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What Retailers Can Learn From Recent Bankruptcies

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Numerous lessons can be learned from last year's retail bloodbath that saw bankruptcy filings by large retail mainstays such as Toys "R" Us and Gymboree and countless smaller retail stores. Understanding the factors leading up to these bankruptcies, as well as the strategies used by retailers to emerge from bankruptcy, can give retailers significant knowledge about trends in consumer spending and how retailers can improve their overall positions going forward.

In addition to learning from what went wrong, retailers also can learn from what went right. Zara, one of the largest international fashion companies, has found continued success notwithstanding the industry's challenges by employing certain key strategies that other retailers may want to emulate.

A Sophisticated Online Presence Is a Necessity

It should be no surprise that a significant change in consumer spending habits has contributed to the downfall of a number of retailers. More purchases are being made online than ever before and, in fact, some speculate that online spending actually exceeds spending in traditional brick-and-mortar stores and shopping malls. Nothing evidences this change more than Cyber Monday's record-breaking sales that exceeded $6.5 billion in U.S. online sales.

Payless, Gymboree, and Toys R Us all cited an inadequate online presence as a significant factor leading up to their bankruptcy filings. Accordingly to its bankruptcy pleadings, Payless had plans to further develop and implement its online digital presence, but a decline in sales during 2015 and 2016 delayed these efforts.

Gymboree's chief restructuring officer, James A. Mesterharm, attributed the company's financial struggles to, among other things, "the general shift away from brick-and-mortar stores to online retail channels." As Mesterharm readily acknowledged, "retail companies like Gymboree, with a substantial brick-and-mortar presence, bear higher expenses than Web-based retailers and are heavily dependent on store traffic, which has decreased significantly as consumers increasingly shop online rather than in malls or shopping centers."

In contrast, Zara provides a great example of a retailer with a strong e-commerce platform. Shoppers can shop online internationally, and in over 30 languages. Zara also offers shoppers the option to receive periodic information via email about Zara's latest products and offers, including Zara's fashion lookbook, which looks more like high end couture than the affordable fashion it is.

One of most clever features of Zara's online strategy is its offer to ship online purchases for free when shoppers choose in-store pick-up; thereby drawing customers into their physical stores. Zara also allows returns of online purchases to be made at their physical stores. Shoppers making a return in a physical store are more likely to make another purchase than those who make returns by mail.

Bigger Is Not Always Better

Another common theme from last year's bankruptcy filings was the retailers' need to reduce its brick-and-mortar footprint. On the date Payless filed its bankruptcy petition, there were more than 3,500 wholly owned stores in North America, and nearly 400 stores in Latin America. A Chapter 11 plan was confirmed last August, and it is estimated that approximately 800 stores will close as part of the company's restructuring efforts.

An imbalance between brick-and-mortar stores and an online presence was also a factor in the bankruptcy of Rue21, Inc., a specialty fashion retailer of "girls' and guys' apparel and accessories," which exited the bankruptcy process with approximately 420 fewer stores. Like Payless, Rue21 emerged from bankruptcy relatively quickly; it filed for Chapter 11 bankruptcy relief on May 15, 2017, and its plan of reorganization was confirmed less than four months later on Sept. 11, 2017.

Rue21 used Chapter 11 to restructure its debt and relieve itself from underperforming stores, and it is currently working to better its merchandising strategy and e-commerce fulfillment, both of which Rue21 acknowledged were in need of improvement. Gymboree plans to close over 350 stores, with many of the leases ending on a negotiated termination date on Jan. 31, 2018, which allowed Gymboree the opportunity to stay open

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during what it hoped would be a successful holiday season.

Also wanting to take advantage of the 2017 holiday season, Toys "R" Us filed for bankruptcy in an effort to reopen its supply chain and, after its most immediate liquidity concerns were resolved, use the reorganization process to address long-term capital needs, and revamp its operations to meet the demands of today's consumers. Prior to the bankruptcy filing, Toys "R" Us reduced their store count or square footage by taking advantage of naturally-terminating leases and, in some cases, combining Toys "R" Us and Babies "R" Us stores under the same roof.

The company found that these combined stores outperformed preexisting separate store structures and, therefore, it plans to migrate additional stores to a similar model, and even open some smaller-footprint stores. In addition, recent reports indicate that Toys "R" Us is considering closing approximately 100 stores in response to weak holiday sales. These efforts will help relieve the company of above-market leases as part of its overall strategy to optimize its brick-and-mortar footprint.

Each of the above companies found it necessary to close stores and/or reduce square footage to improve liquidity and strike the right balance with an expanded online presence. Their collective experience teaches us that today's retailers should be continually assessing their needs for physical space and, when advisable, take advantage of naturally terminating leases or reign in plans for expansion.

Change Is Good

Another important lesson to be gleaned from recent cases is that change is good. Consumers want to see the latest trends, and they expect more from their shopping experience. This is particularly critical for drawing consumers away from their computers and into stores and shopping malls. Zara accomplishes this by keeping up with "fast fashion," and changing their inventory on a regular basis. To duplicate this, the modern retailer must have a system in place to keep up with a steady flow of inventory, including suppliers that can meet the stores' demands.

Toys "R" Us has recognized the need for change, and the company intends to revamp its stores during the bankruptcy process. According to its bankruptcy filings, Toys "R" Us plans to invest in the revitalization of its stores with the objective of reconnecting customers to the Toys "R" Us brand, and implementing initiatives which improve the in-store shopping experience.

According to Chairman of the Board and Chief Executive Officer David A. Brandon: "Once these initiatives are implemented, Toys "R" Us stores will be interactive spaces with rooms to use for parties, live product demonstrations put on by trained employees, and the freedom for employees to remove product from boxes to let kids play with the latest toys."

The company also "engaged app developers to create augmented reality video games that can be played by customers on their mobile devices in the company's stores." The goal is to create an enhanced shopping experience that will draw customers into the stores, making them better able to compete with "big box" retailers such as Walmart and Target, and online retail giant Amazon.

If All Else Fails, Negotiate with Creditors Before Filing

Sometimes a bankruptcy filing cannot be avoided. Should that time come, and if the circumstances permit, the process can move quickly if the retailer files for bankruptcy relief with a creditor-supported, pre-negotiated plan in place. The Payless entities filed Chapter 11 bankruptcy petitions in April, 2017 with a pre-negotiated plan structure in place, and a goal to move through the bankruptcy process expeditiously and "emerge as a stronger, better-capitalized business." It was able to confirm a Chapter 11 plan approximately four-months later, in August 2017.

Similarly, Gymboree filed for bankruptcy protection on June 12, 2017, by which time it had already negotiated a comprehensive restructuring of its debt, and obtained key creditor support for its reorganization efforts. With most of the details ironed out pre-petition, Gymboree proposed to move through the bankruptcy process swiftly, with an intended plan confirmation date of Sept. 24, 2017. In fact, Gymboree's Chapter 11 Plan of Reorganization was confirmed on Sept. 7, 2017, a few weeks earlier than anticipated, and became effective on Sept. 29, 2017.

Unlike fine wine, bankruptcy cases do not improve with age. Bankruptcy is expensive and the debtor loses a certain amount of control. Moving quickly can make all the difference in the world.

Moving Ahead

Without a doubt, retailers can learn a lot from the ups and downs of 2017 in order to best position themselves for the future. Although 2017 may be over, there is no reason to believe that 2018 will be any better unless retailers make significant changes to keep up with the demands of today's tech-savvy consumer. Brick-and-mortar stores may remain relevant and necessary, but e-commerce is not going away and the importance of a strong online presence cannot be overstated. Nor can retailers become complacent with their physical stores.

Retailers looking for more foot traffic need to be asking themselves: "What is my hook?" In other words, what can I have or do to lure shoppers into my stores? Whether it's ever-changing inventory, or the opportunity to touch, feel, and test products (think Sephora), retailers that offer shoppers a unique experience are more likely to survive the seismic shift that has taken place in retail.

Bankruptcy is not the cure for the problem. It may set a retailer on the path to recovery, but at the end of the day, the most important question will be: "Will the customer miss (fill in the blank) if it goes out of business?" If the answer is "no," you are dead.

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