

'There's a new sheriff in town': Pessina begins transformation at Walgreens

By [Brigid Sweeney](#) April 09, 2015

At first glance, the **closure of 200 Walgreens stores** doesn't seem like a very big deal.

The Deerfield-based drugstore chain has nearly 8,300 stores across the country and, especially here in downtown Chicago, often has multiple locations within a pedestrian's line of sight. Moreover, Stefano Pessina, Walgreens' executive vice chairman and acting CEO, plans to open roughly the same number of new stores, as well as to consider more mergers and acquisitions.

Speaking on a quarterly earnings call this morning, Pessina said old retailers need to be on a maintenance program to close underperforming stores and open new ones in new locations. At Walgreens, "this program has not been done in the past in an orderly fashion," he said. In fact, it's rarely been done at all.

And that's precisely why closing a couple hundred stores is, in fact, a major move.

Only 99 days into his tenure atop the newly created Walgreens Boots Alliance, Pessina is demonstrating a willingness to move quickly and slash costs in a way that his predecessor, Greg Wasson, did not. The store closure decision, disclosed today, came amid a larger announcement that Walgreens will now widen its cost-cutting goal to \$1.5 billion over three years, up from the initial \$1 billion it announced in August. That higher goal was set even as the company reported a higher-than-expected quarterly profit today.

While the closures flout Walgreens' old strategy of geographic expansion, Pessina's cost-cutting initiative also marks a sharp turn at a company that has long been reluctant to lay off corporate staff, many of whom have worked at Walgreens for decades.

"There's a new sheriff in town," said Erik Gordon, an assistant professor at the University of Michigan's Ross School of Business. "Walgreens has always been thought of as a good, solid, high-quality, Midwestern-values company (where) you don't find bold action. It's not going to be that kind of company anymore."

ROOTS OF CHANGE

Walgreens, long averse to acquisitions, surprised everyone when it announced the decision to buy a 45 percent stake in European heavyweight Alliance Boots nearly three years ago. That decision brought Alliance Boots CEO Pessina, an Italian billionaire admired by private equity and Wall Street insiders as a sharp dealmaker, into the fold and dramatically altered one of the Chicago area's oldest and largest companies. Among many other changes, Wasson unexpectedly stepped down as the deal finished, and Pessina took over temporarily.

He clearly has not liked much of what he found. 2012 was a **bruising year** for Walgreen, which saw its profits fall as it tried to regroup from a **lost battle** over reimbursement rates with pharmacy benefits manager Express Scripts.

"Pessina has led a complete re-evaluation of everything the previous management team did," said industry consultant Adam Fein, president of Pembroke Consulting in Philadelphia. "Closing the stores is just the first part of a long-needed cost-cutting that previous management ignored for too long."

Fein expects Pessina's Walgreens to de-emphasize pharmacy initiatives in favor of boosting front-of-store retail options. Shifting emphasis away from pharmacy sales is important because much of the pharmaceutical

world's profit will soon skip over drugstores entirely, he said.

"Within three to four years, the majority of pharmaceutical industry revenues will come from specialty drugs that will flow through specialty pharmacies, hospitals and doctors' offices," Fein said. "Drugstores like Walgreen have become the business of dispensing (less profitable) generic drugs and selling front-end products."

He also expects Pessina, who has widely discussed M&A opportunities, **to purchase** either a specialty pharmacy or a pharmacy benefits manager in the future.

LESSONS LEARNED IN EUROPE

Boots stores in Europe have already mastered the front-end retail game with the popular Boots No. 7 cosmetics line. Boots' U.K. stores derive about half of their revenue from beauty products and a third from pharmacy, whereas Walgreens typically makes two-thirds of its money from selling prescriptions.

Moving forward, both Fein and Gordon expect major bloodshed at the company's Deerfield headquarters.

"You're going to see excruciatingly painful cuts," Gordon said. "You're not going to get to a billion and a half dollars of savings through small layoffs. I think over the next six months, you're going to see whole departments going away or being (outsourced to) another country."

Fein expects that Pessina and his team will remove layers of management inside stores, "right-size" the store count and get out of markets where they're not doing well.

"Walgreens' previous management would almost never admit they were wrong about anything, ever," Fein said. "Pessina is willing to come in with a fresh set of eyes and correct mistakes that have been lingering."

Earlier: Meet Stefano Pessina, the dealmaker who has Walgreen HQ buzzing
