GOOD TO GREAT TO GONE

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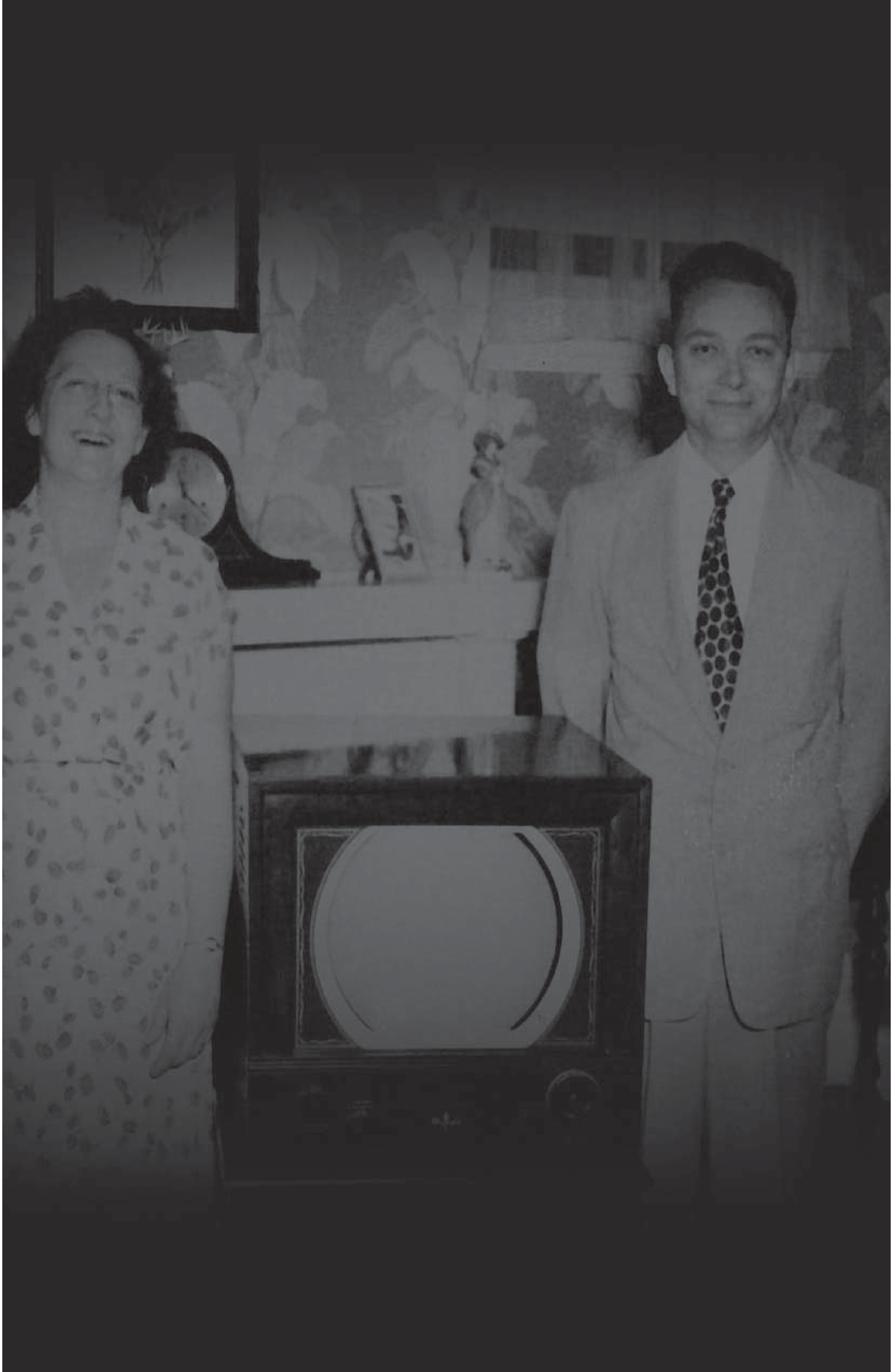

GOOD TO GREAT TO GONE

THE 60 YEAR RISE AND FALL OF CIRCUIT CITY

Alan Wurtzel

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CONTENTS

PROLOGUE: BANKRUPT 15
Turning Points 18
Habits of Mind 19

PART I: GOOD (1949-1970) 23

CHAPTER ONE: DISCOVERING THE OPPORTUNITY 24
The Real World in the '50s 29
Inventing the Business Strategy 34
Habits of Mind 44

CHAPTER TWO: SETTING THE VALUES 46
Customer Values 47
Supplier Values 49
Employee Values 50
Human Resource Policies 51
Sam's Personnel Rubrics 53
Habits of Mind 62

CHAPTER THREE: PUTTING THEORY INTO PRACTICE 64
The Real World in the '60s 64
Wards Joins the Discount Revolution 70
Going Public 71
Undisciplined Pursuit of More 79
Habits of Mind 91
Lessons Learned 93

PART II: ALMOST GONE (1971–1977) 95

CHAPTER FOUR: RUDE AWAKENING 96
The Real World in the '70s 96
Creating a Strategic Plan 101
Wards Hits the Fan 107
Habits of Mind 111
Lessons Learned 112

CHAPTER FIVE: BUILDING THE TEAM 114

Who Gets on the Bus 115

Who Gets off the Bus 119

Creative Hires 120

Develop a Learning Culture 121

Managing Execution 123

Management Style 129

Habits of Mind 130

CHAPTER SIX: GROWING AGAIN 132

Audio Stores 132

Circuit City Electronics Stores 135

Warehouse Showrooms 137

Refining the Consumer Offer 140

Habits of Mind 144

PART III: THE GREAT YEARS (1978–2000) 147

CHAPTER SEVEN: RAMPING UP 148

The Real World, 1978–2000 148

Electronics and Appliances 153

Superstore Expansion 156

Restoring the Balance Sheet 161

Change at the Top: Theory 170

Improving the Infrastructure 172

A New Name 179

Changing of the Guard 179

Habits of Mind 180

Lessons Learned 182

CHAPTER EIGHT: GOING NATIONAL 183

Sharp's Vision 183

Superior Credit Availability 192

Superior Gross Margins 195

Superior Technology 199

Sharp's Team and Style 200

Next Growth Vehicles 202

DIVX Diversion 206
Habits of Mind 209
Lessons Learned 211

CHAPTER NINE: TROUBLE IN THE CITY 212
Gathering Clouds 212
Rise of Best Buy 214
Response to Changing Competition 219
How Circuit City Lost its Way 227
Role of the Board 231
Sharp's Legacy 235
Habits of Mind 236
Lessons Learned 239

PART IV: GONE (2001–2009) 243

CHAPTER TEN: GOING 244
The 2001 Three Year Plan 251
Addressing the Strategic Issues 256
Sales Force Productivity 275
Merchandising 279
Supply-Chain Management 283
Legacy Issues 288
The McCollough Years 291
New Leadership 295
Habits of Mind 297
Lessons Learned 300

CHAPTER ELEVEN: GONE 301
Maintaining the Culture 310
Role of the Board: 2000–2009 313
Last Tango 323
Last Gasp 325
A Perfect Storm 327
Habits of Mind 332
Lessons Learned 333

EPILOGUE: THE LEGACY 334

Habits of Mind Revisited 335
Future of Electronics Retailing 336
Legacies 338

NOTES 342

CHARTS

Chart 1: U.S. Population by Age Group (1949–1960) 30

Chart 2: U.S. Real Gross Domestic Product (1949–1960) 31

Chart 3: Consumer Electronics Factory Sales (1949–1960) 32

Chart 4: U.S. Real Gross Domestic Product (1961–1970) 66

Chart 5: U.S. Population by Age Group (1961–1970) 67

Chart 6: Consumer Electronics Factory Sales (1961–1970) 69

Chart 7: Circuit City Revenues and Earnings (1963–1970) 73

Chart 8: U.S. Real Gross Domestic Product (1971–1977) 97

Chart 9: U.S. Population by Age Group (1971–1977) 98

Chart 10: Consumer Electronics Factory Sales (1971–1977) 99

Chart 11: Circuit City Revenues and Earnings (1971–1977) 108

Chart 12: U.S. Real Gross Domestic Product (1978–1986) 150

Chart 13: U.S. Population by Age Group (1978–1986) 151

Chart 14: Consumer electronics factory sales (1978–1986) 154

Chart 15: Circuit City Revenues and Earnings (1978–1986) 180

Chart 16: U.S. Real Gross Product (1987–2000) 184

Chart 17: Consumer Electronics Factory Sales (1987–2000) 185

Chart 18: Average Sales per Store (1985–2005) 228

Chart 19: Circuit City Revenues and Earnings (1987–2000) 236

Chart 20: Circuit City vs Best Buy Net Earnings per Store (1985–2005) 246

Chart 21: U.S. Real Gross Domestic Product (2001–2009) 249

Chart 22: Consumer Electronics Factory Sales (2001–2009) 250

Chart 23: U.S. Population by Age Group (2001–2009) 253

Chart 24: Circuit City Revenues and Earnings (2001–2005) 296

Chart 25: Sources and Uses of Cash (2000–2008) 320

Chart 26: Circuit City Revenues and Earnings (2006–2009) 324

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While I am solely responsible for the errors and omissions, I relied on multitudes to write the story of Circuit City's sixty-year passage from Good to Great to Gone.

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In telling the story, I have tried to be as objective and factual as I know how. I hope that any unflattering assessments of Circuit City leadership are perceived as they are intended— an honest attempt to explain what happened to a public company as it tried to navigate the waves of change.

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GOOD TO GREAT TO GONE

Prologue

BANKRUPT

In business, the competition will bite you if you keep running;
if you stand still, they will swallow you.

–William Knudsen

Dateline: January 16, 2009. U.S. Courthouse, Richmond, Virginia. The courtroom is crowded with reporters as well as lawyers for Circuit City, its numerous suppliers, and the creditors committee. Tensions are running high. There have been ten days of round-the-clock negotiations. The parties and their counsels are tired and frustrated at not having reached agreement.

Over the previous two years, the company has shed over $5 billion in stock market value. It posted just one profitable quarter since mid-2006.[1] It owes its creditors more than $1.5 billion, including $650 million to its suppliers and $900 million to its banks.[2] Circuit City's net worth has shrunk to little or nothing. It is bleeding cash, having run through more than $200 million between March and August 2008 and untold sums since.

U.S. Bankruptcy Judge Kevin R. Huennekens, in what he says is one of the hardest decisions he has made during his two years on the bench, orders Circuit City Stores Inc. to liquidate its assets to meet the claims of creditors. Circuit City is ordered to close all 567 store locations by March 31, putting 34,000 employees out of work.[3] Going-out-of-business sales at Circuit City stores all over the country are to begin immediately. The desperate last-ditch efforts to find a buyer have ended in failure.[4]

It has been a long fall from the top. Since the late 1980s Circuit City had been recognized by Wall Street and business insiders as the best-run, best-managed, and most profitable specialty retailer of electronics and appliances in the country.

From 1982 to 1997, Circuit City's stock price had outperformed that of the general stock market by an incredible 18.5 times, far better than any other Fortune 500 company for any fifteen-year period since 1965. Yet just twelve years later, Circuit City was no more.

In the process of growing from a single store located in the front of a tire recapping shop to a nationwide colossus, Circuit City transformed consumer electronics retailing; launched CarMax, a revolutionary new way to sell used cars; and provided employment to hundreds of thousands as well as excellent savings and service to millions of consumers.

This is the sixty-year saga of a company that grew from a Richmond, Virginia, mom-and-pop TV store to become an industry leader before it ultimately stumbled and subsequently died.

I know the story well. My father, Sam Wurtzel, founded Circuit City (then known as Wards) in 1949. I joined the company in 1966, became CEO in 1973, and held that position until 1986, when I retired to pursue other interests. I remained on the board until 2001.

I recognize that my direct involvement as the son of the founder, as the second CEO, and as a longtime board member is both an asset and a liability. On the plus side, I was an interested observer for the full sixty years of Circuit City's existence and an active participant for more than thirty years; in the course of writing this book, I was able to interview more than forty of the people who were there after I left.

On the liability side, I am, admittedly, not a totally objective observer. It is impossible to escape the human tendency to admire one's own successes and "explain away" one's mistakes. In writing this account, I have tried to be as objective and self-critical as I know how to be. Only the reader can judge if I have been successful.

Some of the decisions I criticize were mine; some were made by friends and colleagues, including my father. I have tried to be impartial in my examination of both the good and the not-so-good decisions that were made. All of the judgments are mine, but I am reassured by the fact that every one of them is shared by other key individuals who played significant roles in the business.

My purpose in telling the story, however, is not primarily to record the company's history but to shed light on the strategic decisions, good and bad, that successive management teams made, especially at key times in the life of the company—and to see if there are any lessons to be learned from these decisions.

In a sense, this book can be viewed as a case study, illustrating some of the principles developed by Jim Collins in his two books, *Good to Great* and its sequel, *How the Mighty Fall*, neither of which was published until well after I left Circuit City. When Jim called to interview me for *Good to Great* in 1998 I didn't know that Circuit City was one of only eleven companies to outperform the Fortune 500 by at least three times for fifteen years. Nor did I have any idea that I had, during my tenure, unconsciously followed many of the management principles shared by his eleven "good to great "companies. I had simply been doing my best to make commonsense, long-range strategic and operational decisions in collaboration with the board and my senior colleagues. I knew, for instance, that people were the key to success, but I did not talk about "who gets on the bus." I did try to be analytical and honest, without calling it "confront[ing] the brutal facts." With a strong push from my board, I simplified our business and became a "hedgehog," knowing one thing well, instead of a fox that knows many things superficially. I also built the company patiently and step-by-step, or, to use Collins's term, "tended the flywheel." When I read *Good to Great*, however, I realized that these were brilliant metaphors for many of the policies my associates and I had followed in the course of building Circuit City.

More recently, as Circuit City was dying, I had another conversation with Collins about *How the Mighty Fall*. Although I was not an officer, director, or even a shareholder during Circuit City's last eight years in business, when I read that book I was struck, once again, by how perfect his metaphors were:

- Hubris, Born of Success
- Undisciplined Pursuit of More
- Denial of Risk and Peril
- Grasping for Salvation
- Capitulation to Irrelevance or Death

They all described the last days of Circuit City. I am grateful to Jim for creating an intellectual framework for thinking about the fall as well as the rise of Circuit City.

Turning Points

In the multi-decade life of any company, indeed any industry, there are turning points at which the company needs to be "reinvented"—moments when the business model needs to be revised to accommodate changes in the competitive landscape, including the economy, technology, customer preferences, and so forth.[5] The retail scene is littered with examples of companies that made, or failed to make, these necessary transitions.

In looking at the sixty-year life of the business that ultimately became Circuit City, I have identified five turning points at which the company's very existence was in question and it needed to be invented or reinvented.

- The first was the initial decision to open a TV store in Richmond, Virginia, shortly after the South's first TV station went on the air.
- The second occurred in the early 1960s when the discount store revolution caused conventional mom-and-pop TV and appliance stores to struggle.
- The third took place in the early '70s, when most of the many acquisitions my father and I had made were losing money and all the company's discount store landlords filed for bankruptcy.
- The fourth was in the mid-'90s when the Circuit City Superstores

began losing market share to Best Buy and the mass merchandisers.

- The fifth occasion was in 2000, when the company understood the need to reinvent itself but proved unable to do so.

In the course of this book, I will pay special attention to these critical turning points, the ways in which Circuit City's management responded to them, and what we can learn from these decisions.

Habits of Mind

While this book is organized around Circuit City's history, the focus is on the business strategy. Circuit City's sixty-year run in the most dynamic segment of American retailing provides an excellent window onto the ways business strategies interact, both negatively and positively, with the ever-changing economic and competitive landscape. My premise is that there can be no "rules" or "formulas" for business strategy. Strategies are situational; they are specific to time and place. What works today will generally not work tomorrow, in another place or in a different economic environment.

Behind every strategy, however, lie the Habits of Mind of those who developed the strategy. Pessimists see the world differently from optimists. Curious people see problems and opportunities differently from know-it-alls, and gamblers differently from paranoids. Habits of Mind are not situation-specific, but ways of thinking about one's organization in relation to the world in which it exists. It is these Habits of Mind that drive strategic decision-making and lead either to success or to failure. This book attempts to identify the successful and unsuccessful Habits of Mind that guided Circuit City's strategy over its lifetime.

Following are the Habits of Mind that I consider essential to organizational success. I will refer to them again at the end of each chapter as they are relevant and as I share my perspective on key moments in the company's history and the lessons learned from the results of the strategic decisions made.

Be Humble, Run Scared: Continuously doubt your understanding of things. Business success contains the seeds of its own destruction. Worry about what the competition knows that you do not. Andy Grove, the legendary cofounder of Intel, got it largely right in his book Only the Paranoid Survive.

Curiosity Sustains the Cat: The world is constantly changing. Be open and curious and strive to learn from others. Continuously try to understand the market and the changing economic, demographic, and other relevant forces at work that impact your business. Study your competitors. They may have insights and practices worth emulating or refining.

Evidence Trumps Ideology: In business, as in politics, decisions are too often based on unproven assumptions about what works and what doesn't. We all need operating assumptions about human nature, the economy, and the like, but when things do not work out as planned, we need to determine whether our assumptions were based on evidence or ideology. Evidence about the real world trumps ideological assumptions every time.

Confront the Brutal Facts:: The worst person you can fool is yourself. Ignoring or denying reality does not help it go away. Once you understand the issues, be bold enough to take decisive action.

Chase the Impossible Dream: Do not be limited by what Collins and Porras, the authors of Built to Last, call the "Tyranny of the OR." Be willing to embrace the "Genius of the AND." Two worthwhile goals that seem mutually exclusive can inspire an organization of "ordinary" employees to achieve extraordinary results.[6]

Maintain a Current Road Map: If you don't know where you are going, any road will take you there. Regular strategic planning based on how the company relates to its external environment, including the economy, competition, and the customer, is essential to success.

Boldly Follow Through: Big ideas require bold leadership and attract loyal followers. The effort comes to naught if the execution is tentative or not well disciplined.

Mind the Culture: Create a caring and ethical culture where employees can make mistakes without fear of adverse consequences. Beware of employees who are more concerned about their own success than the success of the business. Understand, exemplify, and reinforce the company's positive history and culture.

Pass the Torch with Care: Succession is critical. Most companies cannot withstand successive top management failures. CEOs need to select and groom their successor with care. Boards need to be bold enough to replace the CEO when necessary and to take the time to be sure the right successor is in place.

Encourage Debate: Learn from dissent. Involve senior staff and the board of directors in an open process to find the best answer. Create a board that will raise thought-provoking questions and challenge management to justify its plans.

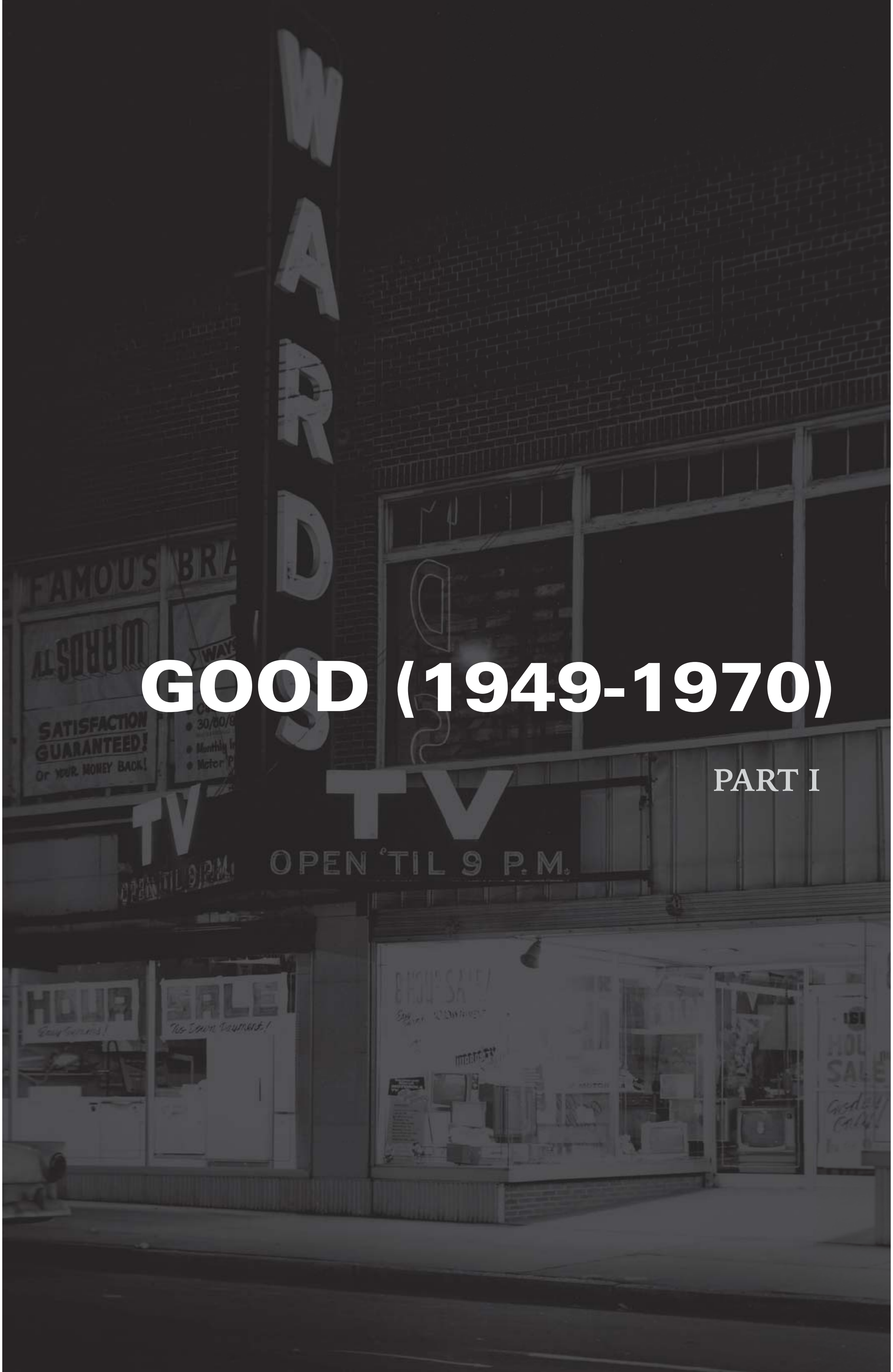
Keep It Simple and Accountable: Develop a clear and well-articulated set of policies for dealing with customers, suppliers, and employees. For any organization to succeed it is essential that each and every employee internalize the company's goals and values. Employees should also be held accountable and incentivized to pursue those goals and values every day.

Focus on the Future: Manage for the long term and not the short. Don't let short-term earnings swings divert a long-term strategy. Ignore the skeptics and short-term market gyrations. If things go well, the value of your company, whether public or private, will respond over time.

So, to begin at the beginning…

GOOD (1949-1970)

PART I



Chapter One

DISCOVERING THE OPPORTUNITY

The secret of success in life is for a man to be ready for his opportunity when it comes.

–Benjamin Disraeli

Sam Wurtzel, a 41-year-old New York businessman, was having his hair cut in Richmond, Virginia. The barber at the next chair was telling his customer that in April 1948, not quite a year earlier, the South's first television station had opened in Richmond.[7]

Living in New York, Sam had occasionally seen television programs in public spaces such as bars or at the homes of wealthy friends who were proud to show off this hottest of postwar products. For most Americans, however, television was still a miracle they had heard about but never actually seen.

News and entertainment over the airwaves was not new. From the earliest days of his presidency, Franklin Roosevelt had galvanized the nation with his "fireside chats" on the radio. Americans had followed the war by listening to famed broadcaster Lowell Thomas. Most kids were addicted to the serialized adventures of Superman, the Lone Ranger, and Uncle Don. And adults were hooked on weekly radio shows such as *Amos 'n' Andy* and *The Jack Benny Show,* as well as soap operas like *The Romance of Helen Trent* and *Our Gal Sunday*.

But *pictures* of the news were captured only in newspapers, in *Life* and other news magazines, or on movie theater screens. Mass entertainment occurred on the stage, in movie houses, or in other public arenas, not at home. Only a relative handful of Americans, mostly in New York and Los Angeles, had ever watched a television, and even fewer had done so at home.[8]

As the barber continued to cut, Sam began to think about what a new TV station in Richmond could mean. He knew something about retailing from working in his mother's grocery store. His mother, Flora, had emigrated from Russia in her early twenties. When her arranged marriage did not work out she was left to raise two boys and two girls, all under ten years old, on her own. With help from her parents, Flora opened a neighborhood grocery store behind their home in Perth Amboy, New Jersey. Life was hard, but Sam's mother was a tough and disciplined woman. She demanded that her four children graduate from high school and make something of themselves, and, in fact, all four became very successful in their chosen fields.

Like many boys without a father in their lives, Sam was often a discipline problem, He was bright enough to graduate from Perth Amboy High School in 1924 despite his less-than-studious habits, but he did not have either the inclination or the opportunity to go on to college.

During the Depression years, finding and holding a job was difficult, but Sam was energetic, personable, and extremely bright. He also found that he had an aptitude for business. For a time, he and his older brother ran a wholesale butter and egg business financed by their estranged father, who also sold butter and eggs to retail grocery stores. After a falling out with his father, Sam moved to another wholesale food firm, June Dairy, in the greater metropolitan area. He was laid off but again landed on his feet

Sam made a favorable impression. Slightly over six feet tall, with a pencil moustache and good bearing, he was polite, charming, and had an excellent sense of humor. Recognizing his educational deficiencies, he took night courses in accounting and business. As he matured, he studied a few chosen fields, such as biblical archeology, and became a serious amateur. He excelled at bridge as well as double acrostics and other complex word games. In 1931 Sam met Ruth Mann, from Mount Vernon, New York, at a party in New Jersey and gallantly agreed to drive her and a friend home in his sporty roadster with a rumble seat. A year later they were married. Ruth came from the opposite side of the tracks—the good side. Her father, Leon, was born in this country and graduated from City College, actually a high school in Baltimore, Maryland. Leon moved to New York and became a successful manufacturer of men's clothing, a pillar of the Mount Vernon Jewish community, and a founder of both the local hospital and the leading Reform synagogue. The city dedicated a small park to his memory.

Samuel S. Wurtzel – circa 1940.

Through Ruth and her family Sam was exposed to a standard of living and a level of refinement he had never known. Her family had servants and she had made the grand tour of Europe with her parents and sisters while she was still in elementary school. Unlike most women of her generation, she had graduated from college.

Leon, an early venture capitalist, had a habit of supporting struggling inventors. One of them was a nearly illiterate Russian immigrant who had invented a two-story-high machine to make papier-mâché packing materials for eggs. The new material dramatically reduced breakage during shipping, thus reducing insurance costs. Unfortunately, however, a patent dispute arose between Leon's protégé and another inventor. To settle the case, Leon agreed to give up the U.S. market and sell the new packing materials only in Europe and South America. In 1938 he enlisted Sam to assist him in that effort. The business they created, Packing Products, was intended to market and sell egg-packing materials.

In Leon, Sam found a surrogate father, and Leon in turn found the son he never had. Leon not only taught Sam about business, but, more importantly, gave him the polish and skills that would benefit him for the rest of his life. Every morning Leon would come into Sam's office and write "HU" on his calendar. "HU" stood for the two precepts Leon believed we should live by: humor and humility.

When World War II broke out a year later, exporting to Europe was no longer possible. Leon was by then 73, and Sam, who was in charge of the day-to-day operations of the company, turned his attention to South America. But with few railroads and highways in place, eggs were rarely shipped long distances, so there was limited opportunity to sell egg-packing materials. To overcome this hurdle, Sam built an import-export business shipping a wide range of products to and from South America.

Packing Products was a broker, matching buyers and sellers, but not taking an inventory position without a confirmed sale in hand. Unfortunately, in 1948, while Sam was away, someone violated that rule and purchased steel that had not been presold. The steel market collapsed and, as a result, the business failed. At that point, Sam's sole material asset was his home, and Leon, now in his eighties, was not in a position to help him start a new business.

Sam and Ruth decided to take a golfing vacation to gain some perspective and make plans for the future. Just before their departure for North Carolina, however, Ruth's mother, Nettie, took ill, and Ruth decided to stay behind in Mount Vernon for a few days until she recovered. Sam, who had a business appointment in Washington, D.C., went on ahead. He would keep his appointment, and then drive on to Richmond and wait for Ruth at the home of her sister before they proceeded together to North Carolina.

As it turned out, Ruth never got there, but while Sam was waiting, his restless mind kept returning to what he'd overheard in the barbershop. He believed that television was destined to bring about major changes in the way Americans were entertained and informed. It was only a matter of time, he thought, before almost every American home would have a television set. In fact, the number of TV stations on the air almost tripled in 1949 alone, growing from 27 to 76. And the number of homes with TV sets went from 1.2 million to 4.2 million.[9]

Sam began to think about how he could benefit from what he was certain would be the television revolution. At 42 years old he was still young enough to start over. While he had never been a retailer, he was aware that he lacked both the capital and the technical knowledge to manufacture TVs. However, through his friend and future partner, Abe Hecht, he knew someone at a TV manufacturing company, Olympic Television, located in Long Island City. And through his sister and brother-in-law, both well-connected, longtime Richmond residents, he had access to local bankers, real estate agents, and their network of business friends and acquaintances, whom he could trust to give him advice about how and where to get started. Leaving New York, where his business had failed, and moving to Richmond had appeal as well. But first, he had to think through the issues of going into the retail business and betting his future on a new and unproven technology.

In making the decision to start the company that would become Circuit City, Sam had to consider the larger economic context, how demographic and social factors might affect consumer preferences, and trends in the retail industry. The essence of any viable business strategy is to define a product or service that meets a real world need and that can be sold at a profit. Understanding the economy, demographics, customer buying preferences, and the competition are all essential to strategic decision-making.

The Real World in the '50s

The Second World War, which had ended scarcely three years earlier, left an indelible mark on American society and its economy. The ability to shift from Depression-level civilian production to extraordinary military production in a year or two had won the war and catapulted the country onto the world stage as the undisputed superpower.

Following the Japanese surrender, there were 12 million Americans in uniform, of whom seven million were overseas.[10] These veterans had returned home ready to begin families[11] and create a baby boom that would continue for the next two decades. The nation's population increased by one-third in the twenty years after the war.

This, in turn, created unprecedented opportunities for businesses that catered to the needs of young families. New mothers, despite their contributions to the workforce during the war, largely went back to their traditional roles as homemakers, though many returned to the workforce once their youngest child was off to school. All this Sam knew. It was the ideal economic environment in which to enter the TV and appliance business.