Preventing Retail History from Repeating Itself

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Every year, many retailers find themselves in enough distress that restructuring advisors are brought in to try to salvage the business. With all of the distressed retailers that have come and gone, can anything be learned regarding mistakes to avoid or successful strategies to emulate?

Clearly, many retail failures are caused by macroeconomic factors, heavy debt loads, or a changing competitive landscape. However, many other failures are related to performance or operational issues that recur in distressed retail businesses. This article addresses some of these performance and operational issues.

Two recurring themes that emerge from the experiences of companies that have successfully addressed these problems to turn around their businesses are:

- **Speed Is a Priority.** Making decisions quickly and taking action immediately significantly enhance the chances of success. By overanalyzing and delaying decisions, companies have actually made decisions—likely bad ones.

- **Product Is a Priority.** Retail is all about the product offering, and every decision should be weighed against its impact on the core customer and the products she wants to buy.

Early Stage Resistance to Change

The decline of a retail business can be fast, but more often than not, the decline is slow and painful. Unfortunately, in this

early stage of decline, an opportunity is missed due simply to a resistance to change. Past success seems to instill fear or hesitancy to change. Even as things get worse and worse, it is typical for troubled businesses to resist change, to overanalyze, and to delay.

A better approach is to simplify the issues by going back to fundamentals and identifying the primary reasons for the sales decline. Looking at retailers from the past, how many distress scenarios were caused by product offerings? Everything else that restructuring professionals do can help performance, increase returns, and provide more time. At its core, however, retail is all about the merchandise offering.

When one looks at Christopher & Banks' performance over the past couple of years, for example, it is noteworthy that the company's executive leadership seems to have maintained a laser-like focus on its core customer and the product offering. The Minnesota-based retailer that specializes in clothing for women 40-60 has closed stores, reduced headcount, and generally executed as one would expect in an effort to right the ship. But the key to what appears to be a great turnaround story is that executives first focused on the product and what the core customer wants.

In addition, the company's restructuring began with a willingness to admit that the status quo was not working and to take action. The company recruited talented leadership with merchandising expertise. Strong and talented merchants

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add dramatic value to every decision, whether it concerns merchandise mix, inventory reductions or allocation, marketing, store closings, etc. Good merchants focus on the customer at every point in the business.

Following this model, there are two things to keep in mind:

1 Know your customer. A miscalculation by failed retailers that seems to repeat itself is thinking that "our core customer isn't good enough." Really? The core customer is all they have, but again and again, distressed retailers try to "rebrand," which almost invariably translates to "go after a higher end consumer." The usual result is that they alienate the existing core customer—while never even attracting the attention of more of the higher spending consumers they covet—and sales fall even further. The best recent example of this involved J.C. Penney. Although the company has now returned its focus to its core customer, a lot of ground was lost, and many core customers were alienated, making the struggling retailer's restructuring even more challenging.

The lesson is clear: Always focus first on the core customer and what needs to be done to strengthen that relationship. Once the relationship with the core customer is solid, then a company can explore ways to supplement the customer base with new consumers.

2 Avoid living in the past. Companies that have enjoyed past success have a strong inclination to think, "It's worked for years, so it will work again." Times change, business dynamics change, and doing things the same way, even after the decline has begun, ensures failure. Where would Best Buy be if the company had realized that the internet would someday present consumers the opportunity to use Best Buy stores—big box stores with high occupancy costs—to "showroom" products before purchasing them online from other retailers? Was this unforeseeable, or was it simply not consistent with Best Buy's historically successful model?

Change Begins

As poor performance progresses, a retailer often begins to make some changes, but still misses the bigger picture. The company begins to make changes that are often disjointed, provide only short-term relief, or exacerbate the problem. These types of changes typically involve overhead or expense reductions, inventory, marketing, and store remodels.

Being thoughtful, honest, and aggressive in making overhead reductions can have an impact on company culture—begin to create a culture that makes clear that "everything is on the table."

When retailers realize that they need to address the downward trend, they are also generally willing to begin to cut expense. This is good, but typically the cuts are not as meaningful as they could be with respect to human capital. This is probably due to the fact that as the company grew, its overhead grew and an attitude that "we have to have that" took hold and continues to prevail.

When restructuring professionals arrive, they can always find additional cuts that do not impact the company's ability to deliver. They also can always find very talented people within the organization who are ready and willing to step up and accept additional responsibility. This is particularly true in the corporate office and, if done appropriately, making meaningful headcount reductions early shows lenders, vendors, shareholders, and all stakeholders a commitment to making tough choices. In the process, many key employees will turn out to be even more talented than hoped, and more importantly, the culture will begin to migrate toward the idea that "everything is on the table." This "no sacred cows" approach can significantly improve the likelihood of a successful restructuring.

Inventory cuts or reallocations must be about more than reducing expense—they must fit into the operating plan.

Inventory is a significant asset and as cash becomes more of a concern, a distressed retailer typically starts to consider whether reductions in inventory can help. This is certainly appropriate. One common approach is to reduce the inventory level in poorly performing stores and focus on the good stores. On paper, this may make sense, particularly ensuring that good stores have inventory. But what happens when inventory is reduced in a store that is already performing poorly? Performance does not

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improve—in fact, it only gets worse. Instead of taking inventory away, the retailer should consider that if the store is performing poorly enough to justify a reduction in inventory, it may make more sense to close it now.

A better idea may be to close the underperforming stores and use the cash generated, or as much of it as is permitted, to focus on product-related solutions. As stated earlier, retail is ultimately about the product, and having the right merchandising team is especially important. When analyzing inventory reductions or allocations, a retailer should ask:

- Do customers want what we sell?
- Is the mix right?
- What products drive traffic?
- What products turn fast?
- What products drive gross margin?
- What are the cross sale synergies?
- Is there a private label strategy? If so, is it adding enough gross margin? Is the percentage of private label too high, too low, or just about right?

Measure marketing effectiveness, and then measure it again—every change to marketing has an impact.

There are several recurring themes in the marketing area. One is to "make a splash," to generate excitement and get customers back in the stores. That's a good idea, but is the underlying problem fixed? If not, even if the marketing works well initially, customers will recognize that there is no change, which will likely exacerbate the problem. What is the retailer doing differently? It must not promise a better experience if it's a work in progress. It seems everyone agrees that Radio Shack's Super Bowl ad was very well done, but did it help the struggling retailer? Was the company actually ready to invite customers to see the changes?

Another idea struggling retailers often pursue mirrors the ill-advised inventory strategy referenced earlier—reducing marketing for underperforming stores. As with inventory reductions, however, reducing or eliminating marketing will negatively impact sales.

Of course, the savings in marketing may exceed the sales decline, but a retailer should be careful. It seems that the stores that receive less marketing are the same ones that also receive less inventory, so these stores get the double performance challenge of improving performance with less inventory and less marketing—and probably less payroll as well. Again, a retailer should consider whether closing these stores now rather than waiting makes more sense in the long run.

Retailers, especially larger retailers, may also consider whether to reallocate the marketing expenditure to a heavier reliance on broadcast messaging. This may or may not make sense. Before embarking on a costly reallocation, a retailer should be sure to do everything it can to measure marketing effectiveness by medium: broadcast, direct mail, flyers, social media, billboards, etc. It is often difficult to measure marketing effectiveness, but one should be skeptical that going to a more expensive medium will necessarily increase traffic.

Don't set stores up to fail—make the decision that gives them the best chance of achieving sustained success.

Most distressed retailers are well aware that they have stores that are significantly underperforming or even losing money on a four-wall basis, but it is not unusual to hear subjective rationalizations for allowing those stores to remain open, such as, "I hear our competition is moving. That should open this market back up to us." There may seem to be a lot of persuasive arguments for keeping underperforming stores open, particularly during the resistance to change phase. But when four-wall cash flow is negative or in the vicinity of negative, it is very risky to place hope in these stores.

Remodeling is another solution that retailers often consider and, to be fair, that can be appropriate. Again, though, a retailer should be cautious. Is the absence of a recent facelift really the reason that sales are slipping? If so, then a well-planned, market-specific remodeling program can be effective. If a remodeling program is started in the early stages of distress,