The Customer Trap

How to Avoid the Biggest Mistake in Business

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Setting Up for Failure

Thomas Edison could have been talking about the Customer Trap when he observed, "many of life's failures are people who did not realize how close they were when they gave up."

For companies who initially pour all that they have into building great products, services, and brands, nothing is more depressing than watching them fail when it comes to the critical next step. Still, falling into a dysfunctional relationship with a Mega-Customer is not something that just happens, but is an intentional strategy.

CHAPTER

1

The Biggest Business Mistake

When you find yourself in the majority, pause and reflect.

—Mark Twain

Many of the people who lead companies, from huge multinationals to brand-new startups, think that if they can just get their product or service into the hands of a Mega-Customer, all their problems will somehow magically disappear. The thinking goes like this: "If we can make enough sales, profits will rise, business will grow, and we will be unimaginably successful. The trick is to find ever-bigger customers who can buy increasingly larger quantities of what we produce."

One of the most influential developments since the turn of the century has been the rise of large-scale customers across the business spectrum. We call these *Mega-Customers*. The temptation to search out Mega-Customers is almost irresistible. After all, they exist in every sector of the economy. In consumer retail, it is the big boxes: Walmart, The Home Depot, and all the rest. Online it is Amazon.com. AutoNation and Penske Corporation that drive a great deal of the automotive industry in America. Boeing and Airbus dominate aviation, as do AT&T and Verizon in telecom. In flowers it's FTD Companies, Teleflora, and 1-800-Flowers.com. And, of course, at the top sits the US federal government, with the nearly $1 trillion it spends in the private sector each year. Uncle Sam is the single largest buyer of everything from paper clips to pharmaceuticals, trucks, cell phones, airline tickets, legal services, energy, hotel rooms, medical care, and information technology.

The perceived benefits of selling to a Mega-Customer are compelling, to be sure. Broader exposure to a wider expanse of the marketplace results—it is assumed—in substantial increases in sales. It also promises the chance to streamline customer management; to have only a few customers instead of hundreds or thousands. Both benefits are attractive, particularly in an era of relentless competition and disruption. Who wouldn't want to bring a few Megas on board?

However, this kind of thinking is shallow and dangerous. Ideas and the decisions we make around them have consequences. The risk is that once the decision has been made to go with the Mega-Customer, there is no turning back, as forces beyond the control of the producing firm quickly and inexorably takes over.

We're reminded of one of our former students, Sam. He was the kind of kid who you just knew was going to do well in business. He asked the right questions and was always exploring the best way to do things. His attention to detail was astounding. During college, Sam ran a pretty successful landscaping / snow removal company. He had two trucks, eight employees, and around 200 residential and commercial customers. Business was good and growing at a steady, sustainable pace. After he graduated, Sam continued to add crews each year, along with more and more customers. He made it through the Great Recession and even picked up accounts from competitors who couldn't survive. He was celebrated by the local media and named an emerging business leader. Eventually Sam's firm was one of the fastest growing landscaping companies in the region. He was well on his way.

One day Sam called one of this book's authors, Andrew, and said he was facing a tough decision. The biggest bank in the region had sent out a request for bid to handle the mowing, planting, landscape maintenance, and snow removal for its nearly 100 branches and offices. It was an 18-month contract. Sam said getting the contract would likely double his overall business, and he wanted to know if he should submit a bid. Andrew told him to be careful, and to not allow the bank to swallow up what had become a successful business. Dishearteningly, what Sam was really looking for was validation. He had already made up his mind to chase the big whale.

Not surprisingly, given his reputation in the marketplace, Sam won the bid. The bank instantly became 50 percent of his entire revenue stream, which meant that he had to immediately lease more equipment and trucks, and he had to hire a lot more people. Money flowed in, and money flowed out. Inevitably, internal resources—most important, Sam's famous attention to detail—were steered away from his original client base and toward the new

Mega-Customer. Service to the "originals" suffered, and many left. Still, it was, overall, a winning proposition. For the next year and a half, Sam was well on his way to becoming a very young millionaire. He bought a new home in a high-end neighborhood, a new Porsche Cayenne, and a new boat.

And then, 18 months later, the bank did what the bank had always done: it issued a new request for bid. Sam assumed that since he had performed so well for them, his contract would automatically be renewed. He was shocked, however, when he learned that the new bid asked for a price 20 percent less than the one Sam had negotiated 18 months earlier. That 20 percent was his margin!

Not without dismay, Sam "sharpened his pencil" and submitted a new bid, knowing that he was going to have to dramatically cut costs to stay ahead. He won the contract again, but he had to pay his employees less. Many of the best people left and went to work for his competitors. Service further suffered. More original customers departed. In 2011, fuel prices spiked, further hurting Sam's business.

By the end of the second 18-month contract, Sam was struggling to make payroll and the lease payments on his equipment. (He also quietly sold the new home, the Porsche, and the boat.) Needless to say, Sam didn't submit a third bid when the bank announced it was looking for a new supplier once again.

With the weight of the Mega-Customer off his back, Sam believed that he could start over with a wide base of residential and commercial customers. The problem was that his brand had become tarnished over the past three years. Word-of-mouth had spread about the poor service that Sam's business was now providing. Most of his old customers had moved on: snow, rain, and sunshine were not waiting for Sam to figure things out. There were driveways to clear and grass to shorten, and somebody else would be doing it. Sam is now selling cars at a local dealership.

It's a Common Story

Before you think this is merely the story of a young kid who did not know the ways of the world, we would like to remind you that similar cases over the past few decades have played out tens of thousands of times inside companies that were exponentially bigger than Sam's. What's more, they had experienced leaders who should have known better.

Let's look at another story, this time from a nationally recognized company that also fell into the Customer Trap. You might remember David Oreck, the founder of the vacuum cleaner company that bears his name. Television commercials featuring Mr. Oreck with a bowling ball over his head being held in place by one of his vacuum cleaners became cult favorites.

For 40 years his company was the kind of example that business students and emerging entrepreneurs were taught to emulate: the innovative, domestic manufacturer—supported by a direct sales strategy—that kept control of its products and brands.

We even once met Mr. Oreck when he spoke at our university. He was rightfully proud of what he had spent a lifetime to build. Hardworking Americans were paid a good day's wage making his products in Louisiana and Tennessee. He shunned the big-box stores at every turn—even calling Walmart "China Mart."

Exclusive franchises and corporate-owned stores kept the brand equity high. They sold only Oreck products. They were, along with the company's web site and call centers, the only places where somebody could buy an Oreck product. Many models cost over $1,000 and carried a 25-year warranty—something unheard of anywhere else in the household goods industry. The business grew. The brand got stronger. Franchisees and consumers were true believers, and the product attained an almost mystical status.

And, then, Mr. Oreck decided to sell the company. He sold it in 2003 to American Securities Capital Partners, a private-equity firm that proceeded to suck the life out of the business and left others "holding a big, ol' dusty bag full of debt."[1] The private-equity geniuses proceeded to wreck the company almost overnight by deciding to sell through Target. The exclusive franchisees, many of them loyal for more than 30 years, were pushed aside in favor of the new, bigger-volume Mega-Customer. The solid customer relationships Mr. Oreck had built over decades were immediately cannibalized. No one would pay $1,000 anymore for a vacuum cleaner that was now sold like a bag of bricks or any other commodity at a big-box retailer. The brand was ruined. The Oreck fanatics were thrown aside, sacrificed at the altar of big volume.

Remarkably, as the company predictably fell into bankruptcy, the new leaders of the firm had the chutzpah to blame the company's demise on not selling out to the big boxes fast enough. They said the transition in how they sold and distributed vacuum cleaners—by selling through large retailers instead of directly to customers—took longer than expected.[2] So, if we follow the logic here, the company was ruined because they couldn't destroy it fast enough.

You can't make this stuff up.

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[1] Al Lewis, "Sucking a Business Dry," *The Wall Street Journal*, May 18, 2013, p. 2.
[2] Katy Stech, "Oreck Family Left in the Dust," *The Wall Street Journal*, July 9, 2013, p. B.4.

So What, Exactly, Is a Mega-Customer?

Simply put, a *Mega-Customer* is a customer that accounts for more than 10 percent of the total amount of sales. Why 10 percent? Is this some arbitrary number? Where does it come from?

Part of the explanation is intuitive. Putting a lot of eggs in one—or even a few—baskets can prove wonderful so long as those big customers stay profitable and loyal. However, change in business, as in life, is inevitable. The minute big customers change their minds, leave, or threaten to do so unless dramatic concessions are met, catastrophic situations can arise. Most of us would remember if we had a major account that announced it was taking its business somewhere else unless it got a dramatic price reduction. Such moments can cause grave harm, or even threaten the entire future of a company.

A more substantive reason for not exceeding 10 percent comes from the practice of managerial accounting. In 1974, the Financial Accounting Standards Board (FASB) established financial accounting standards for financial reporting by nongovernmental organizations. These standards are recognized as authoritative by the American institute of Certified Public Accountants and that Securities and Exchange Commission (SEC).[3]

The FASB has codified the language of accounting in its Statement[s] of Financial Accounting Standards (SFAS). These formal documents detail standards and guidance on selected accounting policies. The FASB issues these standards with the expectation that all reporting companies listed on US stock exchanges will adhere to them. Such standards are created to ensure a higher level of corporate transparency. In other words, this is all designed to provide outsiders a better look at what is going on inside a publicly traded company.

For our purposes, we are interested in SFAS 131:

> An enterprise shall provide information about the extent of its reliance on its major customers. If revenues from transactions with a single external customer amount *to 10 percent or more* of an enterprise's revenues, the enterprise shall disclose that fact, the total amount of revenues from each such customer, and the identity of the segment or segments reporting the revenues.[4]

In layperson speak, this means that under the accepted financial accounting standards of the United States, a publicly traded company must disclose if a customer is more than 10 percent of its total sales. Why? Because according to the accepted standards, a customer that represents more than 10 percent of total sales is a potential risk to the firm that outsiders should be made aware of.

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[3]Financial Accounting Standards Board, "Facts About FASB," www.fasb.org/jsp/FASB/Page/LandingPage&cid=1175805317407, accessed July 22, 2014.

[4]Financial Accounting Standards Board, "Statement of Financial Accounting Standards No. 131," www.fasb.org/resources/ccurl/699/632/fas131.pdf, accessed October 10, 2014.

The 10 Percent Rule

So why would the accountants come up with 10 percent as the benchmark for disclosure? We believe that it is because the 10 Percent Rule just makes sense.

As the Greek philosopher Heraclitus rightly put it, "Nothing endures but change." Customers come—and they go. For example, if a company has ten customers, and they are each about 10 percent of the total sales, and one or two of them fall away, the company will most likely survive. It might be tough sailing for a while. Nevertheless, replacing the two lost customers and their 20 percent of revenue is by no means impossible.

But what about a company that has ten customers, nine of which are 60 percent of the business, plus one—a Mega-Customer—that is responsible for 40 percent of all its revenue? What happens to that company when the Mega-Customer makes unrealistic demands, gets sold, goes out of business, or something else occurs? Replacing 40 percent of sales is a tough proposition, even on a good day. And what about a customer that is more than 40 percent of the business?

The same can be true if a significant portion of a company's revenue is connected to one industry. For example, how many companies were nearly wiped out when their customers in the travel and tourism sector were crippled after the September 11 attacks? In short, overdependency on one Mega-Customer, or one industry, can be devastating.

Something else regularly happens when a company violates the 10 Percent Rule: the Mega-Customer starts to tamper with the supplier's operations, ultimately forcing the supplier to accept and do things that would not have otherwise been considered. Of course, these activities are all designed to increase the profitability of the Mega-Customer, frequently at the expense of the supplier. A few common examples include the following:

- Changing payment terms. ("Now that we are so important to you, we are going to take more time to pay you.")
- Requiring suppliers to buy, learn, and use completely new information technology systems. ("Your systems are OK, yet to do business with us, you need to invest in a new system, bought through our own provider.")
- Charging for every little thing. ("Your truck was 10 minutes late; we will charge you X. We didn't sell all of the inventory we ordered, so we are charging you Y to have you move it out of our warehouse.")

- Providing access to the innovator's formulas and trade secrets. This is usually done under the guise of "quality assurance." And, of course, once that knowledge gets out, it doesn't go back into the tube.
- Holding hostage vital information about how the product or service takes its path to market. ("Since we are the customer, we have the right to not share information about your product with you.")

At the core of the Customer Trap is the promise of incredible wealth. Every supplier who gets a product or service accepted by the dominant player in their industry gets rich, right? Nothing could be further from the truth. The trap is sprung when Fortune 500 companies—or mom-and-pop stores—make the conscious decision to seek out a relationship with a Mega-Customer.

By the time the supplier figures out that a new reality is taking over, it has already entered the Customer Trap. The outcomes are predictable and heartbreaking. Product life cycles are dramatically reduced, turning hard-fought innovations into commodities. Long-standing brands and whole sectors are wiped out and become a shell of their former selves. Domestic operations are shuttered in favor of the low-cost advantages of outsourcing and offshoring. And despite strenuous efforts to continually reduce costs, profits cannot be found.

But It's Not the Mega-Customer's Fault!

Before we go any further, and you think this is merely another book pointing a finger at the giant retailors of the world for the ills they bring to local communities, let us be clear: we do not blame Megas for the problem of the Customer Trap and what it leads to. We believe that the true responsibility for a company's products and services lies with that same company. Nobody at FTD, Walmart, Amazon, the federal government, or any other potential Mega-Customer forces a supplier to come knocking on its door.

Whether it is out of naïveté, arrogance, or greed, companies that expect a Mega-Customer to treat them kindly—and to respect their brands, products, and services—are tragically misguided. What business leaders do not know, what they forget, or what they ignore, is that a strategy based on pursuing the Mega-Customer is inherently flawed.

And, yet, this is exactly what has happened repeatedly during the past decades. The shift occurred when marketing began to adopt the objectives of supply-chain management, where scale and efficiency dominate. While producers focused on perfecting their internal capabilities, Mega-Customers, operating under the radar of most business-school professors, management consultants, and the business press, came to dominate every sector of the economy. The message to producers was clear: "Your job is to be 'lean' and 'efficient' and—at the same time—continuously deliver 'customer value' to the marketplace."

On the production and operations side, Six Sigma and other industry certifications are undoubtedly critical components of efficiency that need to be part of a company's DNA. But what about the customer side of the enterprise? This is where the delusion enters in. For example, how many companies believe that outsourcing a customer call center to India, in the name of efficiency and lower costs, is a good idea? We already know the answer.

Let's use Walmart as an example. It has around 125,000 suppliers. Because of its size, the retailer is the largest customer for the vast majority of these vendors. In the lexicon of efficiency, it makes sense to deal with just one customer like Walmart. Still, ask most of those suppliers how their profits stack up next to Walmart, year after year, and you'll likely hear anything but nice words.

Walmart's inevitable price cuts force manufacturers to lower costs, which may mean sending production offshore to China, designing quality *out* of a product, limiting research and development (R&D), and outsourcing service and repair. The result is the erosion of value for the consumer, as cost-cutting measures forced upon the producer by the Mega diminish the very attributes that attracted buyers to the product in the first place. It is difficult to make a lasting compromise between efficiency and value, because the quest for greater efficiency is by far the more powerful force and continually encroaches on customer value through repeated compromises.

Here's an example: Jones Soda used to be a hip, niche producer whose initial sales and distribution strategy was built around selling through unique complementors including tattoo parlors and snowboarding shops. The company had a small sales force that sought to grow the brand through its unique distribution channel. It was a solid model: an innovative manufacturer selling through loyal distributors, and eventually to Panera Bread and Barnes & Noble.

Then the CEO at the time got a brilliant idea: to expand sales and distribution further by selling through Target and other Mega-Customers. It was a tipping point, if you will. Sales volume surged, but profits evaporated. The company hemorrhaged money and has never really earned a profit since. Fast-forward to today: the stock is stuck at around 35 cents a share.[5] Another CEO is brought in. What is the new strategy? To sell in 3,600 Walmart stores, so as to increase sales volume. Wow.

[5]On December 27, 2014, the company's share value was 0.34. It peaked in April 2008 at around $28.22 per share, just prior to the deal with Target.

Who Is Responsible?

To be fair, business leaders who drank the elixir of the Mega-Customer were players in a drama that began in the United States in the 1980s and has since spread around the world. Innovative companies and the people who led them were responding to what management theorists were saying at the time. These business gurus talked about organizational transformation—emphasizing core competencies, resources, capabilities, innovation, technology, and operational effectiveness. Methodologies such as total quality management, lean manufacturing, and Six Sigma were just some of the solutions preached by the business elites to companies of all sizes.

The Megas are both the by-products and the cause of a contagion that has spread across American business and is now being exported to the rest of the world. Beginning in the early 1980s, US manufacturers and service providers moved aggressively away from vertical integration and began to outsource many of their business activities. The concept of *core competence*, which is a mainstay of management education, was given as the primary rationale for jettisoning sales and distribution.

The idea was that the leaders of an organization should identify those areas where they excelled—where they brought true value to the marketplace—and dump everything else. Why manage a string of small customers, dealers, or franchisees when your core competency—your basis of differentiation—is in R&D, innovation, or manufacturing? Taking this advice, companies divested themselves of activities that were not perceived as value-added, and they pushed sales and distribution aside. Thousands of businesses that had previously been in control of all aspects of their innovative development began to lose interest in sales and distribution, preferring instead that specialists take over this "business function." Ironically, this created a marketplace vacuum that the Megas rapidly filled. Soon, the very companies that had taken over these noncore activities began to exert control at the core level, highjacking the strategic direction of the producing companies that had given them life in the first place. This, combined with a rash of international mergers and acquisitions, takeovers, and consolidations in the early 2000s, fueled the evolution of massive distributors in every industry, which became the driving force behind the sales and distribution of innovative products and services in the United States and around the world.

Today, most products and services are controlled by entities other than the ones that created these products and services. We find that, overwhelmingly, the ability of companies to get their innovations into the hands of consumers is blocked, thwarted, and controlled by Mega-Customers. Manufacturers do not even have control over the prices they can charge. This is evidenced by mandates from Mega-Customers who, year after year, impose price reductions while insisting that their suppliers maintain high standards of quality. This is the Customer Trap in action.

Still, in the end, the responsibility and, ultimately, the accountability for the rise of Mega-Customers sits squarely on the shoulders of those executives who decided to outsource their sales and distribution to the Megas in the first place. It was their call and their decision. It is critical to understand that when we talk about responsibility and accountability, it is individuals who must be held to account, not intangible things like corporations.

For every important responsibility, such as developing a sales and distribution strategy, there is accountability. It is the obligation of each person to answer for the discharge of responsibilities that affect others. Accountability includes being responsible for intentions as well as results. Whenever someone has an important obligation, they must answer to stakeholders for their decisions. What we find far too often is that executives, who at one time bought into the temptation of doing business with a Mega-Customer and now realize that they are caught in the Customer Trap, engage in the blame game. They say things like, "Well, we didn't know that this was going to happen to us." Or, "We didn't think that this was going to be the end result."

But, as your parents used to say, those you associate with define you. If you decide to travel to Bentonville, for example, and sit across the table from Walmart's buyers, and you then allow Walmart or any other Mega-Customer into your company, you have to fully accept the consequences of that action.

Mega-Customers are everywhere. They do not lie about who they are. Contrary to the conventional wisdom—and as we make clear in this book—they are not the only option. And they are most certainly not the best one. Doing business with Mega-Customers is not inevitable, nor a fait accompli. It is only when companies decide to search out and do business with a Mega-Customer that the Customer Trap becomes a reality. To provide you a clearer understanding of this all-too-common business mistake, we'll spend the next four chapters laying it out. A warning: this is not for the faint of heart.

CHAPTER

2

The Customer Trap and Brand Destruction

Nobody ever did, or ever will, escape the consequences of his choices.

—Alfred A. Montapert

The Customer Trap can lead to the destruction of many vital parts of a business. The power that a Mega-Customer is able to wield simply overwhelms the strategic toolkit of its supplier. As the Mega-Customer gains leverage, the producing firm loses control over its destiny and is soon nothing more than a colony serving the needs and wants of its colonial master. Once this happens, it is almost impossible to regain control. This is probably nowhere more easily seen than in the area of branding. The scope and magnitude of a deal with a Mega-Customer can quickly erode the brand equity of individual products and services. Ultimately, it will ruin the overall brand image of a company.

Whether your company is a small manufacturer, local retailer, or a Fortune 500 conglomerate, the quality and resonance of your brands is imperative.

What is a *brand*? It is an intangible set of perceptions that represents the essence of a company and the products and services it offers. This is supported by the rational, functional, and emotional attributes those products and services stand for. And, as the saying goes, "Perception often is reality."

The moment Oreck placed its products alongside the cheap, Chinese-made vacuums stacked against the nondescript walls of Target stores, for example, perceptions about the brand were incontrovertibly altered. Consumers now think about the brand in a fundamentally different way; the premium luster has been tarnished. Oreck is damaged goods.

The same is true when businesses such as restaurants, spas, dance studios, dermatologists, and automotive repair shops offer deals through Groupon, LivingSocial, Amazon Local, and similar web sites. These intermediaries can quickly become Mega-Customers to the providers. Producers are too easily persuaded that any losses incurred by lowering their prices will be more than offset by gains in sales volume. And rather than having to build relationships and market to a wide variety of clients (something that is both time-consuming and expensive), the Mega-Customer will take care of it for them.

The thinking goes like this: "We might be giving a spa treatment for 30 percent less through our Groupon special, but think of how many more spa treatments we'll be able to sell. And we won't have to worry about advertising and marketing because Groupon is doing that for us!"

This back-of-the-envelope approach to business strategy is more than dangerous. It fails to take into account the other costs associated with discounting through a Mega-Customer. An unintended but real consequence is the diminution of the brand. Once consumers see the brand associated with these kinds of deals, they will wait until the next round of deals are offered before considering a purchase. This puts the service provider into a downward spiral of constantly having to offer better deals in order to meet or beat their competitors, who are themselves selling through the Mega-Customer. These kinds of sites do not offer exclusivity. Instead, they pit producers directly against one another. Moreover, consumers will not develop loyalty to the service provider, but instead to the intermediary. Customer loyalty becomes based on the deal of the day, rather than the value provided by the product or service.

In this chapter, we'll take an in-depth look at two long-standing brands that have been effectively ruined by the Customer Trap. The harm caused to both Levi Strauss & Co. and Goodyear at the hands of their Mega-Customers provides an object lesson in the dangers of seeking to maximize volume at all other costs.

Levi Strauss Gives It Away

If there was ever such a thing as an iconic American brand, it was Levi Strauss & Co. Their jeans, ubiquitous for more than a century, were at the very center of American culture. Cowboys and aspiring cowboys strapped oversized belt buckles to their Levi's in rural Wyoming; hippies and their cultural progeny put on prefaded versions; and almost everyone in between wore the jeans in some fashion. Levi's were the stuff of legend. James Dean wore them in *Rebel Without a Cause*. They even played a role in the Cold War. *Time* magazine reported in 1962 that bureaucrats in the former Soviet Union opposed their corrupting influence. "There is even a blue-jean fad to the anger of militant party stalwarts, who note acidly the blue denim must have been smuggled in from abroad since it is not even manufactured in the Soviet Union."[1] Smuggling jeans into Russia during the dark days of communism financed many European adventures for young Americans.

Levi Strauss is named after its founder, who created the rugged jeans for the miners of the California Gold Rush of the 1850s. Strauss hired a tailor to make pants out of the brown canvas he had carried across the country to San Francisco. After he ran out of material, he was able to source a new supply from the town of Nimes, France. This material, known there as *serge de Nimes*, was anglicized into the simpler word "denim." Strauss colored the fabric blue, and then he and his successors scrambled for a century to keep up with sales. The company had revenues of $2.4 million in 1880. Innovations such as fastening seams with rivets and branding (the kind involved with a hot iron) with numbers—the first was the now famous 501—followed.

During the first half of the 20th century, the firm struggled against both adversarial economic conditions and a lack of visionary leadership. Nonetheless, circumstances helped the company to break out of its regional market. Visits to western dude ranches by easterners during the 1930s, coupled with the appearance of blue jeans in hundreds of Hollywood westerns, created a mystique around this unique product.

During World War II, the US government declared Levi's to be essential to the war effort and made them exclusively available to defense workers. Pent-up consumer demand after the war created an ongoing product shortage. With only five factories, Levi Strauss was forced to implement a distribution program that favored the intermediaries and retailers that it had worked with during the preceding decades. In 1948, company profits were more than $1 million on the sale of 4 million pairs of jeans.

In the 1950s, noticing that America was in the midst of a baby boom, the company shifted its attention in the direction of the youth market, emphasizing that its pants were for play, not just work. The firm's sales force became national in scope, focusing more on urban than rural stores. New innovations followed, including zippers instead of the five-button fly, preshrunk denim jeans, stretch denim, corduroys, and permanent press. The firm grew at an

[1]Time, "Russia: The Liberal Life," http://content.time.com/time/magazine/article/0,9171,829038,00.html, February 16, 1962.

outstanding pace. From 1963 to 1966, sales doubled to $152 million. In 1968, Levi Strauss had sales of $200 million. It had become the sixth-largest clothing producer in the United States. Still, it was unable to keep up with demand. Despite domestic and international challenges in the 1970s, sales topped $1 billion in 1974 and then doubled four years later.

In the early 1980s, the demand for denim jeans slowed, prompting Levi Strauss to make its initial foray into the mass market. Deals were struck with Mega-Customers J.C. Penney and Sears. However, earnings dropped by 25 percent, and in 1982 the company shuttered nine plants and eliminated 2,000 jobs. Despite beefed-up advertising alliances with the high-end fashion market, and an Olympic tie-in in 1984, profits were down 50 percent by the middle of the decade.

Still, Levi Strauss was able to dig itself out of the hole through the introduction of new products, including Dockers and stonewashed jeans. Sales and distribution in the 1990s was extended to upscale stores like Macy's, as well as company-operated, stand-alone Dockers and Levi's stores. By 1996, the firm was debt free, had robust operations across Europe, was expanding into emerging markets such as India and China, and produced strong earnings.[2]

And, then, seemingly almost overnight, everything changed. In an SEC filing in 2000, the company outlined its precarious financial condition. A mere four years earlier, it had been on a solid footing with strong profits and a sustainable business model in place. In just that short time, however, the company closed 29 plants, eliminated 18,500 jobs, and watched profits shrink from $411.5 million in 1997 to just $5.5 million by 1999.

The root of the Levi Strauss implosion was attributed to a massive accumulation of debt incurred in 1985, when it went private in a leveraged buyout. Things were further complicated by the derailment of a highly touted employee incentive plan that was introduced during the peak year of 1996. The idea was to reward employees with a one-time bonus that would be equal to one-year's pay. The cost was $750 million.[3]

Compounding the company's difficulties was the altered competitive landscape. Levi's products were positioned above low-end alternatives sold by Sears and J.C. Penney. Yet they were below newer upscale brands produced by Calvin Klein and Tommy Hilfiger. Describing the conundrum facing Levi's, Peter Sealey, a former Coca-Cola executive and instructor at the University

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[2]Funding Universe, "Levi Strauss & Co.," www.fundinguniverse.com/company-histories/levi-strauss-co-history/, March 4, 2015.
[3]Andrea Orr, "Levi Must Work Out of Tight Fit: Wal-Mart Deal May End Slide in Revenues," *Houston Chronicle*, September 18, 2003, p. 4.