The Downfall of Sears and the Power of the Free Market

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In a television appearance in 1980, Nobel-prize-winning economist Milton Friedman visited *The Phil Donahue Show* for a wide-ranging discussion of economics, free market theory and the current state of the economy. During his highly decorated professional life, Friedman was an unabashed champion for the benefits of free market capitalism and the “invisible hand,” the unintended social benefits of an individual’s self-interested actions. While Friedman was at times seen as a fan of big business, he frequently denied that perception, stating instead that he was not a proponent of large companies, only of the power of the free enterprise system in general. He also firmly stated that he was a champion not of economic fairness, but of economic freedom for all people.

The large players in retail were of course very different in that era almost 40 years ago, and Friedman and Donahue engaged in a debate regarding large department store chains and the acquisitive nature of America’s large companies. They also discussed powerful and influential companies and the potentially harmful effects of monopolies on the free enterprise system. Sears Corp. at the time was an American business stalwart, as it was the largest retailing chain in the nation and had been for 40 years.

“So, you are saying Sears could buy Kmart if it wanted to?” Donahue challenged.

“Of course they can,” Friedman replied. “But as a matter of fact, if Kmart keeps growing like it has been, Kmart may end up buying Sears!”

Seen through the lens of almost 40 years of business evolution, the debate about the dominance of these two store chains seems quite quaint and humorous now. The retail business marketplace has always been characterized by continuous dynamic change, and certainly has been since this debate. Walmart was not even part of that discussion, nor Costco, nor Target.

Walmart’s place in consumers’ lives grew strongly after tapping into consumer preference and needs and the firm grew to overtake Sears as the largest retailer in the world in 1989. Costco pioneered the membership club store model in 1983 and is now the world’s second largest chain of retail stores. The first Target store opened in 1962 and it grew its store base strongly in the 1980s and 90s and is now the third largest retail chain in the nation. Amazon, today’s internet retail giant, was not even a glint in corporate America’s eye in 1979, as it opened its website in 1995.

In a free market system, the quick and the smart usually beat the slow, complacent and unimaginative. There is no greater example of this principle than in the slow downfall of Sears Holdings Corp. Sears declared bankruptcy this week and is in the process of liquidating its assets and shutting down its operations.

Sears, Roebuck & Company was founded in 1892 as a mail order catalog for Midwest consumers who lived far from stores. Sears opened its first retail store in 1925 and grew its store base quickly through the 1970s. A staple in America’s retail consciousness for decades, consumers shopped at Sears for Toughskins jeans, Kenmore appliances and Craftsman tools. Customers waited at their mailbox for the annual Sears Christmas catalog and got their autos repaired at a Sears Auto Center. Sears was the largest retailer in the U.S. until 1989, when the rise of specialty stores, the convenience of online shopping and a loss of corporate focus while diversifying into unrelated businesses such as finance all combined to lead to Sears’ slow downfall into oblivion.

Some of Sears’ biggest creditors are now pushing for Sears to liquidate and shut down rather than try to reorganize through the bankruptcy process, as there seems to be no hope of reviving the Sears chain in a vastly different consumer world than it grew up in. But as the constant change in the retail landscape marches on, many of the owners of malls where Sears has stores could not be happier. Malls with trendy retailers, popular restaurants and new entertainment venues have continued to evolve and prosper. Many of these landlords would welcome Sears’ departure, as the store's exit would allow them to take over these big-box spaces and lease them to more profitable tenants. In malls where leases were signed decades ago, Sears rents could be as low as $4 a square foot. New tenants in the same space could bring as much as six times that amount today.

Although the failure of a large company may cause creditors to lose money, force unemployment on their workers for a short time, and cause the physical assets to lie dormant for a time, a corporate bankruptcy is simply the pruning of the free market tree. Creditors will write off the losses and refocus attention on their more profitable loans. Employees will find new jobs with new companies or in new industries. And storefronts, manufacturing plants, equipment and brands will be purchased by more profitable companies and revamped for new purposes. This creative destruction is at the heart of a dynamic free market system, and it always will be.

Over time, many folks have worried that large companies may wield too much economic leverage in the marketplace and have too much influence on consumer behavior. However, being a large company does not save a business from bankruptcy, as was shown in the cases of Sears, Chrysler, General Motors and Penn Central Railroad. It may seem as if large businesses enjoy a position of great power, but a business cannot get a dollar from a consumer unless they hand it over willingly, as all these businesses discovered. The bigger they are, the harder they fall. Friedman did not fear corporate monopolies, saying instead, "The best anti-monopoly legislation you could have is completely free trade." He was convinced by history that the free market could take care of itself. The businesses that served consumers best would rise, and those that did not would fall.

Chrysler Corp. filed for bankruptcy in 2009 in the depths of the global financial crisis of 2008-09, but it also had a near-death experience in the late 1970s. Chrysler was only saved from bankruptcy at that time by a government bailout package that was passed by Congress in 1979 to keep Chrysler in business. The debate over the wisdom of that government intervention was raging when Friedman was a guest on that *Donahue* show in 1979. Donahue challenged Friedman on why it was not a good idea for the government to step in to save Chrysler.

Friedman noted, "The government should not help to save Chrysler, of course not. This is a private enterprise system. It's often described as a profit system but that's a misleading label. It's a *profit and loss* system. And the loss part is even more important than the profit because it's what gets rid of badly managed, poorly operated companies. Chrysler ought to be allowed to go broke."

Chrysler was able to avoid bankruptcy in 1979, but it would not avoid that fate in 2009. The government did not step in to throw it a lifeline the second time, and the company declared bankruptcy. However, through the bankruptcy process, Chrysler reorganized, trimmed costs, discontinued some brands and products and re-emerged as a stronger company. But only because there was still consumer demand for Chrysler autos. There seems to be no such demand for what Sears offers to today's consumers.

Sears will soon be dead and gone due to the rapid and savage changes in the retail sector that it did not or could not keep up with. Sears did not lose its edge overnight. There was not one moment that it missed or one decision that sunk the once-proud company. It took decades for the slow drip of time, management inaction and missed opportunities to doom the company to the ashbin of avoidable business failures.

And who knows, 40 years from today we may look back and lament the slow slide of Walmart, Target or Costco, bested by a new company founded this morning that no one knows about, that will continue corporate America’s never-ending march of change.