HANDLEMAN COMPANY

A CASE FOR BREAKTHROUGH INTELLIGENCE

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"LOGIC IS THE ART OF GOING WRONG WITH CONFIDENCE" MORRIS KLINE

Since its founding in 1934 the Handleman Company (HDL) made numerous strategic decisions and changes to expand and / or offset declines in its business. Many of these were brought on by shifts in consumer preferences, changes in technology and the emergence of new opportunities.

In the 1950's, HDL morphed from being a distributor of pharmaceutical sundries to being a wholesaler of records. In the 1970's, the firm moved into the marketing and distribution of books. In fact, the history of HDL can be seen as a story where periods of stability are disrupted by episodes of significant change and adaptation. During these episodes, HDL's core distribution and marketing strengths were redirected, enabling it to become a player in various new arenas such as home entertainment, education software and accessories, exercise and Hollywood videos, compact discs, children's entertainment, etc.

In 1991, Stephen Strome became President and CEO of HDL. Ten years later, at the age of 56, he was selected to serve as CEO and Board Chairman.During Strome's tenure annual HDL revenues grew steadily reaching over $1.2 billion by 2003.

The firm's leadership had expectations of reaching the $2 billon mark in several years. These financial results and expectations were derived from the company's expertise in entertainment category management, store marketing and the physical control / distribution of music, movie titles and video game inventory. HDL's customer base included mass market retailers (e.g., Wal-Mart, Target, Kmart) specialty chains (e.g., Best Buy, Blockbuster, Circuit City) and independents.

HDL was based in Troy, Michigan and traded publicly on the NYSE. Its approximately 2,700 HDL employees serviced 4,000+ retail stores across the United States, Canada and the United Kingdom. At its peak, over 11% of all music sold in the US was attributable to HDL operations. HDL described itself to investors, creative producers and customers as the "indispensable link" between entertainment suppliers and retail merchants. Its core operational strength was the ability to "add value to the supply chain by providing services at a cost less than the retailers or entertainment manufactures could provide on their own."

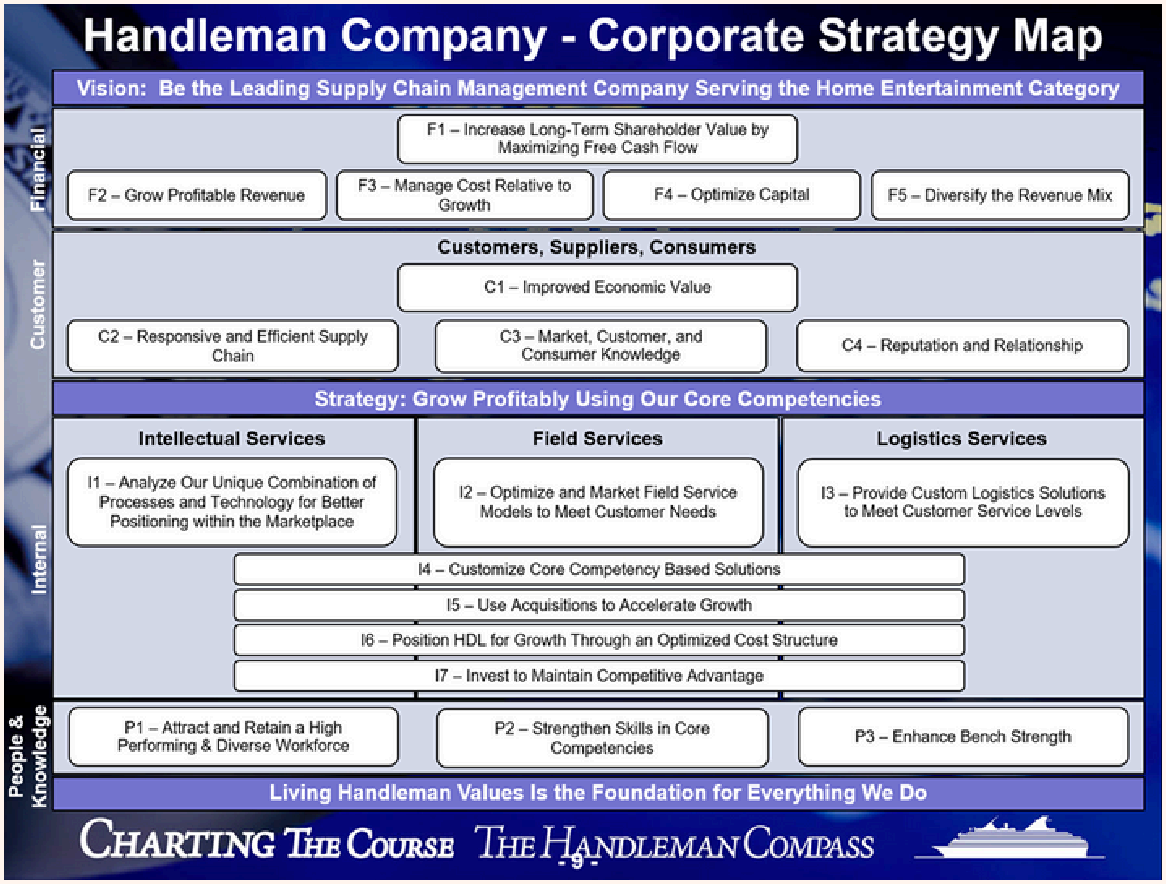
In 2003 and 2004 Strome explained that the long-term goal he, his executive team and board were focused on was to increase shareholder value by maximizing free cash flow (Figure 1- Handleman Company Corporate Strategy). This would be accomplished via earnings growth and market multiple improvements. As a routine practice the HDL leadership team and board assessed the competitive landscape.Strome and senor leaders were very aware of emerging marketplace factors that posed a threat to this objective (e.g., double digit decline in music industry sales, emergence of digital distribution, lack of new category management customers, Kmart's questionable survival, etc.) and the need to address them. However, to belay these concerns and keep attention on bettering the market multiple Strome also argued that the investment community was overlooking HDL's unrivaled fundamentals (i.e., its history of generating record revenue, net income and EPS growth derived from a sound business model).

Strome reasoned that the market probably did not grasp HDLs plans to diversify its product lines and industries by acquiring alternative growth opportunities. He emphasized HDL's need to stay focused on execution and its need for more persuasive external communications about its plans to make strategic changes.

Internally, HDL was invested in using a sophisticated balanced scorecard as the centerpiece of its strategy management system. It was used primarily to establish discipline and accountability throughout the firm. Its goal was to ensure the organization carried out this strategy by making strategy execution everyone's job. Secondarily it was a feedback mechanism (on the relative success of the strategy) to promote reflective learning and adaptive change in the organization.

As illustrated in Figure 1, HDL had 19 integrated objectives in its corporate strategy. The majority of the 19 objectives pertain to the core existing business. The objective most oriented to delivering a breakthrough future (surpassing the boundaries of HDLs current business) is I5 (use acquisitions to fuel growth). Strikingly, approximately three FTEs were devoted to activating objective I5.

FIGURE 1: HANDLEMAN COMPANY CORPORATE STRATEGY



It’s unlikely that HDL had the capacity to keep pace with the digital developments responsible for revolutionizing how people experience music. However, with different priority and lead time could they have identified (and activated) opportunities to extend their SKU intensive management capabilities in new ways?

In retrospect, HDL made accurate and early assessments of its market risks (e.g., changing consumer preferences, the rise of digital music). However, HDL was unable to add new revenue streams to offset revenue declines. It was unable to lessen its reliance on a core business model and a market opportunity that was increasingly fading and out of step with new market realities. By 2007 HDL revenues had reversed course and were down from their peak of $1.3 billion a year earlier. The revenue decline worsened. By the close of 2008 they eroded to under $500 million. In May 2009 HDL liquidated its assets and was dissolved, bringing its 75-year run to a close.

Reflection Questions:

- Why do you think HDL senior leaders and board members were unable to keep HDL on a growing or profitable path?
- Might HDL’s strategy and scorecard program have kept the company from uncovering new market possibilities and bringing them into existence? If so, how?
- HDL’s scorecard program was a structural mechanism that reinforced how groups and individuals contribute to the execution of the HDL strategy. In retrospect, what was likely missing or out of balance in HDL’s effort to evolve and remain relevant in the market?
- If HDL leaders could have known with certainty the eventual fate of their business model, when and how should they have taken different actions?
- What does the HDL case reveal about business vulnerability? What does it suggest about recognizing the markers of decline? What are the implications for the level of effort and speed leaders devote to creating future possibilities?
- Should we view HDL’s decline as an outlier (a single, point-in-time industry phenomenon)? To what extent is it a story that applies to many firms, large and small?

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