Industry leaders and analysts continue to debate the future of retail — whether it’s in-store, online, voice-enabled or otherwise. In the middle of these projection wars, the industry’s fate is being hashed out somewhere else: in court.

Retail bankruptcies hit a fever pitch in 2017, with 50 major chains filing chapter 11, up from 30 in 2014. Adding insult to immovable inventory, bankruptcy is proving to be a less effective tool for retail restructurings and turnarounds. A Fitch Ratings analysis found that U.S. retail bankruptcies more often end in liquidation and have outstanding first-lien recoveries than in other industries (with an average unsecured recovery rate of 24 percent and median of 8 percent). A growing club of retailers has had to pursue second, even third, bankruptcies.

What’s driving this vicious cycle for already distressed retail organizations? As the industry moves through a critical phase of natural selection, the keys to survival may have as much to do with brand identity as they do financial stability.

Smart people have speculated that most bankruptcies end in liquidation, but the story isn’t that simple. To be clear, not every retailer will be able to compete in today’s retail environment (let alone tomorrow’s). However, most retail restructurings do not focus on fundamental issues that need to be addressed.

Three Core Reasons Why Retail Restructurings Go South

Amazon alone is not to blame for the retail industry’s state of distress, or individual organizations’ struggle to right the ship. Rather, too much focus and energy revolve around simply fixing the balance sheet and not enough thought goes into a transformational change in the business. There are three reasons why most retail restructurings do not end well:

• **A lack of post-restructuring vision:** It’s easy for distressed or restructuring brands to develop a narrow focus around closing unprofitable stores, eliminating costs or resolving vendor obligations. None of these areas, however, constitutes a meaningful strategy or lends itself to a strong brand position. When orchestrating a turnaround, it’s imperative to keep your current and future consumers in mind. As e-commerce brands and gig economy services shift consumer expectations, and as the industry’s center of gravity moves away from traditional malls, retail leaders need a clear understanding of the jobs customers “hire” them to fulfill.

There are several traps restructuring organizations face when developing a transformation plan. First, they don’t understand their future store footprint and the impacts this will have on assortment and inventory
levels. Without this insight, companies fail to clean up old and outdated inventory during the bankruptcy process. Second, transformation plans are usually not aggressive enough or appropriately linked to changes in products, capabilities and customer experience. Minor adjustments alone do not position retailers to be viable independent entities or acquisition targets for a competitor or strategic partner. Third, retailers fail to develop a plan B prior to filing for bankruptcy. Hopefully this plan is never needed, but boards should demand that management is prepared like the Pentagon (i.e., with readymade strategies for any possible conflict). The key is to assemble these plans long before entering bankruptcy.

Former JCPenney CEO Ron Johnson outlined a transformational strategy in 2011 with smart elements that retailers (especially those in Chapter 11) could benefit from today: simplified pricing and systems, a true lower store cost structure and more experiential store environment. Though Johnson’s plan failed due to a lack of proper testing and the impact on its current consumers, it showed promise. Too many retailers only focus on store closings, which is important, but much less vital in the long run than ensuring the business and operations strategies are in sync.

- **A disjointed real estate strategy:** It is paramount that retailers understand the true financials for all points of distribution. In many cases, there is a strong relationship between your online channels and store base. Developing a robust process for evaluating the metrics, demographics and accounting treatment behind store and channel profitability is imperative, along with a full review of lease options, and complete understanding of how these channels interact. Retailers that fail to exit unprofitable locations or renegotiate lease terms will fail to drive sustainable profitability.

- **Outdated infrastructure:** Reflecting on the last decade of retail, an obvious pattern emerges: organizations became overloaded by debt, shackling them to paying down obligations rather than investing in growth or innovation. This has been particularly true for many private equity-backed brands. Of the largest leveraged retail buyouts since 2017, more than half have defaulted, gone bankrupt or are in distress. As repeat bankruptcy filings at organizations like Bachrach and The Walking Company illustrate, chapter 11 can be a reset button, but it can’t make up for a lack of available funds or years of under-investment in new infrastructure, technology or capabilities.

The cost of debt has prevented organizations from evolving the way they do business. Many of these organizations have tired stores, lack the capital to evolve the customer experience and operate similarly to the way they went to market a decade ago. For example, in the case of one global retailer that filed chapter 11 in late 2017, around 75 percent more cash flow was dedicated to debt service and paying shareholders, compared to capital investments in the business, since 2016.

More often than not, distressed retailers have legacy backend systems that prevent them for making material changes to how they function. Compounding matters, these systems aren’t equipped to unify online and in-store activity. This limited emphasis on infrastructure keeps retailers from revamping their supply chain and streamlining corporate expenses. Post-bankruptcy, retailers must compensate for these past failings, investing in the core systems required to enable a true omnichannel experience for consumers. Unfortunately, many companies underestimate the investment needed post-emergence to create technology parity with leading retailers today.
How Retailers Can Outfit for the Future

In the middle of this distressed retail landscape, some organizations are thriving.

Discount apparel retailer T.J. Maxx has consistently added stores even as peers cut back. This growth, especially for a brand that was a latecomer to e-commerce, is largely attributable to its financial discipline and its leadership’s grasp on the core functional and emotional needs of T.J. Maxx shoppers.

The retailer’s operations hinge on maintaining stores where consumers “treasure hunt” for brand name apparel at a bargain price; that means giving merchandise buyers autonomy to bring in new inventory, maintaining an agile fulfillment network and keeping store layouts flexible. At the same time, its parent corporation points to reinvesting in their business as a key success factor. The company follows robust capital spending plans to fuel continuous improvement across its footprint.

Achieving stability in today’s retail industry is the result of more than in- or out-of-court financial restructuring. It requires leadership teams who are willing to plan ahead, maintain a sense of urgency and be proactive, rather than maintain the status quo and erode shareholder value in the process. Distressed retailers can begin to own their futures by:

• Delineating between actions that buy time and those that fuel a long-term strategy: Management teams that can be objective and maintain a degree of foresight will be best prepared to infuse positive momentum in their businesses. Rushing into partnerships (e.g., joint ventures, mergers and acquisitions) to secure an immediate cash infusion or create efficiencies aren’t a surefire cure for dissipating customer loyalty. Similarly, simply closing unprofitable stores or reducing headcount can’t compensate for deep-rooted operational flaws. It can be difficult to consider the big picture when an organization is struggling to pay its vendors, but successfully restructuring demands that executives focus on the long game.

• Eliminating activities that don’t fulfill customer needs: No brand can be all things to all people (not even Amazon). As you plan for your organization’s future, it’s important to shed services, products or other strategies that don’t (or will cease to) satisfy consumer demands. Shortly after Walmart unveiled its turnaround strategy at its 2015 annual shareholders meeting, the chain shut down its “Express” concept — freeing up resources to devote to its omnichannel efforts. Nordstrom, to maintain customer affinity even as the department store sector struggles, regularly drops poor-performing products to keep merchandise relevant. Identifying tactics to eliminate starts with understanding your competition, a challenging but crucial exercise as technology and emerging partnerships blur industry lines.

• Anticipating consumers’ future needs: Knowing today’s retail consumer is the path to survival; getting ahead of tomorrow’s consumer is the path to longevity. Beyond a chance to retool the balance sheet, restructuring can be an opportunity to reorient your brand around a future state. Retailers that arm themselves with insights into how future consumers will interact and buy can graduate from reactive to proactive strategies. A post-bankruptcy plan
for labor cuts or store closures won’t hold up against fluctuating consumer preferences or competitors’ investments. Instead, retailers need to play offense, considering new store experiences, brand collaborations or cross-industry alliances that will create value for years to come.

**Using disruption to your advantage:** Just as insurance companies adopt robotic process automation (RPA) to expedite modeling and healthcare providers expand telehealth programs to simplify care delivery, retailers must find ways to make emerging solutions work for them. But rather than invest in shiny new objects to chase trends, executives should identify concepts that reinforce their brand purpose. For example, Sephora is known for being a place where consumers can discover, learn about and experiment with products hands-on. Over the last couple years, the cosmetics chain has rolled out multiple initiatives (including in-store beauty workshops and augmented reality apps) to double down on that mission. Largely due to the brand’s success, LVMH (Sephora’s parent organization) experienced 13 percent organic growth rate for its selective retailing group in 2017 and generated record revenue from recurring operations companywide.

The traditional restructuring playbook is no match for today’s complex retail environment. To own your organization’s future, you need to articulate the consumer needs it exists to serve — the “job to be done.” With that understanding, retailers can think more clearly and creatively about the path forward.