efforts.

Reactions to Fair and Square Pricing

Industry observers could not contain their strong opinions on the new pricing strategy. Some called the move "refreshing, daring and probably exactly what the retailer needs."[27] But others were far more skeptical. Pricing consultant Rafi Mohammed proclaimed, "[I]f competitors drop prices on comparable products, J.C. Penney's hands are tied—it is a sitting duck that can't respond."[28]

Ignoring the skeptics, Johnson was committed to his new pricing plan, rolling it out across all stores on February 1, 2012, after deciding not to conduct market research to test its appeal with customers. "We debated whether there was a way to test. . . . We knew the customer would love the new strategy. We decided to get on with our future."[29] Johnson also believed that customers didn't always know what they wanted. "You can't follow the customer. You've got to lead your customers—anticipate their needs and meet those needs, even before they know what they want."[30]

Communicating "Fair and Square"

DeGeneres was featured in a new advertising campaign, launched during the 2012 Academy Awards broadcast. The campaign encouraged consumers to revolt against complex pricing structures, never-ending sales, an overabundance of coupons cluttering their mailboxes, and the hassles of returning unwanted products without a receipt. In the ads, DeGeneres traveled back in time to learn if today's confusing price environment was always the norm. The creative campaign was witty and contemporary, quite a departure from J.C. Penney's previous campaigns.

Initial Results

In the first three months after the launch, 67% of products sold at J.C. Penney were purchased at the Fair and Square price. Johnson was very pleased, saying, "This is profound. People are now buying at the first price, [the] right price. That's the dream of every retailer."[31]

However, trouble was looming on the horizon. Through mid-March, mothers, a critically important target market for most department stores, steadily rated J.C. Penney lower on value-perception scores. These women were downgrading their opinion of whether J.C. Penney offered good value for the money,[32] despite the fact that J.C. Penney's prices during the time period were actually quite competitive. A Deutsche Bank analyst report showed that for a random basket of 50 identical items, J.C. Penney was 9% cheaper than Macy's and 26% cheaper than Kohl's.[33]

Consumer research firms showed Macy's gaining ground on J.C. Penney in the women's apparel category following the launch. (See **Exhibit 8** for trends.) Morgan Stanley's Michelle Clark reported on consumer survey results revealing that "[s]hoppers think that the J.C. Penney of old actually offered better value than the 'fair and square' model. Of the consumers who had been inside a J.C. Penney store since February, more cited higher prices (rather than lower) at the department store. Furthermore, customers cited that bargains were harder to find and fewer aisles with deals were evident.[34]

Loyal J.C. Penney customers were moving away from the retailer. One shopper complained that she was no longer receiving coupons from J.C. Penney and was shopping more frequently at Target and Walmart. "The closest J.C. Penney is about a half hour away from me. If I don't get a special discount, it's not worth the trip," she said.[35] Another shopper e-mailed the *Huffington Post* saying, "They are catering to the younger shopper, and it isn't the younger shopper that kept them afloat."[36] A third who considered herself "frumpy and proud" commented, "He's working hard to 'de-frump' the store without considering that many if not most of its customers might have shopped there precisely because they like the more conservative frumpy look."[37]

These early indicators played out in J.C. Penney's first earnings report following the launch of the new plan. Johnson had to announce a significant earnings loss ($163 million) based on plummeting sales revenues (down 19% overall, with e-commerce sales dropping 28%), gross margin compression (from 40.5% to 37.6%), and decreasing customer conversion. Johnson asked investors to be patient, calling the first-quarter sales drop "the price we're paying to get integrity back."[38] He held fast to his convictions, saying, "We had to make the bold step. It's one big year we have to go through. It's really hard but we'll get through it."[39] Investors showed no patience, sending the company's stock down 20%, the biggest single-day drop in over four decades.[40]

The critics did not waste time piling on Johnson. *Time* columnist Brad Tuttle wrote, "JC Penney's message seems to be one that some shoppers don't want to hear. They like playing games and hunting for deals, and the markdown from the original price is how they keep score. No more games, no more fun—and not much reason to visit JC Penney on a regular basis anymore."[41] A *Forbes* columnist concurred, "By taking away the weekly sales customers loved, Johnson abandoned his core JCP shopping enthusiasts. In effect, signaling to core JCP enthusiasts—shoppers who have sustained J.C. Penney through its years of retail muddling—that they no longer mattered. He confused them, and he pissed them off."[42]

Macy's CFO Karen Hoguet was crowing that her company was benefiting, reporting that sales in Macy's stores that shared a mall with J.C. Penney were up significantly since the changes.[43] And J.C. Penney's apparel suppliers were becoming anxious, as their sales dropped precipitously, some as much as 70% over the prior year. One prominent supplier indicated that he was increasing his business with Kohl's to make up for the shortfalls at J.C. Penney.[44]

These developments were sobering for Johnson, yet he remained unfazed, commenting, "We are down a little more than we thought, but not enough to change the strategy. . . . We're treating this company as a startup. . . . We're inventing a whole new model to do business. . . . It is a one year transition that's part of a multi-year transformation. But once we get to one year of de-promoting or repurchasing our integrity, I fully expect us to grow."[45]

When Johnson was asked if he had a contingency plan whereby the company would revert to its previous high/low pricing strategy, Johnson swore it was not in the cards: "It won't happen while I'm here because I know it's not the right thing to do. . . . Every longstanding company has a DNA in its core that typically goes back to its founder. And when you reconnect with that, that's when good things happen. That's what Wal-Mart has had to do. And it's really led to great success. That's what Apple had to do when Steve came back. That's what we're going to do."[46]

Making Some Adjustments

J.C. Penney management tried to decipher the disappointing results. Mike Kramer, J.C. Penney's new chief operating officer, expressed his frustration. "Coupons, that drug. We did not realize how deep some of our customers were into this. . . . We have got to wean them off this and educate our consumers."[47] Johnson blamed the marketing execution, claiming it failed to communicate the new pricing strategy: "Our pricing is kind of confusing. Our marketing kind of overreached. [Now] the most important thing is to educate consumers on the price changes and make sure the core customer understands J.C. Penney still has products they love, at exceptional value, every day."[48] Francis took the fall for the poor earnings, leaving the company a mere eight months after he started as president.

Johnson took over marketing and merchandising, believing that customers didn't understand the story behind Fair and Square. He tweaked the marketing plan, adding five additional "Best Price Fridays" to the calendar, including the important Fridays anchoring Memorial Day weekend and Black Friday. The advertising creative was changed to incorporate a harder-hitting "Do the Math" positioning, which encouraged customers to calculate on their own how much they were saving over price promotion tactics. In June, J.C. Penney reintroduced the word "sale" into its advertising.

Under pressure, Johnson speculated about what his old mentor, Steve Jobs, would have advised: "I think Steve's advice would be don't worry about what others say. Trust your instincts. . . . Stay the course. But he would also say the essence is in the simplicity. And so he would have liked where we are going on pricing."[49] Johnson doubled down, saying, "What you can't do is chicken out. If you had looked at the data on the Genius Bar after a year and a half, we should have taken it out of the store. But it was something I believed in with every bone in my body."[50]

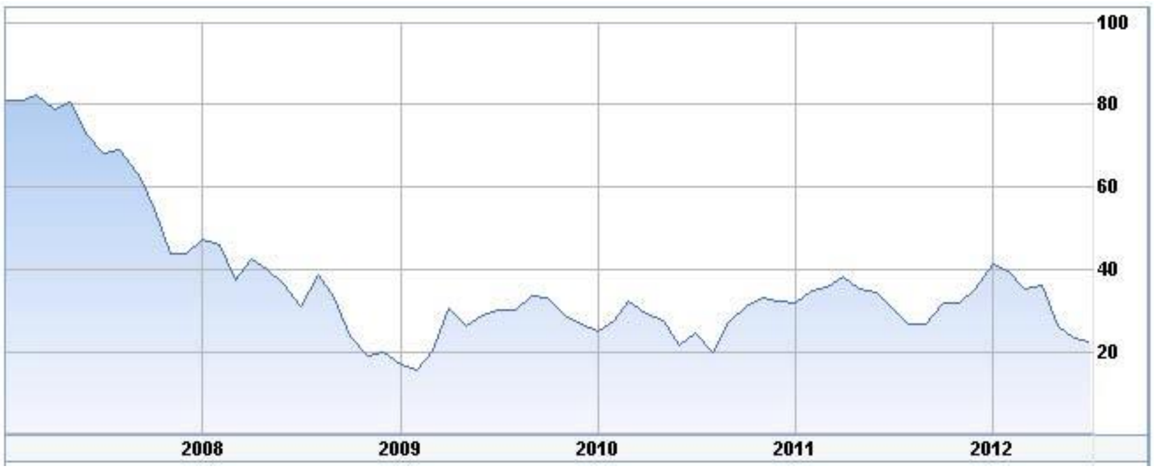
Second-Quarter Results: Further Adjustments

Johnson had a lot to look forward to in the fall of 2012. The first 10 Shops were slated to launch, and 47% of the fall merchandise in the stores would be new, as designers Nanette Lepore, Vivienne Tam, and Cynthia Rowley created low-cost lines for the retailer. Another 20 Shops were in development. However, as he stared at the Q2 results he was about to release to Wall Street (see **Exhibit 9**) and with the back-to-school and holiday selling seasons just around the corner, staying the course on the centerpiece of the new plan—the bold pricing moves—appeared to be an untenable proposition. In August 2012, Johnson abruptly decided on a number of changes, eliminating the Monthly Values pricing tier and modifying the name of the Best Price Fridays to "Clearance." To simplify consumers' understanding, he eliminated the name Fair and Square from the everyday price, which was now featured in black type in the store. He bumped up the promotional spending to run circulars every Friday during the back-to-school period. He explained the changes as a way to simplify the program: "We thought simplifying 590 unique sales events into three types of pricing would be easier, but it turns out . . . customers and others found the pricing a little confusing. Now we're going from 590 to 3 to 1: The first price is the right price."[51] He also said, "We had to retrain a customer that for years we taught to look for value through the illusion of savings. And we're just going to deliver those savings every day."[52]

Johnson wondered whether he had done the right thing. Were these recent changes enough to turn things around? Did they bump J.C. Penney too far from the course he had set for it? Was communication of the program to consumers the problem or was the Fair and Square strategy itself flawed? Johnson once again drew upon his past experience: "Apple went through much tougher years than we are going through this year at Penney's. . . . A transformation is a marathon, not a sprint."[53]

Exhibit 1 J.C. Penney Co., Inc., Stock Performance

Five-Year Performance (January 2007– July 2012)



Source: Adapted from E-trade Financial website, https://www.etrade.wallst.com/v1/stocks/charts/charts.asp?symbol=JCP, accessed August 15, 2012.

Exhibit 2 J.C. Penney Co., Inc., Financials and Sales by Category

Fiscal Year Income Statement (FY 2007–2011) and FY 2012 First-Quarter Results (Millions)

	2007	2008	2009	2010	2011	1st Quarter FY 12
Revenue	19,860	18,486	17,556	17,759	17,260	3,152
Gross Profit	7,671	6,915	6,910	6,960	6,218	1,186
% Margin	38.6%	37.4%	39.4%	39.2%	36.0%	37.6%
Operating Income	1,879	1,146	680	847	485	(226)
% Margin	9.5%	6.2%	3.9%	4.8%	2.9%	(7.2%)
Net Income[a]	1,110	572	251	389	(152)	(163)
% Margin	5.6%	3.1%	1.4%	2.2%	(0.88%)	(5.2%)

[a] Net Income measures the residual income that the company receives after all expenses have been accounted for; operating income measures the income that the company realizes from its core business operations.

Selling, General, and Administrative Expenses (FY 2010 and FY 2011)

	2010	2011
Total SGA	5,613.0	5,230.0
Marketing expenses	1,172.0	1,039.0
Marketing as % of SGA	21%	20%
Marketing as % of revenue	7%	6%

Exhibit 2 J.C. Penney Co., Inc., Financials and Sales by Category (continued)

Sales/Revenue Breakdown by Category (FY 2010 and FY 2011)

	FY 2010	%	FY 2011	%
Revenue	17,759.0	100%	17,260.0	100%
Women's apparel	4,262.16	24%	4,315.0	25%
Men's apparel and accessories	3,196.62	18%	3,452.0	20%
Home	3,551.8	20%	2,589.0	15%
Children's apparel	2,131.08	12%	2,071.2	12%
Women's accessories	1,953.49	11%	2,071.2	12%
Family footwear	1,243.13	7%	1,208.2	7%
Fine jewelry	710.36	4%	690.4	4%
Services and other	710.36	4%	863.0	5%

Source: Bloomberg Capital IQ Company; and J.C. Penney Co., Inc.

Exhibit 3 Comparative Performance Relative to Primary Competitors

Select Financials FY 2011 (millions)

Company Name	J.C. Penney Co., Inc.	Kohl's Corp.	Macy's, Inc.	Sears Holdings Corp.	Target Corp.	Wal-Mart Stores, Inc.
Revenue	17,260	18,804	26,405	41,567	69,865	446,950
Gross Profit	6,218	7,179	10,667	10,731	20,893	111,823
% Margin	36.0%	38.2%	40.4%	25.8%	29.9%	25.0%
Marketing Expenses	1,039	962	1,136	1,900	1,360	2,300
SG&A Expenses	5,320	4,243	8,281	10,454	13,440	85,265
Operating Income	485	2,158	2,386	(568)	5,322	26,558
% Margin	2.8%	11.5%	9.0%	(1.4%)	7.6%	5.9%
Net Income	(152)	1,167	1,256	(3,140)	2,929	15,699
% Margin	(0.88%)	6.2%	4.8%	(7.5%)	4.2%	3.5%

Sales per Retail Square Footage

Company	**FY 2007**	**FY 2008**	**FY 2009**	**FY 2010**	**FY 2011**
J.C. Penney Co.	$189.41	$170.77	$158.45	$159.06	$154.93
Kohl's Corp.	$249.14	$226.24	$223.98	$232.01	$231.62
Macy's Inc.	$168.89	$160.85	$152.13	$162.00	$172.52
Target Corp.	$316.83	$301.71	$287.58	$289.50	$297.72

Source: Capital IQ, company, and Bloomberg.

Exhibit 4 E-commerce 2011 Sales and Sales Growth,[a] J.C Penney, Macy's, and Kohl's

Company	2011 ($million)	YoY Change	3-Yr. CAGR	5-Yr. CAGR	7-Yr. CAGR
J.C. Penney Co.	$1,523	-0.2%	1.3%	3.3%	9.4%
Kohl's Corp.	$1,012	36.2%	41.7%	40.6%	42.7%
Macy's Inc.	$1,800	39.6%	29.0%	34.1%	38.5%

Source: Adapted from "JC Penney's Multichannel Fail," iStockAnalyst, June 8, 2012, http://www.istockanalyst.com/finance/story/5888491/jc-penney-s-multichannel-fail, accessed August 28, 2012.

[a] E-commerce sales include all sales made through the retailer's online website.

Exhibit 5 J.C. Penney's New Logo

Source: J.C. Penney Co., Inc., http://www.jcpmediaroom.com/, accessed January 3, 2013.

Exhibit 6 J.C. Penney New Layout and Store Design

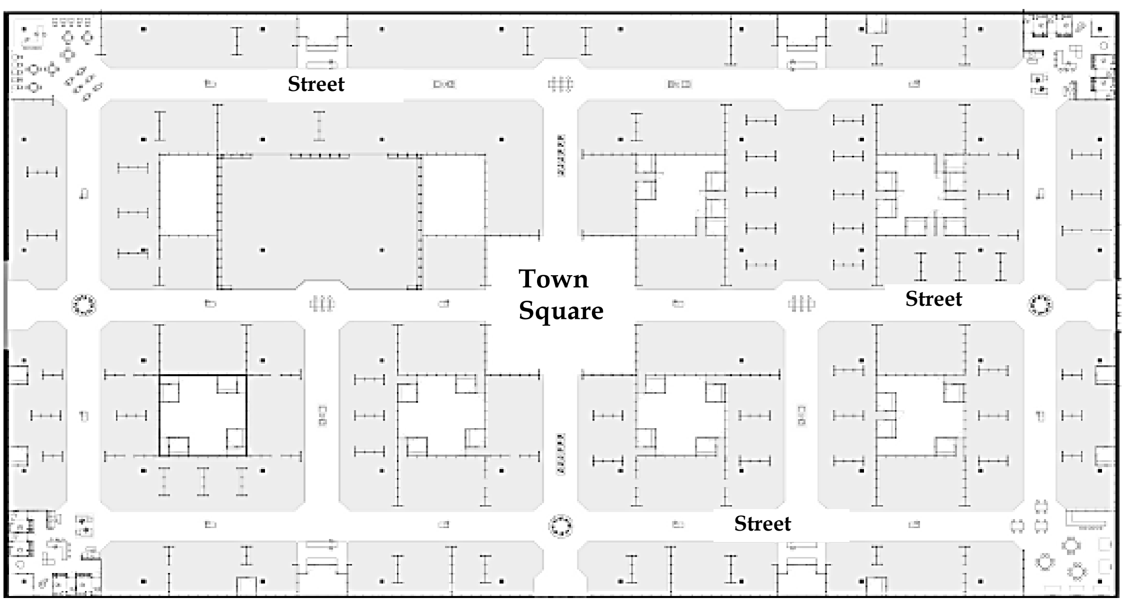


Exhibit 6 J.C. Penney New Layout and Store Design (continued)

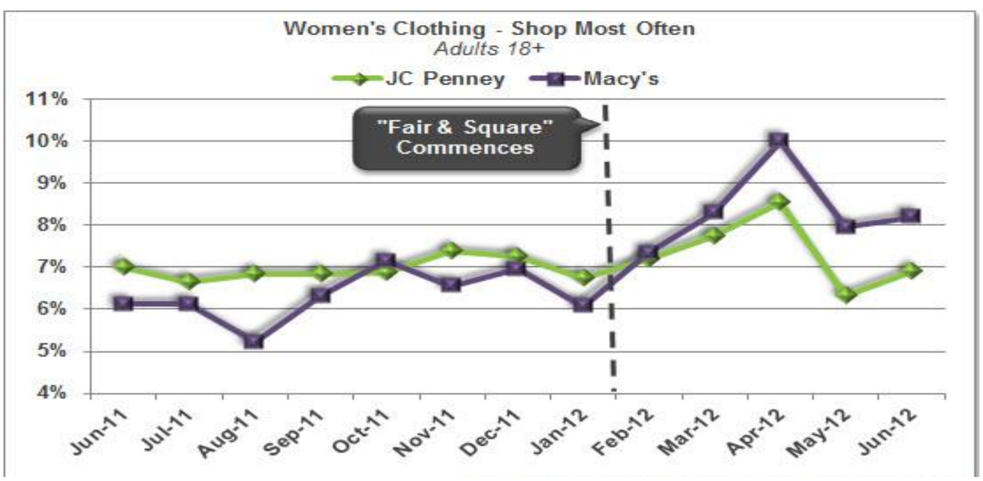
Source: J.C. Penney Co., Inc., 2012 2nd Quarter Report for the Quarter Ended July 28, 2012, http://www.JCP-Q2-2012pres-withDetail1.pdf, accessed July 2012.

Exhibit 7 Cost of a T-shirt at J.C. Penney: Old versus New Pricing Model

Old High/Low Pricing Strategy		New Fair and Square Pricing Strategy		
MSRP	Average Selling Price	Every Day Fair Price	Monthly Value	Best Value
$13.99	$5.99	$7.00	$6.00	$4.00

Source: Casewriters.

Exhibit 8 Shopping Trends—Women's Clothing—Following Fair and Square Launch



Source: Adapted from Monthly Consumer Survey, June 2012, as featured in http://www.forbes.com/sites/brucerogers/2012/06/22/more-trouble-ahead-for-jc-penney/print/, accessed July 31, 2012.

Exhibit 9 J.C. Penney Q2 2012 Results (dollar amounts in millions, except per share data and data on average spending per visit)

J.C. Penney Company	**Q2 2012** **Three Months Ended July 28, 2012**	**Six Months Ended July 28, 2012**	**Six Months Ended July 30, 2011**
Revenue	3,022	6,174	7,849
Gross Profit/Loss	1,004	2,190	3,092
% Gross Margin	33.2%	35.4%	39.4
Selling, General, & Administrative Expenses (including marketing expenses)	1,050	2,210	2,524
Total Operating Expenses	1,187	2,599	2,850
Operating Income/(Loss)	(183)	(409)	242
Earnings per Share	(0.67)	(1.42)	0.35
%Selling Margin[a]	42.5%	41.2%	41.9%
% Revenue Earned from Products Sold at Everyday/Month-Long Value Prices	83%	84%	86.5%
% Revenue Earned from Products Sold on Clearance	17%	16%	13.5%
Customer Traffic vs. year ago[b]	(12%)	--	--
Customer Conversion[c]	21.9%	--	--
Average Spend per Visit	$44.2	$44.9	$47.8

Source: Morningstar, from J.C. Penney Co., Inc., JCP Q2 2012 Earnings Call Transcript, August 10, 2012; ThomsonReutersStreetEvents, Edited Transcript, JCP-Q1 2012 Earnings Conference Call, May 15, 2012, http://ir.jcpenney.com/phoenix.zhtml?c=70528&p=irol-presentations, accessed August 2012; By the Numbers and Beyond the Numbers, http://beta.fool.com/fishbiz/2012/06/14/jc-penney-numbers-and-beyond-numbers/5782/, accessed, August 2012; and casewriter estimates.

[a] Selling margin in dollar amount ($) captures the difference between average retail price of each unit sold (AUR) less the average cost per unit to the retailer (AUC). As a percentage (%), it is expressed (AUR–AUC)/AUR.

[b] Quarterly comparison of the number of customers shopping in the stores this year versus last year.

[c] Reflects the percentage of people who enter a store and buy something.

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