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Big Customers and Their Suppliers: A Case Examining Changes in Business Relationships and Their Financial Effects

Martin L. Gosman and Trish Kelly

ABSTRACT: In this case, you will analyze large retailers' increasing clout and its implications for the pricing, inventory, and credit practices of their suppliers. You will use accounting data to explore how changes in these business practices and other phenomena at the firm and industry levels affected retailers' and suppliers' financial performances. In addition, you will examine stock return information to determine how Wall Street responded to the effects of these changes on firms' profitability. As a result, the case will increase your understanding of how to use accounting data to assess the effect of marketing and managerial decisions on financial performance. You will consider these issues for four large retailers (JCPenney, Target, Toys "R" Us, and Wal-Mart) and three manufacturer-suppliers (Garan, Mattel, and National Presto).

INTRODUCTION

The 1990s witnessed the growth on a national scale of low-price retailers such as Wal-Mart, Target, and Home Depot. As a result, the percentage of national retail sales accounted for by the top 10 retailers climbed from 11.0 percent in 1989 to 16.1 percent in 1999 (Standard & Poor's 1992, R79; Hoover's Inc. 2000). This increase occurred in part due to Wal-Mart's spectacular growth; the firm's sales increased at an average annual rate of more than 20 percent during this period (Wal-Mart 10-K 1999).

This consolidation at the retail level has been accompanied by sales concentration in the manufacturing sector, where manufacturers report that fewer retailers account for an increasing share of their sales. Accounting standards require that firms disclose the existence of a major customer—defined as "a single firm, group of firms, or government responsible for at least 10% of its sales" (FASB 1997, para. 39).

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Table 1 presents the results of one study that looked at changes in major-customer citations and sales concentration during the 1989–1997 period (Gosman and Kelly 1999–2000, 58). As noted there, major-customer citations became much more frequent during that time period. In fact, 55 of the 98 suppliers reporting at least one major customer in 1997 had no major customers eight years earlier.

The identity of a firm's major customer is a required SEC disclosure only when loss of that customer "would have a material adverse effect on the registrant and its subsidiaries as a whole" (SEC Regulation S-K). Nevertheless, suppliers usually name their retailer major customers—in 80 percent of all cases according to one study (Kelly and Gosman 2000, 53).

As "big customers" with increasing clout, large retailers have been able to initiate a variety of changes in business practices that have altered their relationships with the manufacturers who supply them. This case focuses on changes in three areas: pricing, inventory, and credit terms. Four large retailers are highlighted: a traditional department store (JCPenney), two discount department stores (Target and Wal-Mart), and a category specialist (Toys "R" Us). Three manufacturers that supply at least two of these retailers are also featured: a clothing manufacturer (Garan), a toy producer (Mattel), and a housewares maker (National Presto). The four retailers capture a variety of different pricing and/or product-line strategies, while the three manufacturers represent diverse industries and (as will be seen) varying levels of sales dependence on their retailer customers. As a result, the relationships among these firms offer a broad perspective concerning the impact of big customers on their suppliers' business practices and financial results.

The case is divided into several sections. The first section describes the anticipated learning outcomes. The second section details the extent to which the three manufacturer-suppliers' sales are concentrated among the four large retailers. The third section discusses changes in pricing, inventory, and credit policies that have resulted from large retailers' increasing clout. The retailers and suppliers examined in this case are profiled in the fourth and fifth sections, respectively. The case concludes with questions for discussion. These questions include consideration of whether the general trends discussed in the third section appear to apply to the firms profiled in the fourth and fifth sections.

TABLE 1
Growth in Major Customers, 1989–1997[a]

For 98 firms reporting at least one major customer in 1997 and making financial disclosures for all three years:

	1989	1993	1997
Number of firms citing at least 1 major customer	43	72	98
Mean number of major customers	0.6	0.9	1.5
Mean combined sales percentage to major customers	10.0%	16.3%	26.2%

[a] Source: Gosman and Kelly (1999–2000, 58).

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LEARNING OUTCOMES

In this case, you will learn how large retailers' increased influence over suppliers' pricing, inventory, and credit practices has affected the operating results and financial positions of retailers and suppliers. You will analyze accounting data for seven actual companies and determine whether retailers, suppliers, or both have benefited from changes in business practices and relationships. The case will increase your appreciation of the growing concentration of suppliers' sales and the usefulness of firms' major-customer disclosures. In addition, the case provides you with an opportunity to engage in critical thinking as you use accounting data to explore economic, financial, marketing, and managerial issues relevant to real firms.

SUPPLIERS' SALES TO THEIR RETAILER MAJOR CUSTOMERS

Table 2 details the extent to which the three manufacturer-suppliers' sales were concentrated among the four retailers examined in this case. As shown there, all three suppliers became increasingly dependent upon Wal-Mart during the 1994–1999 period.[1] The share of their 1999 sales with that retailer ranged from approximately 16 percent for Mattel to 89 percent for Garan, with National Presto in between at 46 percent. Each supplier disclosed in its SEC Form 10-K a second major customer in addition to Wal-Mart for one or more years during the 1994–1999 period.[2]

[1] In 1999, Mattel disclosed its combined sales percentage to Wal-Mart and Toys "R" Us without breaking down that figure by retailer.

[2] Firms with 500 or more investors and $10 million or more in assets are required to file an annual report on SEC Form 10-K within 90 days of the close of the fiscal year. The 10-K includes information on the firm's business and the risks that it faces, a Management's Discussion & Analysis section, financial statements and related notes, and other disclosures required by the SEC.

TABLE 2
Suppliers' Sales to Their Retailer Major Customers, 1994–1999[a]

Supplier	Major Customers	1994	1995	1996	1997	1998	1999
Garan	Sales % to Wal-Mart	62	63	66	71	80	89
	Sales % to JCPenney	18	20	15	12	10	7
	Combined sales %	80	83	81	83	90	96
Mattel	Sales % to Toys "R" Us	23	23	22	18	16	X[b]
	Sales % to Wal-Mart	13	12	12	15	15	33–X
	Combined sales %	36	35	34	33	31	33
National Presto	Sales % to Wal-Mart	35	36	38	43	44	46
	Sales % to Target	< 10	< 10	< 10	< 10	< 10	12
	Combined sales %	> 35	> 36	> 38	> 43	> 44	58

[a] Source: Firms' 10-Ks.

[b] In 1999, Mattel disclosed its combined sales percentage to Wal-Mart and Toys "R" Us without breaking down that figure by retailer.

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In 1997, Garan and National Presto both exhibited much larger sales concentrations than the averages for firms in their industries. In that year, the combined sales percentage to major customers was 33 percent for Mattel, 43 percent for National Presto, and 83 percent for Garan. This contrasts with average sales concentrations of 42 percent for toy manufacturers, 28 percent for housewares producers, and 36 percent for apparel manufacturers (Kelly and Gosman 2001).

CHANGES IN PRICING, INVENTORY, AND CREDIT PRACTICES

Large retailers' growth during the 1990s has been accompanied by changes in a variety of business practices at the retail level. This section examines changes in large retailers' pricing, inventory, and credit practices as well as manufacturer-suppliers' responses to changes in these policies.

Pricing

Large retailers face considerable pressure to keep prices low due to competition and the demands of price-conscious consumers. In this retail environment where price is emphasized, such firms have been able to hold down their prices in part by using their clout to influence supplier prices. For example, National Presto's 1999 Proxy Statement (p. 13) reveals the pricing pressures facing manufacturers:[3]

> In recent years, the durable housewares industry has suffered difficult business conditions, largely resulting from ever increasing concentration of power in a handful of dominant retailers. Such dominance has enabled these retailers to withstand price increases attributable even to inflation, demand added distribution services without compensation, dictate product design, insist upon random promotions, etc.

National Presto was not alone in experiencing pricing pressure. When Rubbermaid attempted to obtain price hikes to recoup increases in its raw material (resin) cost, Wal-Mart, Kmart, and Target responded by reducing shelf space and promotional materials for Rubbermaid products and increasing both for Rubbermaid's competitors (Tucker and Shearer 1996, 33). Moreover, when resin prices later fell, Wal-Mart forced price reductions from Rubbermaid rather than allowing the supplier to earn additional profits (Schifrin 1996, 42). Large retailers gain access to the information needed to force such price reductions through the increasingly common practice of "open book costing," whereby suppliers provide retailers with cost and profit data on items sold in their stores.

Inventory Levels, Risks, and Carrying Costs

To reduce warehouse costs, maximize shelf space, meet consumer demand, and improve operating margins, large retailers' inventory policies involve commitments to "just-in-time" (JIT) delivery and rapid replenishment. Advances in computerization allow large retailers and their major suppliers to utilize electronic data interchange (EDI) to exchange sales information daily, to order replacement goods immediately, and to replenish store shelves within 24–48 hours.

[3] This statement was part of management's response rebutting a shareholder proposal to sell the firm to the highest bidder.

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Moreover, when large retailers persuade manufacturers to ship goods on consignment, the supplier retains the inventory risk; the goods, although on the retailers' shelves, do not appear on the retailers' books (Ailawadi et al. 1995, 217).

However, retailers' success at reducing inventories has created planning and financial difficulties for some of their manufacturer-suppliers. In its 1998 10-K (pp. 11–12) Mattel referred to the effects of customers' JIT policies:

> Many of our significant customers have recently shifted to just-in-time inventory management systems to track sales of particular products. Such customers are timing reorders so that they are being filled by suppliers closer to the time of purchase by consumers, rather than maintaining large on-hand inventories to meet consumer demand. While these systems reduce a retailer's investment in inventory, they increase pressure on suppliers like us to fill orders promptly and shift a significant portion of inventory risk and carrying costs to the supplier. These systems may also limit our ability to accurately forecast reorders and create potential volatility in our operating results.
>
> The recent shift to just-in-time inventory management by one of our largest customers, Toys "R" Us, Inc., resulted in an approximately $250 million decrease in our net sales in 1998 as compared to 1997. It is not clear if more of our customers will shift to just-in-time inventory management systems or the extent to which those retailers that have shifted will ultimately reduce their overall inventories of our products.

Because retailers' JIT policies leave no excess inventory on shelves, suppliers who cannot deliver goods in a timely manner risk lost sales. For example, problems with a new computer system at Hershey Foods led to missed/incomplete shipments to Wal-Mart, causing the mega-retailer to increase purchases from others in late 1999/early 2000 (Sulon 2000).

Credit Terms, Returns, and Discounts

Large retailers' increasing clout enables them not only to negotiate generous credit terms upfront, but also to engage in the growing practice of "payables stretching" (Panczyk 2000, 39). In the words of one CEO whose small firm supplies lighting to several large retailers, "it doesn't matter what the terms are. They're going to pay you whenever they want. If you're going to need payment in 30 days, don't expect it from a chain" (Ostrowski 1998, B1).

When payments are made by retailers, they are sometimes reduced by what suppliers view as overzealous chargebacks in the form of unauthorized product returns and unjustified penalties (Ostrowski 1998, B1).[4] It has been reported that many large retailers take questionable, undocumented deductions from supplier invoices near the end of a quarter, suggesting that this practice might be used to "window dress" their financial statements (*Managing Credit Receivables & Collections* 1999, 5).

On goods that retailers receive on consignment from their suppliers, no obligation to pay is incurred until the consigned goods are purchased by the ultimate consumer. Toys "R" Us and Wal-Mart initiated consignment arrangements with their suppliers in the early 1990s. By 1999, Wal-Mart had extended the practice so that many of its key suppliers (including Procter & Gamble) acted as consignors,

[4] Retailers charge penalties for such "infractions" as the wrong label on a box or a minor mistake on a purchase order.

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retaining title to their goods while they were on Wal-Mart's shelves (*San Francisco Chronicle* 1995, B1; Mitchell 1999, 42). Under consignment accounting, the supplier (consignor) does not record the sale and accounts receivable and the retailer (consignee) does not record the purchase and the related account payable until the suppliers' goods are presented for checkout.[5]

Manufacturer-Supplier Responses

Faced with changes instituted by their retailer customers, some manufacturer-suppliers have responded by instituting similar changes with their own suppliers, including increased oversight of their own supply chains. For example, dye-maker Hoechst Celanese complained that its clothing-manufacturer customers were denying it price increases due to Wal-Mart's refusal to increase prices paid to the manufacturers (Foroohar 1995, 27). In some cases, manufacturers have adopted JIT systems of their own in dealing with their suppliers. In addition, some manufacturers have adopted "postponement" tactics, whereby partially completed products are stored, to be customized quickly when purchase specifications are received from retailer customers (Atkinson 1999, 13). A 1999 survey by The Performance Measurement Group found that manufacturers with vigilant oversight have cut their supply-chain management costs in half, to approximately 4–5 percent of sales (Atkinson 1999, 13).

RETAILER PROFILES

For the four large retailers featured in this case, brief sketches of their company histories, vendor relationships, and other developments are presented below.

JCPenney

Penney's went public in 1929, an inauspicious year for an IPO, but the company actually grew during the Depression. As of October 28, 2000, its operations consisted of 1,102 department stores (totaling 54 percent of sales, including its catalog operations), 2,622 Eckerd drug stores (42 percent of sales), and a direct marketing operation (4 percent of sales). Penney's department stores focus on soft goods, such as apparel, footwear, and sheets/towels. In the Management's Discussion & Analysis (MD&A) section of its 1999 10-K, Penney's reports that gross margins at the Eckerd drugstores chain, acquired in 1997, were approximately 10 percentage points lower than the gross margins for its department store and catalog operations.

In response to prolonged sluggish sales, in early 2000 Penney's finalized plans to close 45 underperforming department stores and 289 Eckerd drugstores and it began to re-emphasize its key private-label brands (e.g., Arizona Jeans). At the same time, Vanessa Castanga, executive vice-president and chief operating officer, announced that centralized merchandise teams would make all purchasing decisions. Previously, individual store managers had made up to one-half of these decisions. Castanga, who oversaw the merchandising of women's and children's apparel at Wal-Mart prior to her August 1999 move to Penney's, pledged that the firm would work more closely with vendors to "get rid of the clutter, spotlight hot

[5] Frequent instances of the front-loading of revenue, including situations where suppliers accounted for consignments as if they were final sales, led the SEC to expand its guidance to firms in its Staff Accounting Bulletin (SAB) No. 101, *Revenue Recognition in Financial Statements*, issued in December 1999.

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fashions, jump-start sales, and speed replenishments" (Williamson 2000, 38). She noted that suppliers "will increasingly take on more risk and shoulder with us the responsibility of delivering the product to our customers at the right time" (*PR Newswire* 2000).

In September 2000, Ms. Castanga was joined by Allen Questrom, a highly regarded turnaround retailer, who assumed the role of Penney's CEO. Mr. Questrom had led both Federated Department Stores and the upscale retailer Barneys New York out of bankruptcy during the 1990s.

Target

With its Target stores accounting for approximately 80 percent of its revenues and profits by early 2000, Dayton Hudson changed its name to Target Corporation. Officials hoped that the name change would cause Wall Street to focus on its Target segment, because successful discounters command higher price-earnings multiples than full-price department stores (Strauss et al. 2000, 5B). As of October 28, 2000, the firm's retail operations consisted of 928 Target stores, 267 Mervyn's discount stores, and 64 full-service department stores operated as Dayton's, Hudson's, or Marshall Field's.

Target has been described as "the discount store with attitude—where department store customers feel very comfortable shopping" (Moore 2000, 5D). According to company figures, the median household income of Target shoppers is $47,000 and 80 percent attended or completed college (Strauss et al. 2000, 5B). In response to restocking problems attributed to rapid growth, Target in late 1999 realigned its logistics capabilities and began working more closely with vendors to improve inventory flow (Pachuta 1999, B7).

Toys "R" Us

Charles Lazarus opened his first discount toy store in 1958. Aided by extended credit terms from manufacturers, he pioneered the concept of selling toys throughout the year, rather than only in the six weeks before Christmas. By October 28, 2000, Lazarus, now Chairman Emeritus of the firm, had seen the company grow to include a co-branded Internet operation with Amazon.com and 1,579 stores in the U.S. and 25 other countries, operating under the Toys "R" Us, Kids "R" Us, Babies "R" Us, and Imaginarium names.

In 1997, the Federal Trade Commission ruled that Toys "R" Us had impeded competition by pressuring Mattel, Hasbro, and other manufacturers to curtail their sales to Price/Costco and Sam's Club. Toys "R" Us was allegedly concerned that these warehouse stores could undercut its prices due to lower advertising and promotional costs (*Newsday* 1997, 51).

In response to declining market share, the firm reduced its inventory by more than $560 million in 1998, closed underperforming stores, and consolidated its distribution operations. In that same year, Toys "R" Us, the pioneer category specialist, lost its place as the nation's top toy retailer when its 16.8 percent market share was surpassed by Wal-Mart's 17.4 percent (*Sacramento Bee* 1999, G1). By the late 1990s, toy chains accounted for only 23 percent of all toys sold, while discount stores accounted for 42 percent (*The Irish Times* 2000, 56).

Wal-Mart

Sam Walton and his brother opened the first Wal-Mart Discount City store in Rogers, Arkansas in 1962. As of October 31, 2000, the world's largest retailer

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operated 1,723 Wal-Mart stores, 866 larger Supercenters, and 469 Sam's membership clubs in the U.S. An additional 1,045 units served nine other countries. According to the firm's 1999 10-K, hardgoods comprised 22 percent of sales that year; other product categories at or above 10 percent were softgoods/domestics (20 percent), grocery, candy, and tobacco (18 percent), and pharmaceuticals (10 percent).

The company had become the largest private-sector employer in the U.S (excluding temporary [temp] agencies) and by 1998 accounted for $1 of every $6 (16 percent) spent on general merchandise, apparel, furniture and appliances, and miscellaneous shopping goods (GAF sales) in the U.S. (Standard & Poor's 1999, 11). According to a survey by WSL Strategic Retail, "about 40 percent of women aged 18 to 70 shop at Wal-Mart once a week" (Mirabella 2000, C1).

Wal-Mart's growth has been fueled by a low-price strategy. In late 1999, the firm announced plans for additional markdowns of $10 billion during the coming year (*Minneapolis Star Tribune* 1999, 3D). By 2000, Wal-Mart had become the largest retailer of supermarket items in the world (Mirabella 2000, C1).

Over 100 major manufacturers, including Procter & Gamble, Colgate-Palmolive, and the Gallo Winery, have set up offices near Wal-Mart's Bentonville, Arkansas headquarters to service the mega-retailer. However, Wal-Mart's longstanding relationships with its "supplier partners" have not precluded its development of private-label products. In 1999 for example, the retailer announced plans to introduce Sam's American Choice laundry detergent, with a package color scheme very similar to that of Procter & Gamble's Tide brand (Negley 1999, 13).

SUPPLIER PROFILES

For the three manufacturer-suppliers featured in this case, brief sketches of their company histories, customer relationships, and other developments are presented below.

Garan

Founded in 1941, Garan manufactures activewear and girls' and women's apparel. However, it is best known for its Garanimals line of children's clothing. Introduced in the early 1970s, Garanimals features matching animal logos on children's shirts and pants. Garan was ranked as the eighth most profitable clothing manufacturer in the U.S. during 1997, out of 100 companies studied by Apparel Industry Magazine (*Business Wire* 1998).

Headquartered in New York City, Garan sold to approximately 900 accounts in 1999, including Wal-Mart and JCPenney. Its manufacturing takes place in the southeastern U.S. and, to an increasing extent, in Central America. According to the firm's 2000 proxy statement, Garan's Board Chairman and CEO, Seymour Lichtenstein, owned 13.6 percent of the firm's outstanding stock as of January 20, 2000; he had been an officer and director of Garan since 1948.[6]

[6] Proxy statements are filed annually with the SEC on Form DEF 14A. This submission includes data on the compensation and share ownership of top executives, profiles of candidates nominated to the Board of Directors, the firm's stock-market returns relative to similar companies, and the text of any resolutions proposed by shareholders.

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Mattel

Mattel began in 1945 when Harold Matson and Eliot Handler began manufacturing dollhouse furniture in a converted garage in California; the company's name came from Harold's last name and Eliot's first name. The world's largest toy manufacturer, Mattel has grown internally through such product introductions as the Barbie Doll (1959) and Hot Wheels miniature model cars (1968) and externally through such acquisitions as Fisher-Price (1991), Tyco Toys (1997), and The Learning Company, a leading educational software maker (1999).

To complement its manufacturing business, Mattel has made some moves toward Internet sales, but the firm has proceeded cautiously, reportedly out of fear of unfavorable reactions from Wal-Mart and other major retailers (Rosenberg 2000, C1). Sizable, unexpected losses at The Learning Company ($205 million pre-tax according to Mattel's 1999 MD&A) led to the resignation of CEO Jill Barad in early 2000 (Goldman 2000, C3). A new CEO, Bob Eckert, was appointed in May 2000. In September 2000, he announced that The Learning Company had been sold for no upfront consideration; future proceeds, if any, would depend on how the firm performed for its new owner (Edgecliffe-Johnson 2000, 10).

National Presto

Wisconsin-based National Presto manufactures housewares such as pressure cookers, griddles, and its famous SaladShooter. Sales are made directly to retailers and through distributors. In the late 1990s, this firm benefited from a revival of interest in pressure cookers, sparked by Generation X consumers intent on spending less time in the kitchen. According to the firm's 2000 proxy statement, Board Chairman Melvin Cohen, a member of the Board since 1949, held 6.3 percent of the firm's shares as of March 8, 2000. His daughter, Maryjo, CEO and President, held 27.9 percent of the shares, most as sole trustee of a family voting trust. Although there were only 828 stockholders of record as of December 31, 1999, National Presto has an institutional following because it is included in the S&P Smallcap 600 Index.

In 1999, the New York Society of Security Analysts (NYSSA) selected the firm for a project examining how potential changes in corporate governance practices might increase shareholder value. In its final report, the NYSSA faulted National Presto for its concentration of stock ownership, the paucity of truly outside Board members, an "excessively conservative" working capital policy whereby 80 percent of *total* assets were either held in cash or invested in low-yield (4 percent) municipal bonds, and a "worrisome" increasing dependence on Wal-Mart (Reda and Janjigian 1999, 4, 14).

At its May 2000 annual meeting, National Presto informed shareholders that Wal-Mart would reduce its purchases from the firm by 14 percent in 2001 as a result of the retailer's plans to introduce private-label small appliances, a practice already begun by Target and Kmart (Hajewski 2000; Lieber 2000, 1). A major-customer relationship with Kmart had ended in 1993 "because of the inability of the parties to agree upon modification of terms and conditions which affected Kmart's net cost" (National Presto 10-K 1994, 2).

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FINANCIAL DATA

Selected financial data for the 1994–1999 period are presented in Tables 3 and 4, respectively, for the four retailers and the three suppliers.[7] All data were contained in, or derived from, financial statements or note disclosures in 10-Ks or proxy-statement (Form DEF 14A) filings.

[7] Data for fiscal years ended in late January are shown in the prior year's column; e.g., the data for JCPenney for the year ended January 29, 2000 are reported in the 1999 column.

TABLE 3
Financial Data for Large Retailers, 1994–1999[a]
(dollar amounts in millions)

	1994	1995	1996	1997	1998	1999
JCPenney						
Sales revenue	$20,380	$20,562	$22,653	$29,618	$29,656	$31,391
Gross margin %	31.5%	30.3%	29.0%	27.6%	26.3%	25.5%
Net income	$1,057	$838	$565	$566	$594	$336
Days' sales in inventory	97	99	110	101	102	94
Days' purchases in accts. payable	26	25	26	26	26	23
Index of firm's stock returns	100.0	111.0	119.0	175.0	106.0	53.0
S&P department stores index	100.0	110.0	124.0	164.0	163.0	128.0
Target						
Sales revenue	$21,311	$23,516	$25,371	$27,757	$30,951	$33,212
Gross margin %	26.6%	25.5%	26.6%	26.8%	26.9%	30.7%
Net income	$434	$311	$463	$751	$935	$1,144
Days' sales in inventory	62	60	59	56	54	58
Days' purchases in accts. payable	41	43	47	47	47	52
Index of firm's stock returns	100.0	110.9	171.7	332.5	594.5	618.2
S&P retail stores index	100.0	107.8	128.7	190.9	312.9	313.3
Toys "R" Us						
Sales revenue	$8,746	$9,427	$9,932	$11,038	$11,170	$11,862
Gross margin %	31.3%	30.1%	30.6%	30.2%	26.7%	29.9%
Net income	$532	$148	$427	$490	($132)	$279
Days' sales in inventory	115	111	112	111	97	86
Days' purchases in accts. payable	73	70	65	60	64	66
Index of firm's stock returns	100.0	75.2	85.5	91.7	51.3	34.4
S&P retail stores index	100.0	107.8	128.7	190.9	312.9	313.3
Wal-Mart						
Sales revenue	$82,494	$93,627	$104,859	$117,958	$137,634	$165,013
Gross margin %	20.5%	20.4%	20.2%	20.8%	21.0%	21.4%
Net income	$2,681	$2,740	$3,056	$3,526	$4,430	$5,377
Days' sales in inventory	70	74	70	63	56	52
Days' purchases in accts. payable	27	29	31	33	32	32
Index of firm's stock returns	100.0	90.0	106.0	178.0	387.0	495.0
S&P retail stores index	100.0	107.8	128.7	190.9	312.9	313.3

[a] Source:Firms' 10-Ks and proxy statements.

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TABLE 4
Financial Data for Suppliers, 1994–1999[a]
(dollar amounts in millions)

	1994	1995	1996	1997	1998	1999
Garan						
Sales revenue	$173.0	$141.3	$146.5	$153.3	$194.2	$228.9
Gross margin %	23.9%	21.1%	21.7%	23.8%	23.6%	25.3%
Net income	$9.4	$5.5	$6.9	$9.7	$14.0	$18.3
Days' sales in receivables	85	84	65	68	69	81
Days' sales in inventory	86	94	93	94	82	75
Index of firm's stock returns	100.0	114.0	118.0	174.0	217.0	268.0
S&P textiles index	100.0	97.0	131.0	172.0	117.0	94.0
Mattel						
Sales revenue	$3,205.0	$3,636.8	$3,786.0	$4,834.6	$4,781.9	$5,515.0
Gross margin %	50.0%	49.2%	50.4%	49.6%	49.4%	47.2%
Net income	$255.8	$357.8	$377.6	$285.2	$332.3	($82.4)
Days' sales in receivables	76	72	68	69	79	75
Days' sales in inventory	64	68	70	60	76	71
Index of firm's stock returns	100.0	154.3	175.6	237.8	151.5	86.2
Peer group index	100.0	121.9	136.5	180.7	247.5	279.7
National Presto						
Sales revenue	$128.1	$120.2	$106.0	$109.5	$107.1	$114.7
Gross margin %	39.6%	35.6%	31.7%	32.4%	33.8%	32.1%
Net income	$21.5	$19.0	$14.7	$17.0	$19.7	$20.8
Days' sales in receivables	92	114	103	70	61	57
Days' sales in inventory	100	105	109	90	89	74
Index of firm's stock returns	100.0	100.4	99.0	110.5	125.1	110.5
Peer group index	100.0	66.3	104.4	167.3	45.1	47.2

[a] Source: Firms' 10-Ks and proxy statements.

Descriptions of many of the items in Tables 3 or 4 follow:[8]

1. *Gross margin percentages* were calculated by dividing gross margin (excess of sales revenue over cost of goods sold) by sales revenue. Changes in this percentage over time could reflect adjustments in selling prices and/or purchase costs.
2. *Days' sales in receivables* equals average accounts receivable divided by average daily sales. Changes in this metric would signal that customers' accounts remain unpaid for a longer or shorter period of time.[9]
3. *Days' sales in inventory* equals average inventory divided by average daily cost of goods sold. Changes in this ratio would indicate that inventory was carried on the firm's books for a longer or shorter period of time prior to its sale.

[8] Several financial measures are affected by the choice of an inventory method. All four retailers used LIFO throughout the period. Among suppliers, Garan and Mattel used FIFO, while National Presto used LIFO. Conversion of National Presto's data to FIFO would produce only minor changes.

[9] Averages for balance-sheet accounts equal one-half of the sum of the reported beginning and end-of-year amounts.

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4. *Days' purchases in accounts payable* equals average accounts payable divided by average daily purchases. Changes in this performance indicator would signal that retailers take a longer or shorter period of time from the date of purchase to pay their suppliers.
5. *Index of firm's stock returns,* a required disclosure in firms' proxy statements, indicates the extent to which a $100 investment in the company's stock in 1994 would have grown/declined since then. For example, Table 3 reveals that $100 invested in Target's stock at the end of 1994 would have grown to $618.20 by the end of 1999, based on price appreciation and an assumption that all dividends were reinvested.
6. *S&P index of stock returns*, also a required proxy-statement disclosure, benchmarks a firm's stock returns with those of a comparable group of companies. However, firms can construct a peer group of their own if they believe that such a group would furnish a more representative benchmark than that provided by an S&P industry grouping.

QUESTIONS FOR DISCUSSION

Refer to the Table 3 data in answering Questions 1–5.

1. Compare and contrast each retailer's performance on the following financial measures:
   a. gross margin percentage
   b. net income
   c. days' sales in inventory
   d. days' purchases in accounts payable
2. Do stock returns for the various retailers make sense in light of your findings in Question 1? Explain.
3. Do changes in days' sales in inventory and days' purchases in accounts payable provide evidence that large retailers increased their clout in their relationships with suppliers? Explain.
4. Economic theory predicts that retailers with buying power may be able to raise their profit margins at the expense of their suppliers and competitors. Why might this not have fully occurred?
5. Do the retailer data provide support for the following? (Explain and support with appropriate analyses.)
   a. The quote in the case that "if you're going to need payment in 30 days, don't expect it from a chain."
   b. JCPenney's 1999 decision to recruit its executive vice-president/chief operating officer from Wal-Mart.
   c. Target's decision in late 1999 to take steps to improve its inventory flow.

Refer to the Table 4 data in answering Questions 6–8.

6. Compare and contrast each supplier's performance on the following financial measures:
   a. gross margin percentage
   b. net income
   c. days' sales in accounts receivable
   d. days' sales in inventory
7. Do stock returns for the various suppliers make sense in light of your findings in Question 6? Explain.

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8. How might sales concentration at National Presto have affected shareholder value?

Refer to the data in Tables 2, 3, and 4 in answering Questions 9–12.

9. For each of the supplier-retailer relationships shown in Table 2, do the data in Tables 3 and 4 indicate that any of the following reciprocal changes occurred?
   a. Gross margin percentage fell for the supplier as it rose for the retailer?
   b. Days' sales in inventory rose for the supplier as it fell for the retailer?
   c. Days' sales in accounts receivable increased for the supplier as days' purchases in accounts payable increased for the retailer?

10. What business and economic factors could allow suppliers and retailers to simultaneously show improved ratios? Did any "win-win" situations occur among the firms in this case? Explain.

11. Which supplier is best at managing its relationships with its major customers? Explain.

12. On the basis of your reading of this case and your analysis of the supplier-retailer relationships discussed:
    a. Indicate which item/relationship surprised you the most.
    b. Suggest several new disclosures that suppliers should be required to include in their 10-Ks. Explain how these disclosures would aid in evaluating suppliers' performances and the economic relationship between a supplier and its major customers.

Access the retailers' and suppliers' 10-Ks and proxy statements for the years 2000 and beyond from EDGAR (the SEC's database) and then make the calculations necessary to update the financial data presented in Tables 3 and 4. On the basis of these new data, answer Questions 13–16.

13. What changes (if any) occurred after 1999 in the sales dependencies depicted in Table 2?

14. What absolute or relative changes occurred after 1999 in the levels of the retailer and supplier financial measures listed in Questions 1 and 6? What firm-specific or other factors might have accounted for these changes? Explain.

    Note: The comparative data shown in 10-Ks for Year 2000 and later will sometimes differ from the original data shown in Tables 3 and 4; for example, Mattel's 1999 sales revenue as reported in its *2000* 10-K is substantially lower than the 1999 sales revenue originally reported in its *1999* 10-K. This difference reflects Mattel's 2000 divestiture of The Learning Company.

15. Did price movements in the seven firms' stocks, as revealed in the stock return data presented in their proxy statements for the years 2000 and beyond, make sense in light of their post-1999 financial results? Explain.

    Note: In proxy statements, the indices for stock returns for a firm and its industry or peer group are reset to 100.0 for the beginning year of subsequent five-year

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periods. For example, the index for Target's stock returns as of the end of fiscal-year 1996 was reported at 171.7 in the proxy statement filed during 2000 (where 1994 represented 100.0, as shown in Table 3), but was reported at 153.6 in the proxy statement filed during 2001 (where 1995 represented 100.0). You need not convert the indices in later proxy statements to 1994 = 100.0 to address this question.

16. Have the updated data changed your answer to Question 11? Explain.

TEACHING NOTES

The Teaching Notes associated with cases published in *Issues in Accounting Education* will no longer be printed in the journal. Access is protected by password and is limited to full members of the American Accounting Association (AAA) at http://aaahq.org/pubs/issues/feb2002.htm. The username and password will be emailed to full members of the AAA in February 2002.

Starting in May 2002 the Teaching Notes will be available through the American Accounting Association's new electronic publications system at http://aaahq.org/ic/browse.htm. Full members can use their personalized usernames and passwords for entry into the system where the Teaching Notes can be reviewed and printed.

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