[redacted]

All the while, management has to win over old-timers who don't necessarily see eye-to-eye with the influx of outsiders transforming the company from the top down [redacted]

2,000 locations; by 2003, it had doubled again to 4,000.

Cork Walgreen, outwardly unassuming but inwardly driven, also hived off side businesses including optical centers, the Sansborn department stores and Robin Hood's and Wag's restaurants to focus on the core pharmacy business.

His successor, Daniel Jorndt, the first non-family member to run the company, continued Walgreen's growth spree. From 1990, when he became president and chief operating officer, to his retirement as chairman and CEO in 2002, revenue more than quadrupled to $28.68 billion and earnings increased more than fivefold to $1.02 billion.

Even as the top boss, Mr. Jorndt legendarily answered the phone in the same manner he did as a young pharmacist at a North Side store in the 1960s: "This is Dan Jorndt. How may I help you?" Employees followed his old-fashioned humility, calling everyone in top management mister, rather than using a first name.

HOLDING COURSE

Throughout the 1990s, Walgreen's reputation was similarly conservative. While other drugstore giants such as CVS Corp., Rite Aid Corp. and Eckerd Corp. were rapidly acquiring smaller chains and independent pharmacies, Walgreen — which felt burned after acquiring New England's MediMart in 1986 and spending too much time and money to convert the stores — refused to detour from its course of getting bigger solely by building more of its own stores.

The site-by-site expansion continued into the 2000s under CEO David Bernauer, another Walgreen lifer who was promoted to run the company in 2002. But it began to sputter under Jeffrey Rein, who took over in 2006 as the pharmacy landscape grew increasingly complicated.

Mail-order pharmacies spent most of the 1990s and early 2000s aggressively courting health care administrators with 30% discounts, which were passed on to consumers via lower co-payments.

Bentonville, Ark.-based Wal-Mart, the world's largest retailer, shook up the pharmacy business further by offering $4 generic drugs, a profit-crushing discount Walgreen reluctantly matched with a prescription savings club. Then, in 2008, archrival CVS of Woonsocket, R.I., bulked up by topping a last-minute bid from Walgreen for Walnut Creek, Calif.-based Longs Drugs; the $2.9-billion acquisition made CVS Walgreen's equal in store count.

In the fourth quarter of 2007, Walgreen's quarterly income fell for the first time in nearly a decade, the start of a rough patch that includes a 7% drop in annual profit in fiscal 2009 and a decline in 2010's third quarter.

"For a period of about five years, there were new competitive threats popping up everywhere, and CVS was consistently outflanking Walgreen," says Neil Stern, an analyst at Chicago-based retail consultancy McMillan Doolittle LLP.

Mr. Rein didn't last long. He left the company in October 2008, two days after he lost Longs to CVS. Mr. Wasson, who started as a Walgreen pharmacy intern while studying at Purdue University in 1980, replaced him.

Despite possessing a résumé typical of Walgreen's top brass, Mr. Wasson, 52, has dramatically changed the way the company does business. His gutsiest move came earlier this year, when he jettisoned Walgreen's in-house pharmacy benefit manager.

Walgreen family saga: from helm to bleachers

When Galesburg native Charles R. Walgreen emptied his savings to buy a South Side corner store in 1901, he set into motion one of the great family businesses in American corporate history.

By 1925, Walgreen's had 65 stores, all of which housed bustling soda fountains where, if company lore is to be believed, a soda jerk added chocolate syrup and milk to Walgreen's Double Rich Ice Cream to create the world's first milkshake.

By the time Mr. Walgreen's son, Charles Jr., took over the company after his father's death in 1939, the chain had grown to nearly 500 stores with $69 million in annual sales.

Charles Jr., or Chuck, ran the company quietly for nearly 25 years, a period of calm, if minor, expansion. He oversaw the switch from counter assistance to self-serve stores in the 1950s and, a decade later, the purchase and growth of the Globe discount department store. When he stepped down as president in 1963 — he stayed on as chairman for another 13 years — Alvin Borg, his roommate at the University of Michigan School of Pharmacy, took over the No. 2 job, staying for six years.

Chuck's son, Charles III, was named president in 1969, at age 33, later succeeding his father as chairman, too. When he retired as CEO in 1998, the affable leader known as Cork could claim 23 straight years of record sales, six stock splits and an increase in the company's value to $19 billion from $164 million. He remained on the board until early 2010.

Today, only one fourth-generation family member works for Walgreen. Kevin, 50, became a vice-president in 1995 and was promoted to senior vice-president overseeing Southern stores in 2006. He left the company abruptly in 2009, during a period of cost-cutting and early retirements, but returned a few months later to oversee business development.

Today, he and his father collectively own less than 1% of Walgreen's stock. Though one of Cork's young-adult grandchildren interned at the company, he's now in law school, and no other heirs apparent remain.

Brigid Sweeney

PBMs are third-party administrators that negotiate prices with pharmacies and drugmakers on behalf of corporate clients and pay their prescription drug claims. Walgreen created its own, Walgreens Health Initiatives, in 1995, but the business never achieved the heft necessary to negotiate good deals for its customers.

CVS took a different approach, paying $26.5 billion for Caremark Rx, one of the country's largest benefit managers, in 2007. The purchase put Walgreen on the defensive. PBMs handle about 70% of all prescriptions filled in the U.S., and the top three managers — CVS Caremark Corp., MedCo Health Solutions Inc. and ExpressScripts — account for 60% of all PBM business.

"Walgreen was really an also-ran in the PBM industry," says Adam Fein, president of Pembroke Consulting Inc., a pharmacy-industry consultant in Philadelphia. As the ninth-largest manager, it had less than 3% marketshare in 2010, he says.

In March, Walgreen sold its PBM to Catalyst Health Solutions Inc. for $525 million.

"They made a very public sale of it, really just to kind of rub it in CVS' face," says Jeff Jonas, a New York-based analyst at Gabelli & Co. "Caremark was pitched as this big transformational thing, but Walgreen wanted to point out that the PBM business is pretty rocky and not what they do."

FOLLOWING SUIT?

Lately, analysts have speculated that CVS might spin off Caremark, which lost revenue in 2010 as it failed to renew clients and received lower reimbursements.

But the lack of a captive PBM leaves Walgreen dependent on outsiders to steer prescriptions its way. Insured Americans, most of whom are customers of the three big PBMs, have little incentive to fill a prescription at a Walgreen store. Indeed, PBMs, whose main goal is to reduce costs for their corporate clients, prefer cheaper mail-order options — or, in CVS Caremark's case, CVS stores.

So far, Mr. Wasson has used Walgreen's unmatched network of stores, including 6,533 with drive-through windows and 1,613 open around the clock, to retain business from PBMs. Last year, for instance, he threatened to stop filling prescriptions for Caremark plans unless Caremark paid Walgreen more for filling prescriptions and dropped policies favoring CVS. The companies pounded out an agreement in less than two weeks.

Now he's threatening to cut off St. Louis-based ExpressScripts at the end of 2011, arguing that it isn't paying Walgreen enough. This time, the PBM claims to have the upper hand: Customers can pick up prescriptions at other pharmacies within a half-mile of most Walgreen stores, it says, which means losing Walgreen would inconvenience only a few patients.

"The crux of the issue is the question, 'How valuable is Walgreen's store network?' " Ms. Adler of Barclays says. "I don't know that we have an answer yet."

PBMs have hurt Walgreen in another way. Because they have reduced consumer co-pays by as much as 30% to lure them to switch to mail-order, analysts say, the pharmacy benefit managers have forced Walgreen to begin matching mail-order prices on 90-day prescriptions filled at its stores this year. "Walgreen is willing to accept lower profitability in order to keep people visiting its stores," Mr. Fein says.

Kermit Crawford, Walgreen's president of pharmacy services, says that's not true. Walgreen still commands a slight premium over mail rates, he says, because its 90-day store refills offer convenience and the option of more generic drugs saves PBMs money. It also costs Walgreen less to dispense one 90-day prescription than three 30-day scripts, he notes. The company doesn't break out financials for its pharmacy business.

Walgreen long has relied on drug sales for two-thirds of its profit. It filled 778 million prescriptions in 2010, up from 651 million in 2009, thanks in part to its $1.08-billion acquisition of the 258-store Duane Reade chain in New York. Walgreen accounts for 16% of all prescriptions filled in the U.S. CVS stores have 14% and Caremark another 6%, making them the market leader. Rounding out the rest are MedCo with 9%, Rite-Aid Corp. and Wal-Mart each with 6%, and ExpressScripts with 5%.

An upcoming flood of generic drugs should give pharmacy sales another lift, increasing profits for now. Generics are much cheaper than brand-name drugs, such as blockbusters like Lipitor and Plavix, which will lose patent protection over the next year or so. Generally, though, retailers can mark up generics more because wholesale pricing is opaque to outsiders.

But with pressure from all sides to lower drug costs, Walgreen can no longer count on prescription revenue to lift long-term sales. Nor can the retailer grow much by enlarging its footprint. After increasing store locations by 9% a year in the early to mid-2000s, Mr. Wasson concluded that the marketplace was saturated and slashed additions to 3% in 2011.

Instead, he is trying to boost performance through something he's dubbed customer-centric retailing. This entails adding food, beer, wine and liquor, expanding beauty-products aisles and decluttering shelves by eliminating slow-selling goods. The makeovers cost about $45,000 per store. Over the past two years, more than 4,000 stores have been revamped, with a goal of reaching 5,500 by October.

(The foray into food has become a political plus. At the behest of former Mayor Richard M. Daley, Walgreen announced it would add fresh fruit and vegetables to 11 stores in poor neighborhoods; now, working with Mayor Rahm Emanuel, the company recently said it plans to set up 30 more such oases in "food deserts" and add 600 jobs.)

Analysts initially were skeptical of customer-centric retailing. But Walgreen says the effort has eliminated $500 million in inventory and lifted same-store sales. "CCR started a little slow and got burned during the recession, but it's beginning to pay off," Gabelli's Mr. Jonas says.

WEB PRESENCE

Mr. Wasson is going after online customers, too, scooping up Drugstore.com for $429 million in March. The deal gives Walgreen access to Drugstore.com's 3 million online shoppers and 60,000 over-the-counter health and beauty items, putting the company a step ahead of CVS and in a better position to fend off challenges from Wal-Mart and Target Corp., whose aisles, and websites, contain many of the same products as Walgreen's.

But the price reflected a 113% premium on the stock price of a dot-com that has never posted a full-year profit in its 13-year history. And despite its name, drugstore.com won't help Walgreen's online drug sales: The site sold off its prescription drug business to BioScrip in 2010 in a deal valued at $10.9 million.

"I think they were sold a bill of goods," Mr. Palizza says. "They paid a lot of money for an unsuccessful company."

Mr. Wasson also is looking to beef up pharmacy sales by broadening the definition of what, exactly, a pharmacy is.

Rather than just filling prescription bottles like everyone else, Walgreen is convincing employers and health plans to have people come to its stores for expensive, complicated medicines for chronic diseases previously treated in a doctor's office, like rheumatoid arthritis, cancer and hepatitis C. Spending on these specialty drugs spiked 20% last year, twice the 10% increase on regular drugs, according to ExpressScripts. By 2014, researchers at Thomson Reuters predict, seven of the top 10 drugs by dollar sales will be specialties.

Walgreen also owns the largest network of worksite and in-store clinics in the country following its 2007 acquisition of Take Care Health Systems, which operates nearly 700 clinics staffed with nurse practitioners. Wal-Mart, by comparison, has fewer than 150; CVS has about 500, but it aims to double that figure by 2015.

"Walgreens has made a strategic decision to become the largest dispenser in the country right now," Mr. Fein says. "They have the largest and most diverse set of dispensing channels of everyone out there."

The worksite clinics, in particular, offer growth potential as employers try unconventional ways to cut health care bills. Large companies that invest in an onsite clinic save 10% to 30% on their health care, according to Fuld & Co. in Cambridge, Mass.

Although Walgreen sold more than 7 million flu shots during the 2009-10 winter, the in-store clinics have not yet proven to be year-round moneymakers. "It's hard to justify the cost of a nurse practitioner when you're only doing high volume five months out of the year," Ms. Adler says.

As Walgreen transforms the way it does business in its second century, Mr. Wasson is overturning the steady and staid corporate culture that was so integral to its first 100 years.

"Pharmacists are among the world's most conservative professionals because if they make a mistake they can kill someone," says Mr. Palizza, the former Walgreen investor relations executive. As a result, "the image Walgreen has always wanted to project was one of corporate Boy Scouts" who had come up through the ranks of store operations.

'PLAIN-SPOKEN'

Mr. Wasson fits the mold: After starting as a college intern, he became a pharmacist and a store manager in Houston before being promoted to district manager and regional vice-president. "He's a Midwestern, plain-spoken, what-you-see-is-what-you-get guy," Mr. Palizza says.

But, as part of massive cost-cutting that began in 2008, a wide swath of veteran executives who fit that image was offered early retirement. In their stead, Mr. Wasson hired the first slew of outsiders ever to run the company, which had prided itself on internal promotions.

The new people include CFO Wade Miquelon, a former chief financial officer at Springdale, Ark.-based Tyson Foods Inc., where insiders say he was well-regarded and a future CEO candidate; chief merchant Bryan Pugh, an alum of British grocer Tesco PLC; Kim Feil, the company's first-ever chief marketing officer, who came from Sara Lee Corp. in Downers Grove; Joseph Magnacca, the former head of Duane Reade who is overseeing the front-of-store push as a division president, and Sona Chawla, a Dell Corp. veteran who was named president of e-commerce.

Another outsider in a key role is former Harris Bank CEO Alan McNally, who was named chairman of the Walgreen board in 2008.

Savvy, confident and aggressive, the new leaders have been well-received by Wall Street, but they still need to prove themselves to another, arguably more important, sector: their underlings.

"The engine that drives this train is the humble Walgreens drugstore that accounts for 90%-plus of earnings, profits and sales," Mr. Palizza says. "Walgreen's success lies in whether the store managers, the district managers, the regional VPs buy into this transformation."

After a lost decade, shareholders are counting on them.

What do you think?

Donald P. wrote:

Unless Walgreens focuses attention on the shabby, often dirty store chain that they have become, they will continue to lose customers and share. Who really needs them any more?

7/18/2011 10:09 AM CDT
Recommend Report Abuse Permalink

Ryan W. wrote:

"But what started to happen in the mid-2000s is they got so enamored of growth that they lost sight of the expense line."

Truer words were never spoken, not just of one business, but of the local, state and even national economy.

7/18/2011 10:09 AM CDT
Recommend (1) Report Abuse Permalink

Nikki B. wrote:

Brigid, this was a great comprehensive story. I really put Walgreen's into perspective. Thanks for your research efforts.

7/18/2011 9:34 AM CDT
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