CASE 26
HIGHTOWER DEPARTMENT STORES: IMPORTED STUFFED ANIMALS

On the morning of January 17, 1993, Julia Brown gathered together the past sales data on stuffed animals. As toy buyer for the chain of Hightower Department Stores, she knew that a careful review of the performance of the various models of stuffed animals sold during 1992 was necessary prior to her annual round-the-world buying trip in late January.

During this trip she would be buying all the imported toys that the Hightower chain would carry during the 1993 Christmas season. In particular, she would choose approximately 15 different types of bears, raccoons, elephants, and so on from the stuffed animals offered by various manufacturers in West Germany. These choices would be made after viewing what each manufacturer had to offer and then considering the overall attractiveness of this menagerie. She often made the decisions fairly quickly, using the sound judgment she had gained through her many years of buying experience.

Julia knew that her major purchase would be Steiff stuffed teddy bears, which Hightower had carried almost every year since they were first manufactured in Germany in 1903. She also had had experience with other stuffed-animal manufacturers and planned to reorder with them. But in choosing the last few animals for her assortment, Julia sometimes hedged her bets by ordering a minimum quantity of new models to test their sales potential. These test models were sold in only one store within the chain, and the results of the sales were then used to decide the fate of each animal for the succeeding year.

Julia was preparing to go over the test sales data for the three models tested in 1992: a bear, a pig, and a raccoon. A description of these models and the sales results are given in Exhibit 1. At first glance, the raccoon results looked very promising. Julia tentatively decided she would go with it for 1993 but knew she still needed to determine what quantity to order. In contrast, the pig had turned out to be a real "dog," and Julia was ready to admit that her attraction to this model on last year's trip may have been a mistake. Last, deciding whether to order the bear was one of those tough choices Julia had to make quite often. Although the test market had indeed succeeded in separating the raccoon from the pig, it had done nothing to help determine the future success of the bear.

Hightower Department Stores

The Hightower chain was a small but profitable company operating 16 full-line department stores in six major metropolitan areas in the eastern United States. The Hightower name was associated with quality, large selection, and good

EXHIBIT 1 1992 Test Animals

Animal	*Description*	*Landed Cost**	*Retail Price*	*Sales Proj.†*	*Purchases*	*Sales*	*Closeout Inventory*
Bear	Dark brown, long nose, 12 inches, handmade, plush	$5.43	$12.95	150	50	10	40
Pig	Cartoon-like, pink, 10 inches, soft plastic handmade	$6.23	$13.95	180	50	4	46
Raccoon	Grey/black, 14 inches, plush, realistic, handmade	$6.42	$13.95	170	50	32	18

* Total cost per unit; includes manufacturer's cost, shipping, import duties, and insurance.

† During her January 1992 buying trip, Julia Brown projected these holiday-season unit sales volumes based on all stores.

value. The company envisioned itself as a fashion leader; it took special pride in its ability to respond quickly to changes in fashion and style. Management also emphasized that TV and newspaper advertising, point-of-sale presentations, and knowledgeable and friendly sales personnel had been important to the success of the chain.

For the fiscal year ending January 31, 1992, the Hightower chain had reported $371 million in sales and $17.5 million net profit after taxes (see Exhibit 2). The expectations for the 1993 fiscal year were for small increases over 1992, but, as in previous years, these increases would not keep up with the general inflation rate.

Toy Department

Buying toys that could be sold at a profit had been an increasingly difficult challenge for Julia Brown and department stores in general. Toy departments were typically not so profitable as other store departments. Competition from general merchandise chains, mass merchandisers, variety stores, toy supermarkets, and toy specialty stores had lowered conventional department store toy sales to about 9 percent of the total market. The department stores' need for high margins made it difficult for them to compete in the toy business. Whereas the Hightower chain looked for margins of 40 to 50 percent, specialty toy chains such as Toys R Us operated with only 30 percent margins for most merchandise.

EXHIBIT 2 Store Sizes and Sales Volume (year ending January 31, 1992)

Store	*Size (thousand square feet)*	*Sales Volume ($ millions)*
Washington, D.C.		
Downtown	370	$36.7
Prince George's Plaza, Md.	182	22.2
Columbia, Md.	150	19.7
Tysons Corner, Va.	205	26.8
Boston		
Downtown	361	34.0
Burlington Mall	104	14.4
South Side Plaza	139	18.3
Philadelphia		
Downtown	369	32.8
King of Prussia	145	17.7
Cherry Hill, N.J.	105	12.3
Baltimore		
Downtown	320	27.4
Towson	139	17.0
Golden Ring	107	12.4
Pittsburgh		
Downtown	420	39.2
Monroeville	150	18.3
Westmoreland Mall	171	21.6
Total	3,437	$370.8

Julia Brown had developed the following strategies to help cope with the increasing competition:

1. Deemphasizing TV-promoted toys—the high-demand, lower-margin toy category.
2. Excelling in areas that mass merchants could not, such as special events, displays, and demonstrations.
3. Emphasizing imported items and exclusive items not available elsewhere.
4. Varying the amount of floor space devoted to toys; in many department stores, toy floor space tripled during the Christmas season.
5. Developing the "grandmother" business—that is, stocking toys often purchased by grandmothers, who tended to shop in department stores and usually were not as concerned about price as other toy buyers.

As a consequence of these strategies, about one-half of Hightower's toy business was imports, compared with probably less than 20 percent for the mass merchandisers and toy supermarkets.

EXHIBIT 3 Stuffed-Animal Performance History: Christmas-Season Sales

Year	*1988*	*1989*	*1990*	*1991*	*1992**
Unit sales	5,932	5,837	5,879	6,025	5,983
Dollar sales (thousands)	52.7	58.0	63.9	66.8	68.5
Gross margin† (thousands)	25.0	26.2	26.8	31.0	31.5

*Preliminary figures.

†Retail sales plus end-of-year closeout minus landed cost.

EXHIBIT 4 Performance Statistics (year ending January 31, 1992)

	Toy Departments	*Total Stores*
Net sales percentage change from last year	2.8%	4.7%
Cumulative mark-on	41.3%	47.5%
Mark-downs (total price reductions from original retail—as a percentage of net overall sales)	13.3%	11.6%
Stock shortage (lost merchandise from theft, unrecorded mark-downs, and so on—as a percentage of sales)	2.2%	2.6%
Gross margin	30.8%	43.4%
Gross margin return on inventory cost (gross margin/ average inventory)	$1.40	$2.60
Stock turns	3.2×	3.4×
Sales per square foot	$86.00	$108.00

In almost all types of stores, nearly 50 percent of the toy sales occurred in November and December each year. Data on sales and gross margins for November and December of the last five years for Hightower's stuffed animals are given in Exhibit 3. Although the margin figures appeared considerably higher than those for the toy department in general, Julia knew that, when the total year was considered, stuffed animals performed only slightly better than average.

Figures for 1991 (see Exhibit 4) showed that the Hightower toy department's performance was like other department stores. The two figures Brown paid particular attention to were gross margin return on investment (inventory) and sales per square foot. Gross margin return on investment was calculated as the ratio of gross margin (sales minus cost of goods sold) to average inventory at cost. Sales per square foot was relevant, because it specifically considered the amount of selling space consumed to produce a given dollar of sales volume.

Stuffed animals occupied about 20 square feet of display space in each store during the Christmas season, compared with 5 square feet at all other times. The nature of the display varied somewhat from one year to the next, but the animals were always exhibited together in a single display. Anywhere from 15 to 20 different animals were available in a given year.

Imported stuffed animals were items consistent with Brown's merchandising strategy. They carried relatively high margins, responded well to creative display efforts and to advertising, and appealed to the grandmother business. If carefully chosen, they could be distinctive Hightower department store items; in most cases a particular imported animal would be exclusive to the Hightower chain.

Imported stuffed animals were carried only through the Christmas season. In January unsold inventory was unloaded at 80 cents on the dollar[1] to Fernstone's, a job-lot retailer. This policy had been instituted to clear out year-end inventories in preparation for the cut-back in display space allocated to toys. Brown felt this alternative was preferable either to marking the merchandise down for the year-end sale or storing unsold animals until the next season. Marking down items hurt the Hightower image, and carrying inventory until the next year was costly and greatly interfered with the selection of new animals for the succeeding year. The higher-valued imports were thus always sold before fiscal year-end, and the small selection carried in the off-season consisted entirely of domestic products.

Imported Toy Buying

Each January a number of buyers from the Hightower Department Stores chain went on round-the-world buying trips to select and order merchandise Hightower would offer during the fall and Christmas seasons. Since most foreign manufacturers operated on a make-to-order basis, lead times ranged from six to eight months. Hence, a January trip was necessary to ensure deliveries in time for the next Christmas selling season.

Julia Brown had bought toys for 15 years and had been on 10 previous Hightower foreign buying trips. This large base of experience served her well when evaluating new items. Her usual procedure was to decide a retail price and project a sales volume for each item of interest. If these projections were particularly encouraging, Julia would then place an order on the spot, using a very rough rule of thumb to determine exactly how many to order.

For the riskier items, she would try to buy test models for possible inclusion in the succeeding year's line of toys. Specific offerings changed greatly from one year to the next; but Julia was often able to persuade some of the smaller manufacturers to provide a small lot in one year, with a promise that the same item would be manufactured the next.

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[1]Sold at 80 percent of the landed cost. *Landed cost* included all costs associated with buying an imported item: manufacturer's cost, freight, import duties, and so on.

Terms for the purchase of European-manufactured toys were delivery net 30. Payment was due within 30 days of delivery, and the purchaser was responsible for import duties, freight, insurance, and so forth.

The buying procedure for stuffed animals differed slightly from that used with other toy merchandise. Because the stuffed-animal manufacturers were concentrated in West Germany, Julia was able to visit each in turn before placing any orders. At the end of these visits, Julia determined her desired stuffed-animal merchandise assortment for the following season. In this manner she was able to judge each item relative to the others available that year.

This buying strategy necessitated a careful system of note-taking and evaluation. For each animal of interest, Julia filled out a form she had personally developed. The completed form contained a description of the animal, information on the manufacturer, the manufacturer's price (in U.S. dollars), and estimated landed costs. In addition, Julia usually jotted down her evaluation of the salability of the animal, the features that differentiated this item, and any other information that might make her order-writing easier.

Two quantitative judgments also included were the retail price Julia thought the animal should carry and a projected sales potential at that price. Mark-ups on stuffed animals were customarily at least 50 percent over landed cost, and Julia set the retail price based on her feel for the appeal and price sensitivity of a particular animal. To round out her notes, Julia would then estimate the unit sales to expect if this animal was placed in the Hightower chain for the Christmas season.

Test Market

Each year Julia selected up to three imported animals as test models, which she bought in small lots of 50 units, the customary minimum order accepted by the German manufacturers. They were then sold exclusively in the Tysons Corner, Virginia, store (chosen as a representative Hightower store because of its size, sales volume, and consumer profile).

Once purchased, the test animals were treated like the other imported items. To avoid complications associated with the test, each test animal replaced a similar nontest animal. Thus the total number of animals was the same at the test store as at all other stores. Likewise, the display space per animal was not affected by the test.

Over the past 10 years, 20 different animals had been tested. Eighteen of these had been adopted for the succeeding year, and data were available on resulting total sales. The two animals not chosen were a rabbit in 1984 and a skunk in 1988, because both had very poor sales during their test years. Exhibit 5 contains the relevant information on these 20 test animals, including the projected sales volume Julia had estimated on her first exposure to each item. When a test animal was adopted as a regular the next year, it was offered at all 16 stores (the Tysons Corner store included) at the same retail price used in the test.

EXHIBIT 5 Past Test Results

Test Year	Animal	Landed Cost (dollars)	Retail Price (dollars)	Sales* Projection (units)	Test Sales (units)	Realized Sales (units)
1981. . . .	Ape	$2.33	$4.95	260	27	304
1982. . . .	Bear	3.15	5.95	280	19	374
1982. . . .	Dragon	2.52	4.95	230	14	234
1983. . . .	Bird	2.63	5.95	170	7	144
1984. . . .	Rabbit	2.85	5.95	180	6	ANA+
1984. . . .	Bear	3.18	6.95	140	8	133
1985. . . .	Dog	2.99	5.95	260	12	209
1986. . . .	Elephant	2.74	6.95	250	11	140
1986. . . .	Cat	3.20	6.95	270	30	458
1987. . . .	Bear	3.91	8.95	160	13	245
1987. . . .	Monkey	4.39	9.95	210	10	208
1987. . . .	Dinosaur	2.70	5.95	150	14	308
1988. . . .	Skunk	3.14	5.95	190	4	ANA+
1988. . . .	Mouse	4.91	10.95	150	7	47
1989. . . .	Raccoon	4.29	8.95	200	16	244
1990. . . .	Bear	4.34	9.95	220	23	385
1990. . . .	Alligator	5.88	11.95	250	8	269
1990. . . .	Dog	5.04	10.95	270	15	243
1991. . . .	Monkey	5.88	12.95	270	8	146
1991. . . .	Bear	5.19	11.95	170	10	259

*Made prior to the test market.
+ANA means animal not adopted.

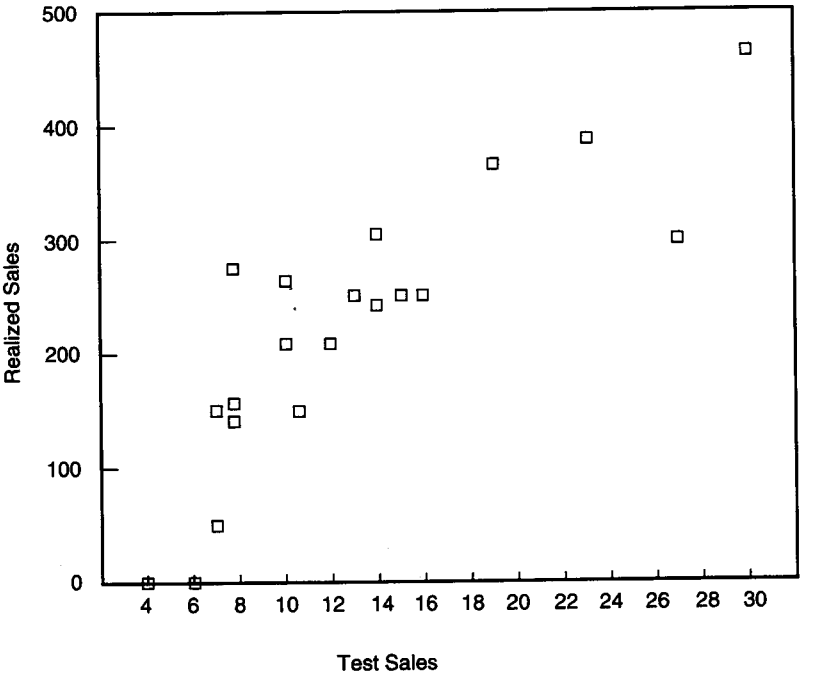
Brown's Analysis

Julia Brown called up her Lotus spreadsheet file that contained historical test sale data. Her first step in analyzing test animals was to update her plot of the first full year's unit sales versus the previous year's test sales. This year she had two points to add, one for a monkey that sold 8 during its 1991 test and 146 when adopted for 1992 and the other for a bear that tested at 10 units and sold 259 last year. This scatter plot is given in Exhibit 6.

The general shape of this cloud of points convinced Julia that test results were a good indicator of eventual sales volume. It appeared to her that the better the animal did during the test market, the better it would generally do when offered in all stores the succeeding year.

Turning to the three items tested in 1992, Julia made some mental notes about the sales potential of each. The pig, tested at four units, was in uncharted territory. Julia guessed that, if she did adopt it for 1993, sales would run about 100 units. Julia figured that the bear, with a test of 10 units, ought to sell about

EXHIBIT 6 Scatter Plot of Realized versus Test Sales



200 units. Last, the raccoon looked like the leading seller of the season. Test sales of 32 projected to a total sales volume of 500 for the coming year.

Next, Julia ran some numbers to decide the fate of the three animals. Exhibit 7 shows the calculated gross margin of each animal at its projected sales volume. The figures for the raccoon and bear looked promising, but Julia felt the pig was not worthy of adoption. She reasoned that Hightower was better off using the display space for another animal. She could certainly find a domestic animal that would still bring in at least $1,150 contribution during the Christmas season. In addition, the domestic animals could be ordered as needed, avoiding the inevitable mark-down and closeout to Fernstone's.

Julia then turned to work out order quantities for the two adopted animals. Her 150 percent rule of thumb implied ordering 300 bears and 750 raccoons. This rule had worked well in the past—she had almost never stocked-out of an imported stuffed animal. She had always felt that the only way to turn a profit was to make sure her inventories lasted through the Christmas season. In her mind a stock-out would be deadly to profits. Not only would Hightower lose the foregone contribution of the stocked-out item, but it might also lose some amount

EXHIBIT 7 Calculated Gross Margins of Each Animal

Animal	*Projected Unit Sales*	*Gross Margin per Unit*	*Estimated Total Gross Margin*
Bear	200	$7.52	$1,504
Pig	100	7.72	772
Raccoon	500	7.53	3,765

of future sales to those customers upset because a particular item was not available. On the other hand, Julia could also see that, since stock-outs would probably occur at the very end of the year, panicky last-minute buyers might easily switch to another animal. In this situation, the consequences of stocking-out of any one item were not that damaging. Julia figured that upset customers and switchable customers might cancel each other out, so the net effect of a stock-out was probably just the lost contribution of that item. Julia promised herself she would think more about lowering the order quantities.