INSOL International

Retail Disrupted - Welcome to The Hunger Games

November 2017

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Acknowledgement

INSOL International is very pleased to publish this special report titled “Retail Disrupted – Welcome to The Hunger Games” by Mr James Stewart and Mr Mark Tippet of Ferrier Hodgson, Australia and Mr Cory Lipoff of Hilco Merchant Resources LLC, USA.

At INSOL 2017, our 10th World Congress held this year, we presented a technical session with this same title and the session was chaired by Mr Stewart and Mr Lipoff was a speaker. Following from the great enthusiasm and interest shown during the session, INSOL invited the speakers to prepare a special report so that we can share some of the insights discussed during the session with our membership.

This paper is not theoretical in nature. It highlights a range of practical issues that would be of interest to insolvency practitioners dealing with retail sector restructurings in the developed and developing markets. In particular, the report covers:

- The drivers of the disrupted retails industry
- Common denominators of retail failure
- Restructuring - what practitioners need to know
- Examination of the historic buy out of US fashion retailer Aeropostale (in Chapter 11) by a consortium

Globally, ‘old world’ retailers are being forced to invest and change their business models faster than many could have imagined. Digital engagement and data analytics is now what drives best practice and for many retailers this is not only a quantum shift in thinking, but it also means reorganising their business models to survive and prosper in the face of rapid disruptive change.

INSOL International sincerely thanks Mr James Stewart, Mr Mark Tippet and Mr Cory Lipoff for providing this excellent paper which is a delight to read.

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Retail Disrupted - Welcome to The Hunger Games

By
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Introduction

The objective of this article is to better inform INSOL members of the drivers of disruption across the retail industry with a focus on markets such as North America, Australia and Europe and an overview of other markets in Asia such as China, India and Indonesia. This article is composed of four sections:

1. The drivers of the disrupted retail industry

2. Common denominators of retail failure

3. Considerations in retail restructuring

4. Restructuring case study: Aeropostale

People fear change. There's a psychology to it. The primitive part of our brains - the 'instinctive mind' - equates consistency with safety and inconsistency (change) with danger. Therefore, change normally elicits feelings of stress, anxiety and even pain. Change means our lives become inconvenienced – disrupted.

At no other time in history have we been exposed to such levels of disruption - in society, in our environment and in business. Globally, the retail industry is experiencing the full impact of this disruption.

In the space of a decade, retail has been transformed immeasurably and permanently. The combination of rapid advancements in technology and prevailing economic conditions post-GFC has given rise to a new set of consumer behaviours which are forcing well-established retailers to 'adapt or die', demanding that they invest in and change their business models at a faster pace than most could have imagined.

For many retailers, this sort of change requires a quantum shift in thinking, as the balance of power has shifted from retailers to consumers and digital engagement and data analytics are now driving best-practice retail. It also means having to reorganise the traditional retail business model to survive and prosper in the face of rapid disruptive change.

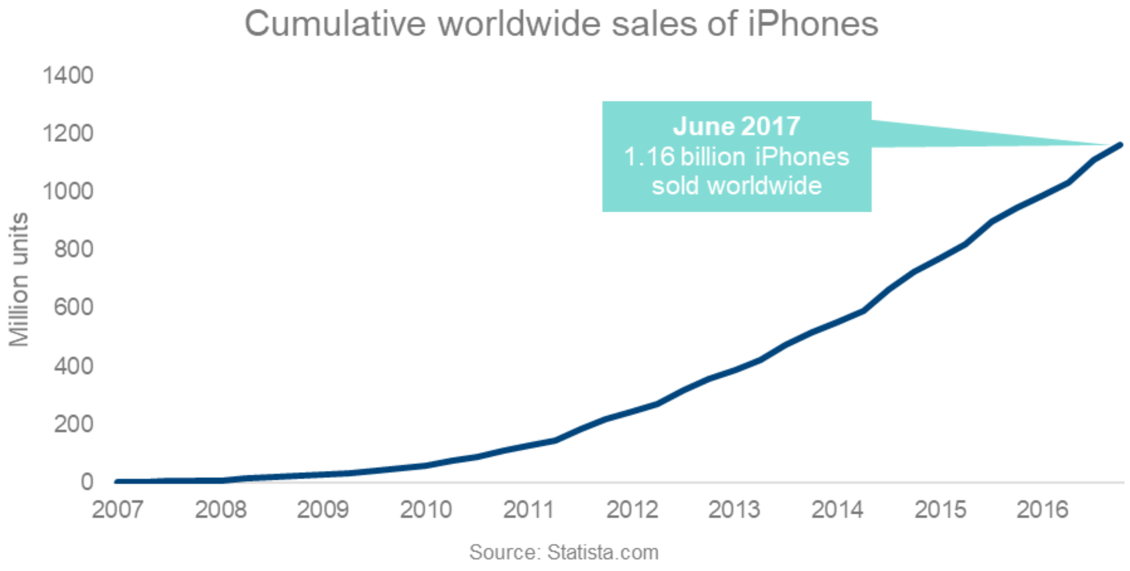
1. The drivers of a disrupted retail industry

1.1 Game of Phones

Of the disruptive technologies that have emerged in the wake of the GFC, smartphones have had perhaps the most significant impact on consumer behaviour and, thus, the retail industry.

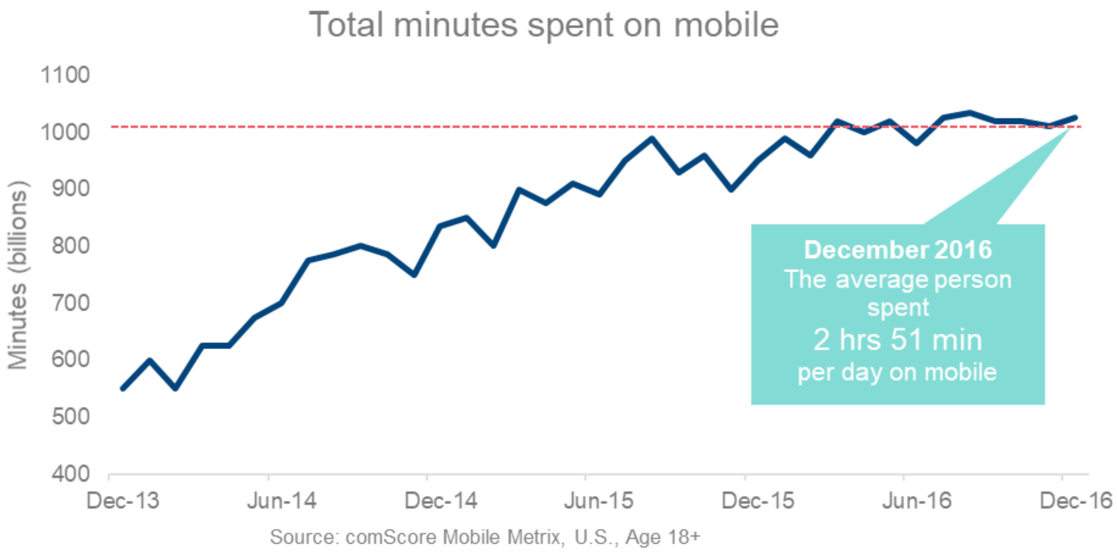
The creation and gradual adoption of the smartphone enabled and defined the 'connected consumer'. Today's connected consumers have access to global markets and an unprecedented amount of information, which has drastically altered the retail path-to-purchase. In this way, many industry commentators mark the advent of smartphone technology as the transitioning of knowledge and power from the retailer to the consumer.

* The views expressed in this article are the views of the author and not of INSOL International, London.



https://www.statista.com/statistics/263401/global-apple-iphone-sales-since-3rd-quarter-2007/

Our mobile phones have become an extension of ourselves. Data from comScore shows the total time spent by US adults on mobile devices has nearly doubled since 2013.



1.2 Data and the pathway to purchase

The rise in connectedness has generated an enormous amount of data. Per IBM, 90% of the data in the world today has been created in the last two years alone. Each interaction we have with the Internet creates data – taking a photo, making a video, sending a text, liking a post, looking for directions or making a purchase. While these pieces of data on their own might be meaningless, patterns and trends in data can tell us a lot about our past and can even predict the future. Having the ability to triangulate and draw insights from this data enables retailers to better understand their customers – who they are, and what they want, how and when they want it.

Uber is a great example of how mobile technology and data can disrupt an industry. Uber has roughly 40 million monthly active users worldwide and commands as much as 84% of the US ride hailing market. In just seven years, the company has taken the clear majority of market share from traditional taxicabs and introduced consumers to the concept of 'crowdsourcing'. In a nutshell, this was achieved with a mobile app backed by a rich repository of data and some clever algorithms.

The transition from ‘product push’ to ‘customer pull’ retail models has gained significant momentum post-GFC as digitisation has allowed consumers to gain access to limitless amounts of information through mobile hand-held technology that didn’t exist 10 years ago.

We are now seeing this level of disruption play out in retail. The new pathway to purchase has digital touch points at each stage of the purchase decision, making young digital-savvy retailers the go-to destination for consumers who prefer a digitally enriched retail experience.

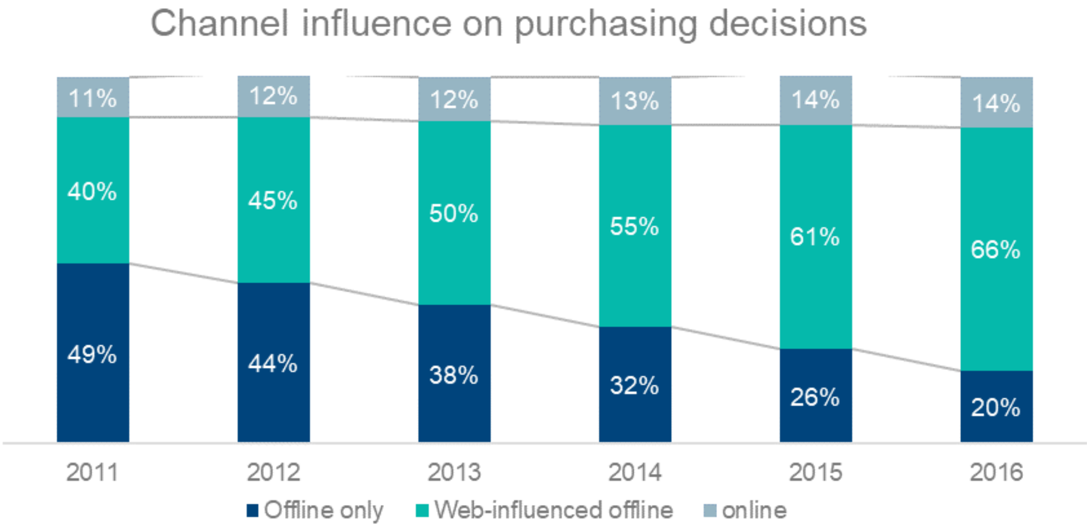
The old vs. new pathway to purchase

	Awareness	Pre-purchase	Purchase	Advocate
Old	TV Radio Newspaper Sales flyer Billboard	Review sales flyer for details Ask friends for recommendations and tips Visit store to experience product in person	Visit store Buy at store Return to store	Word of mouth
New	Social Email Mobile Web Search eFlyer	Visit brand website / mobile site / app Visit brand social media site / blog Visit review websites Locate product on marketplaces	Find nearest store and inventory via website / mobile site / app Order online Ship to store Ship direct to home	Social media channels Messaging Personal blogs Review websites

In the last two years, Google, Apple, Amazon and Microsoft have released ‘virtual assistants’ – voice-controlled artificial intelligence which responds to voice commands. The number of Google voice searches has doubled each year for the past two years and in 2017 Walmart introduced voice controlled shopping. As easy as it was to type a question into Google’s search engine, now we can simply ask Siri (Apple) or Cortana (Microsoft) or Alexa (Amazon) to search for us.

At the awareness stage, social media and Internet advertising has had the most significant impact on the retail pathway. Consumers can now follow their favourite brands on Facebook and Instagram, scrolling through their news feeds to see new product launches or sales announcements. Emails also give retailers a direct line of communication to customers, enabling them to send targeted and relevant messages in a timely manner. Content creators and influencers with blogs or YouTube channels act as brand ambassadors, demonstrating and comparing products for the benefit of consumers.

The result, as shown in research from Fung Global, is that our offline purchase decisions are now significantly impacted by our online activity.

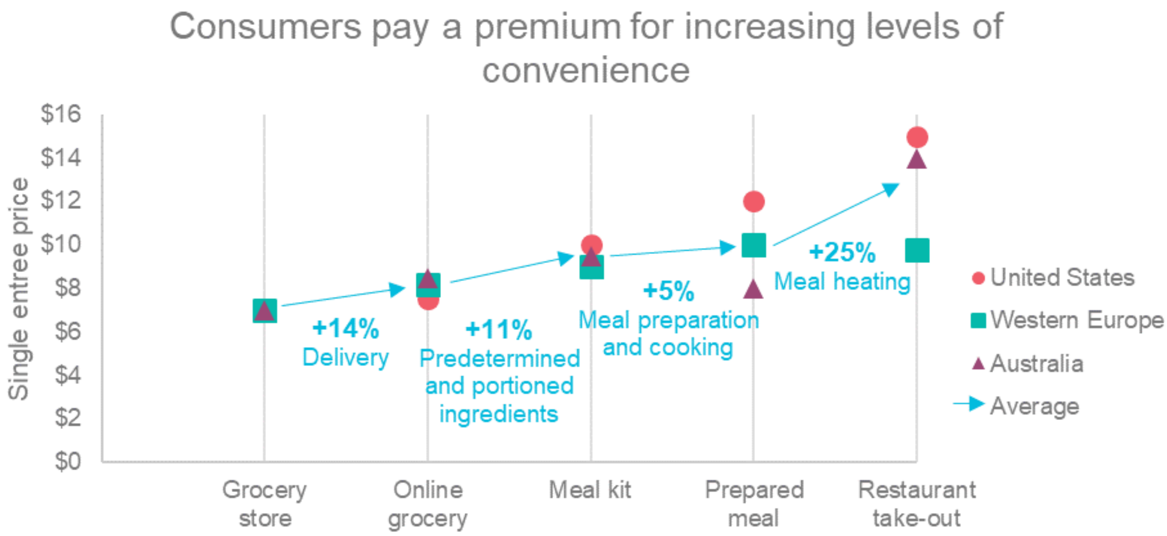


Source: Fung Global, Think with Google, 2017

Interestingly, the shift in power dynamics between consumers and retailers has bred a new consumer who is less trustful and more inquisitive of retailers and consumer brands. This means, at the awareness and pre-purchase stage, consumers also use their mobile devices to compare prices, check product information and availability, locate their nearest store and access product reviews. A consumer survey by Bright Local shows that 92% of customers now read reviews prior to purchase and 89% of us are willing to trust the opinion of strangers when making a purchase decision. The retailer is no longer the primary source of trust for consumers.

According to Oracle, the driving force behind consumer decisions in today's retail environment is the need for convenience. The use of technology has removed many of the traditional barriers that existed in physical retail. Although price is a factor, it is only the ticket to the dance - the need for convenience is crucial, be it click-and-collect, device friendly content, or committed delivery times.

The good news for retailers is that consumers are generally willing to pay more for convenience. For example, Lux Research shows that in food retail, consumers will pay an additional 14% for the convenience of having their groceries delivered and an additional 11% if their groceries are provided in predetermined portions for meals.



Source: www.cnbc.com

1.3 Millennials do it differently

The millennial generation (1981 – 2000) has quite literally grown up with the Internet. Many have had a mobile device from an early age, connect with their peers constantly via social media and do not understand the concept of going to a physical store to buy music. This generation behaves very differently compared to older generations (Gen X, Baby Boomers, Pre-Boomers), particularly in how they interact with their favourite brands and retailers.

Millennials are much more digitally social.

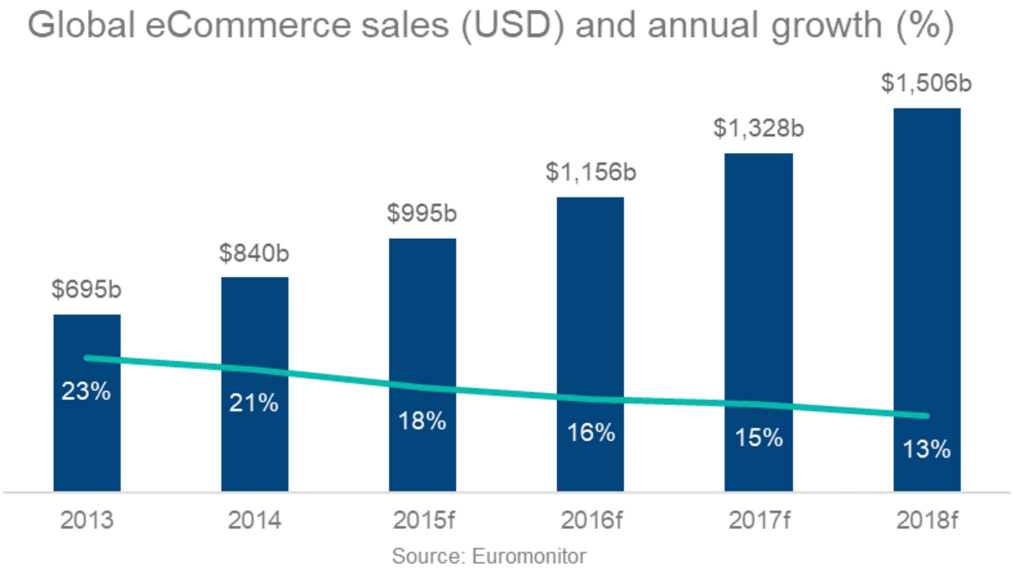
Data from Invoca shows that 33% of the time Millennials spend on their mobile phones is spent browsing and updating their social media channels. It follows that social media has a much larger impact on Millennials purchasing decisions than other generations. Deloitte reports that social media influences 47% of millennial purchase decisions. For comparison, that figure is 19% across all other generations.

Millennials also have different ideals and aspirations to older generations. They assign greater importance to personal experiences than they do to owning things. To make the case for experience-based retailing, a study by Harris Group has found that 72% of Millennials prefer to spend money on experiences rather than 'things'. Conlumino has similarly found that 71% of millennial consumers say that 'owning' things is wasteful and unnecessary.

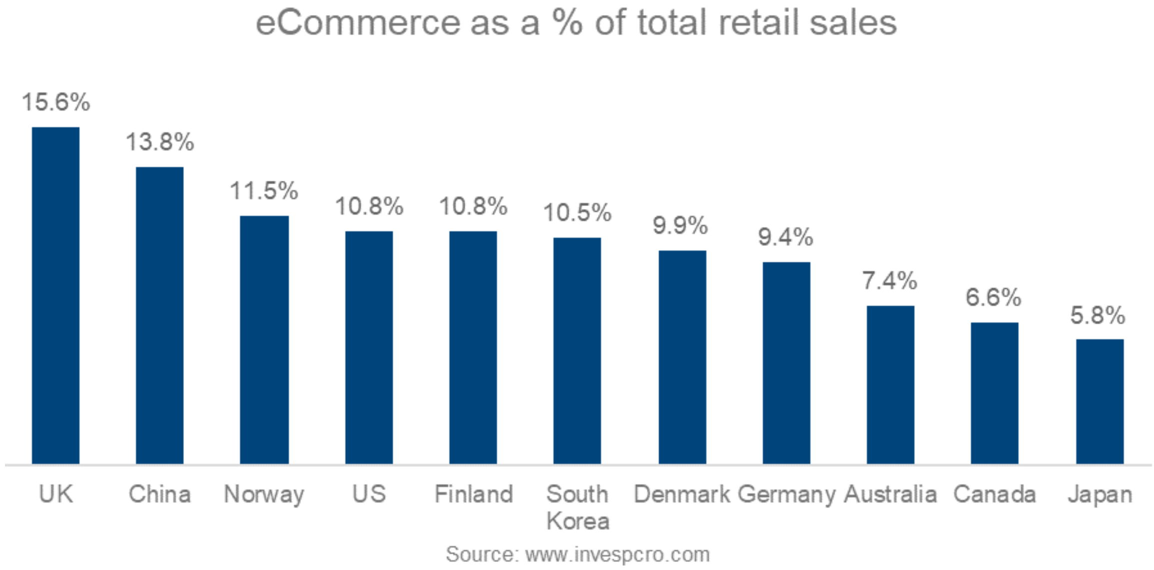
Millennials also have a conscience, preferring to spend their money with brands that are socially responsible. 83% of Millennials surveyed by Nielson in 2015 indicated that they would be willing to spend more on a product if it came from a sustainable brand.

1.4 The online tipping point

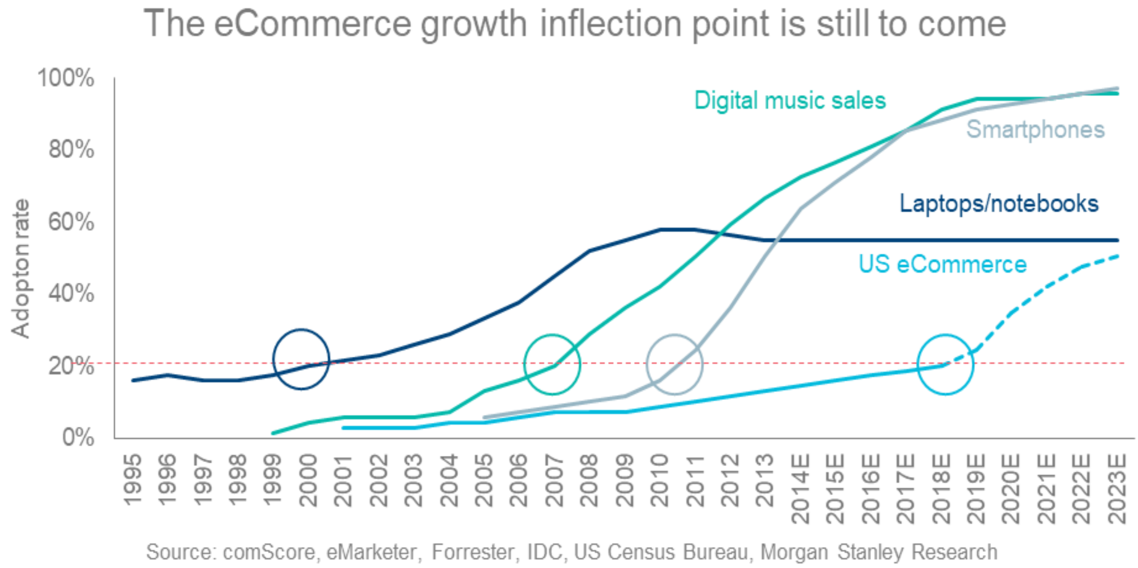
Data from Euromonitor shows that global eCommerce has grown at double-digit rates and continues to do so, as it is expected to reach USD1.5 trillion in 2018.



Per data collected from Adobe, US online retail sales on Black Friday in 2016 (the start of the US holiday shopping period) clocked in at US3.34 billion – a whopping 21.6% increase on the previous year. Fung Global estimates that 14.6% of all non-food retail sales in the US were online.



Morgan Stanley suggest that, much like the maturation process of many other technologies, eCommerce has an inflection point (the point of mass adoption) at which stage growth grows even more rapidly. It is suggested that, for eCommerce, this inflection point is at around 20%, which developed markets have not yet reached.



1.5 The rise of the pure play

Just as online and mobile has created a new channel for retail sales, so too has it created a new type of retailer – the online 'pure play'. The growth of eCommerce has dramatically reduced the barriers to entry in retail. No longer do businesses need to invest significant capital in setting up a physical store to sell their product. Aided by the emergence of social media advertising, smaller players and start-ups are leveraging millennial behaviours to sell their products online.

Although technically now online marketplaces, arguably the big three online pureplays are Alibaba (China), Rakuten (Japan) and Amazon (USA). Amazon began in Founder Jeff Bezos' garage and has grown to become the fifth largest company in the USA with a market capitalisation of c. USD500 billion.

What makes Amazon unique (and ultimately so successful) is the way it has structured itself to take advantage of consumers' growing preference for online retail. Being successful as a pure play online means relying heavily on logistics infrastructure to deliver the products purchased by consumers. Amazon has set about creating an almost wholly vertically integrated supply chain to reduce the cost of product in the hands of the consumer. Reliance on logistics providers like

UPS and FedEx reduces Amazon's control over their supply chain and makes them susceptible to brand damage if these providers cannot meet delivery timeframes.

To achieve total vertical integration, Amazon has invested considerably in building physical and digital infrastructure to support its customer offerings. This includes:

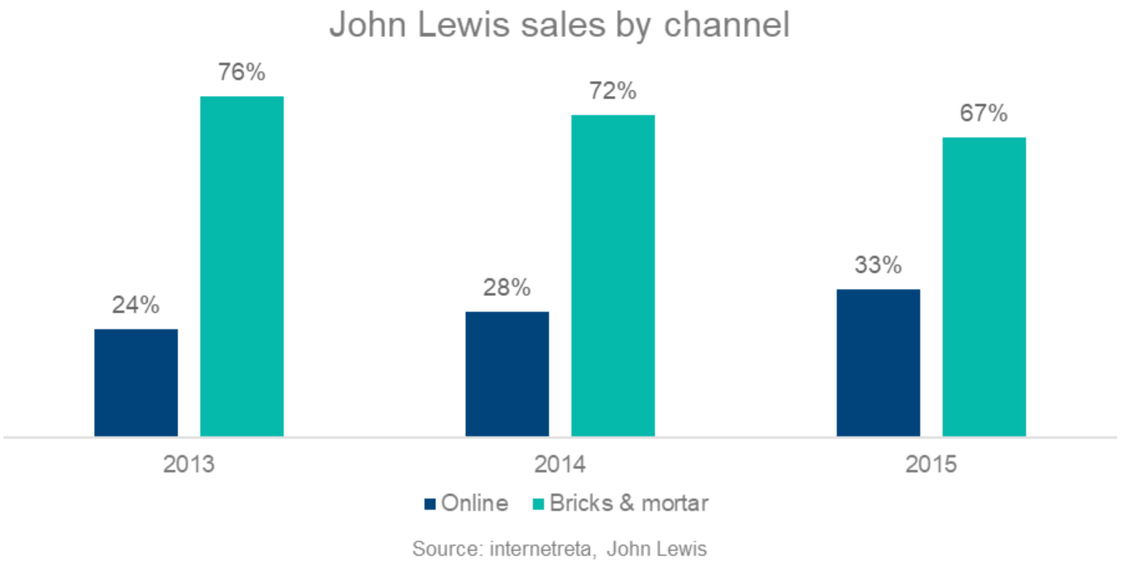
- More than 50 fulfillment and 20 sortation centres in the US
- 160 million square feet of space across its fulfillment centres and data centres worldwide (as at the end of 2016)
- Over 45,000 autonomous robots in these fulfillment centres
- A fleet of over 4,000 trucks
- 40 leased cargo planes and an airport hub (under development)
- 341,000 employees and counting

How has Amazon has changed the face of retail in the US?

- Amazon now accounts for fully 53 per cent of all online sales in the US per Slice Intelligence
- $4.7bn of the $9.4bn (or 37%) spent between Thanksgiving Thursday and Cyber Monday in 2016 was via Amazon
- $1.6bn of the $3.3bn (or 49%) of sales on Black Friday alone was online, 73% of which was via mobile devices

Brick-and-mortar retailers were initially slow to respond to online retail, many assuming it was simply a fad. However, with the likes of Amazon proving that online has the potential to drive significant sales away from physical retail, many traditional retailers have taken up the challenge of creating an online channel to supplement their existing stores.

John Lewis, the iconic UK department store was one of the few physical retailers to adopt online retail early. It began offering customers mobile web access in 2010 and click-and-collect ordering in 2012. By 2013 was generating 24% of its sales from online. Recognising the shift of consumer preferences towards digital, John Lewis has set itself on a path of digital transformation, diverting its marketing spend into growing its social media presence exponentially and investing in optimisation and integration of its online offering with its stores, now generating over 6 million click-and-collect orders per year.



Walmart, the world's largest retailer, has also made significant investments in online. The traditionally brick-and-mortar retailer purchased Jet.com in 2016 amid criticism that it was not doing enough to maintain relevance with its increasingly digitally-savvy customer base.

Since the acquisition, Walmart's e-Commerce sales have grown by a lofty 63% YoY, its online inventory has increased six-fold and it has expanded its click-and-collect offering to over 1,000 of its stores in the US. Additionally, it has recently partnered with Google to begin offering voice-activated shopping for more than 2 million items, improved its shipping program for online orders and will soon allow customers to scan returned goods with their smartphone and leave them at a customer service desk to speed up the return process.

1.6 Is physical retail dead?

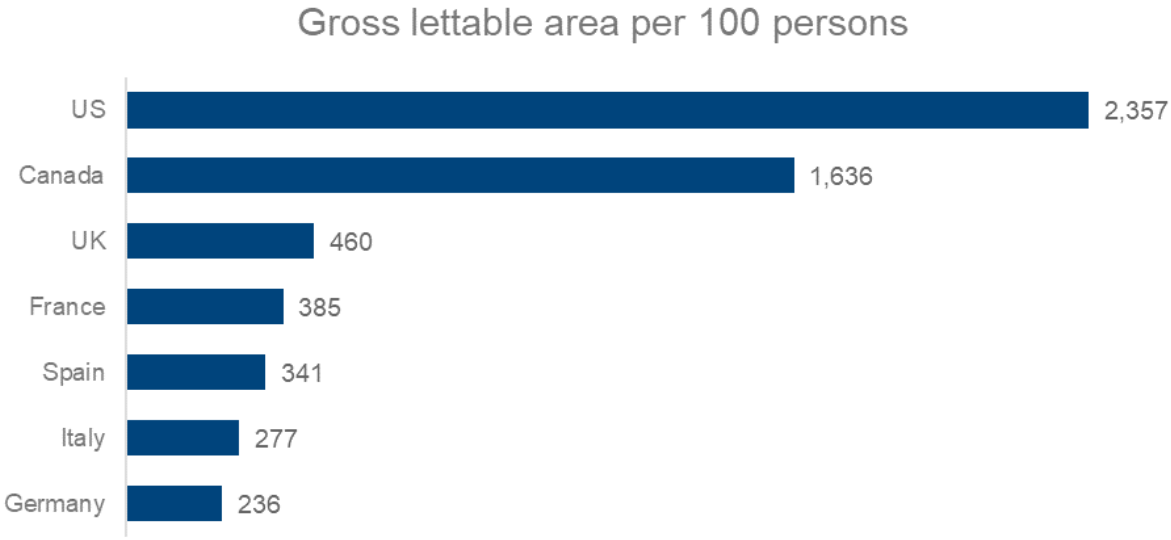
In the US, traditional brick-and-mortar retailers such as Sears and Kohl's are struggling from the effects of a bumper 2016 year for online sales (particularly Amazon):

- America's largest department store chain, Macy's, announced 100 store closures in January 2017, slashing 10,000 jobs in the process.
- Kohl's shares slumped 20 per cent following a decrease in comparable sales during the months of November and December 2016.
- In January 2017 Sears outlined its intention to close 150 stores after announcing a 12 per cent drop in November and December 2016 comparable sales.

Among these and other notable physical retailers in the US, by mid-2017 over 3,000 stores were slated for closure, leaving $2.5bn of retail sales up for grabs, almost three quarters of which will flow to Amazon per Fung Global. Credit Suisse estimate that there will be over 8,500 store closures in the USA in 2017, a record since the GFC.

Source: www.clark.com. Fung Global

However, these drastic actions are somewhat specific to the local market as the US is significantly overstored in physical retail space compared to other developed and Asian markets.



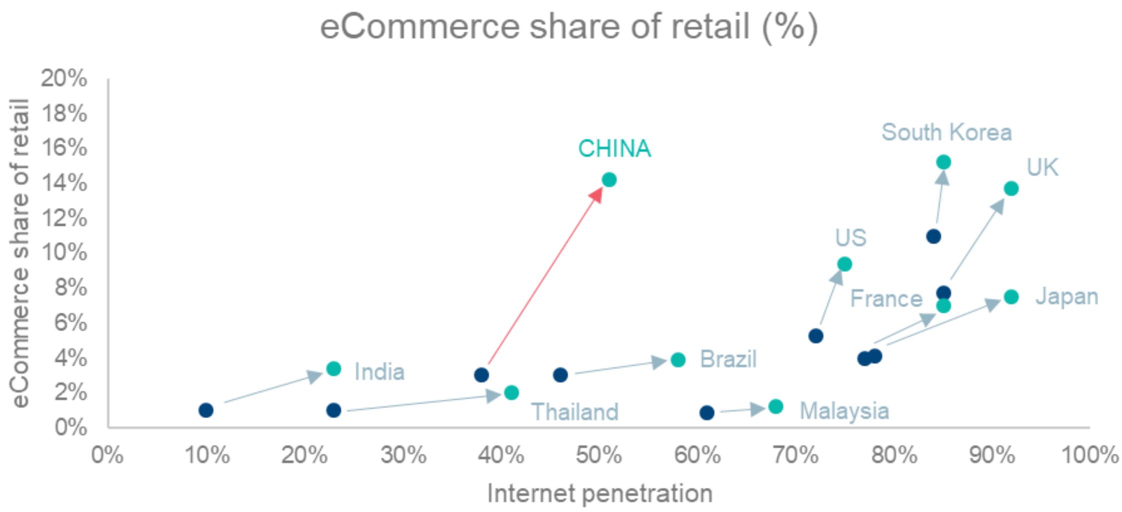
Source: Cowen Research

Physical stores still represent the major sales channel globally, but with the introduction of the online sales channel, the physical store now plays a different role in the retail path to purchase. Indeed, for some brands, the bricks and mortar store is experiencing a renaissance, of sorts. With online retail came the trend of 'show rooming' in stores, where price-conscious consumers researched or browsed in-store before ultimately purchasing online, where prices were lower. Any discussion about online pricing must reflect that the internet often sells products less expensively as the costs to operate are lower (For example it takes far fewer people to sell $10m in goods for Amazon then traditional bricks and mortar). Clearly the impact of consumer price checking is that, not only are brick and mortar retailers losing customers, but their margins are being suppressed as they are forced to try to compete on price. Importantly, however, for image-conscious customers, it's no longer just about the cheapest price, but about the brands' image, as influenced by their social presence, coupled with their digital and physical points of interaction with consumers, that contribute to consumers' willingness to spend.

Best practice retailers are creating a point of difference for their brand using physical retail so that their digital presence inspires purchases while the in-store offerings are highly engaging, enticing an increased in-store spend. Other innovative concepts are being tested including building physical show room stores such as Nordstrom Local, a store with limited/no actual inventory. Retailers are also developing "experiential" stores to help drive business by leveraging specific Brick and Mortar locations to deliver unique customer services or experiences that they cannot find online, (e.g. Nordstrom ear piercings (Claire's), and cooking demonstrations (Sur la Table) or yoga classes (Lululemon). Further, the mall owners are now working in concert with retailers to create experiences for consumers within the malls.

1.7 The state of developing markets (China, India, Indonesia)

Developing nations such as China, India and Indonesia missed out in the tech boom of the 1990's as a relatively small percentage of their populations had either access to electricity grids or the wealth and means to purchase expensive desktop computers. The advent of mobile technology however has seen the opposite take place. The adoption of mobile and eCommerce in these developing nations has outstripped developed nations as the technology is relatively inexpensive and is entirely portable.



Source: Economist Intelligence Unit, Internet World Stats, International Telecommunication Union, World Bank, Euromonitor, BCG analysis

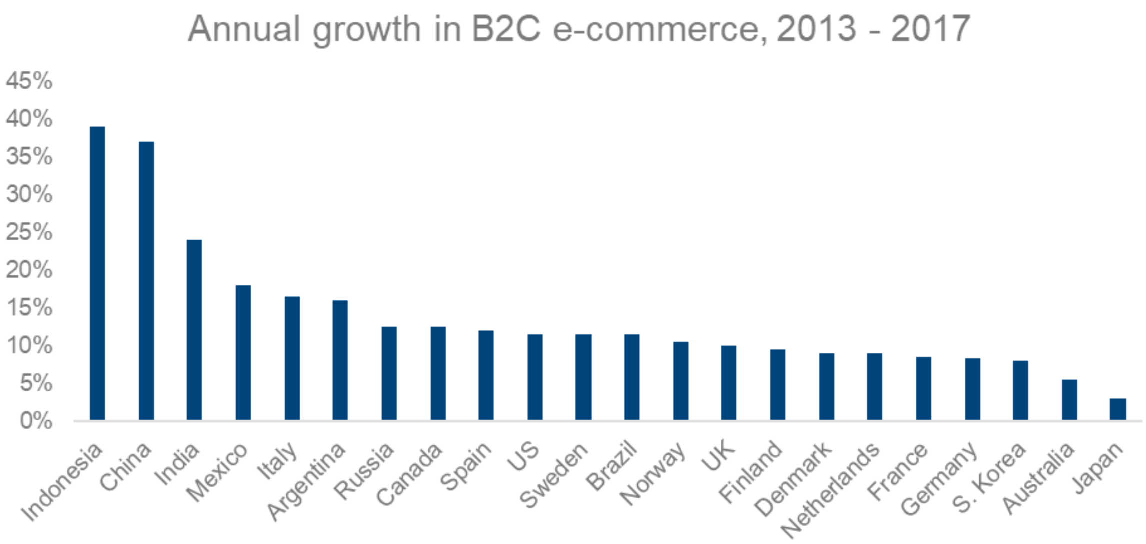
In part, due to a lack of access to quality physical retail, consumers in these countries became accustomed to eCommerce much quicker than western nations. DDM Asia research shows that in 2012, the density of leading physical retailers in China was well below that of the USA, leading Chinese consumers to rapidly adopt eCommerce as it provided a greater selection of quality products (especially from overseas markets) and offered delivery to consumers who lacked a means of transportation.

Source: DDMA China - Online shopping in China report 2012

Fuelled by 'Amazon-like' pure play retailers such as Alibaba (generating sales of USD485 billion in FY16, making it the world's largest retailer), China now represents the largest eCommerce market globally.

The stories in India and Indonesia are much the same. Sales through traditional physical channels are low by global standards and, per Frank Knight Global Research, India ranks lowest in terms of modernisation of its retail industry. Consumers earn significantly less and therefore the price competitiveness of online retail is very attractive. It is common for online retailers in India to offer COD payment terms, making eCommerce even more attractive for consumers who do not have methods of making payment online.

Thus, Indonesia, China and India have seen the largest % growth rates in eCommerce since 2013.



Source: eMarketer

While physical retail in more affluent areas of China is subject to similar competitive tensions seen in the developed world, for the rest of these markets, organised brick-and-mortar retail represents a much lower proportion of total consumer trade and thus is not comparable. The development of retail in these markets compared to the West has been centred on mobile eCommerce.

Western retail developments vs. Indian retail development	
Western retail	Indian retail
Predigital race for physical space by national brick-and-mortar chains	Adoption of eCommerce alongside the expansion of modern chains
eCommerce focused on direct retailing (retailer holds inventory)	eCommerce led my marketplace companies (website is an intermediary)
eCommerce established as a desktop activity	Mobile-first eCommerce adoption

Source: Fung Global

2. Common denominators of retail failure

In Australia in the last two financial years, over 2,100 retail businesses closed their doors or went into administration – more than the Australian mining and manufacturing industries (which have been subject to a significant downturn) combined.

Whilst a significant portion of these retailers were likely small single-store operations, the number also includes many well-known and historically successful retailers such as Laura Ashley, Payless shoes, Top shop and, G Star Raw to name a few.

Our experience is that most retail failures are caused by internal rather than external factors.

We have witnessed, first-hand, some of the mistakes retailers have made. There are valuable lessons to be learned from these failures.

2. 1 Brand and customer relevance

The number one reason retailers fail is because their brand loses relevance in the eyes of consumers. Here are four common symptoms:

1. Product and product mix becomes stale, impacting sales and margin performance.

2. Business strategy becomes confused and execution is uncoordinated, driven by balance sheet constraints or management denial.

3. Technology / capital investment is lacking, impacting the in-store experience and critical back-of-house functions such as warehousing and logistics.

4. Customer engagement drops off because of poor product, in-store and digital experience.

Brands that lack strong positioning, a clearly defined product offering and communication through relevant channels, risk losing touch with their customer. Data driven brands which understand who the customer is, what drives their purchasing decisions and how the brand can best communicate with them are more likely to survive and prosper

The difficulty retailers face is that consumers now expect more from retailers than ever. Consumers crave constant freshness and newness along with convenience and an overall better shopping experience in both the physical and digital worlds.

Successful retail brands manically focus on changes in consumer behaviour and align their value chain to deliver a superior brand experience through a multitude of channels.

2.2 Inventory execution

Even the best retail strategy will fail if it cannot be properly executed.

Many retail mistakes relate to either mismanagement of inventory or a lack of appropriate skillsets within the management team itself to deliver on the strategic plan.
Inventory management is crucial to being able to deliver on the omni-channel experience that underpins brand relevance. Poor planning disciplines and ineffective buying controls can have a severe impact on a business.

Product and range planning, determining product mix and sales and margin outcomes drive EBITDA. Too often the retailer's range plan is 'do what we did last year'.

Weak product planning is evident at the customer level through poor merchandising in stores, a fragmented range and a lack of clarity around what the brand stands for. Ultimately this costs sales and margin dollars.

2.3 Lack of business model innovation

Management hubris borne of past successes can lead to complacency. Stale business strategies based on what worked well in the past do not 'cut the mustard' anymore.

Successful retailers create business models that seamlessly integrate both the digital and physical retail worlds. The best omni-channel retailers will be the ones that successfully challenge and transform their business models by placing the consumer at the heart of their business. The challenge to retailers in the current environment is to change and adapt to a mobile and digital world where physical retailers are becoming digital retailers (e.g. Neiman Marcus and Walmart) and digital retailers becoming physical retailers (e.g. Warby Parker, Amazon).

The best retailers are transforming their retail value chain across sourcing, production and logistics. This doesn't just mean cutting costs, but also improving value through speed to market, ethical standards and quality.

2.4 Other issues

Whilst the three themes above address most of the common mistakes retailers can make, there are some other considerations which management should be aware of:

- Capital structure and investment - Retail companies must have the right capital structure in place to ride the inevitable 'bumps in the road' that occur from time to time. Without an appropriate capital structure, once a retail business becomes cash constrained it can lurch from season to season financially limited and without the necessary capital investment required to keep stores and systems current.

- Financial control and reporting - Quality and timely business-wide reporting is critical to allow retailers to accelerate decision making in a fast-moving world. At a minimum, this should include weekly reviews of:

  - Actual performance against budget
  - Performance of group and business unit KPI's
  - Underperforming stores (detailed review)
  - Inventory balances and mix

- Data analytics and customer insights – Best practice retailers are now running their business 'by the numbers'. The evolution of digital technology has seen more data made available than at any other time in history. Best practice retailers are triangulating their loyalty programmes, POS data and public data to deliver rich customer insights which drive decision-making around:

  - Store locations
  - Product mix
  - Pricing strategies
  - Customer engagement

  Many retailers globally are currently finding themselves in a turnaround phase, whether it be to keep up with the pace of change or to correct a misaligned strategy.

  The harsh reality is that with anything less than total buy-in and commitment to change, a turnaround attempt will ultimately fail. It can take up to 2 years to turn around a retail business. This is due to:

  - The need to clear obsolete stock (whilst minimising gross margin impact)
  - The need to design and introduce new product ranges
  - The need to recruit new human capital with the right talent and experience
  - The time to drive store profitability, through customer-oriented staff and the right product offering and mix to drive traffic

  Most importantly, change within an organisation needs to be owned by someone who is accountable for affecting the change. This may necessitate the establishment of a 'change office' separate and distinct from senior management, who are often too busy focusing on the daily tasks required of their respective positions to allocate time and energy to pushing a change agenda.

3. Restructuring – what you need to know

3.1 Retain key talent

The most important 'P' in retail is not price, product or promotion – it is people! Although retail is the business of selling products, a retail business cannot operate in the absence of good talent. Retaining key staff in a restructuring process is the most critical factor in achieving a successful outcome because:

- Staff in senior positions (e.g. C-Suite and department heads) generally hold a significant amount of tacit knowledge which cannot be easily gained by new staff entering the same role.

- In smaller businesses, the CEO or Head of Product is often the brand's 'spiritual guide' and there is not always an apprentice or succession plan in place, leaving the business directionless if they leave.

Senior staff defecting to rival businesses can cause significant brand and operational damage because of their knowledge of the business and its customers.

3.2 Continuity of supply

Inventory is the second most important ingredient in a retail model and the biggest source of cashflow for the business. Where a retailer is highly dependent on a few major suppliers for most of its product, there is a significant risk that interruptions in continuing supply could cripple the business through lost sales.

Conversely, major suppliers may be heavily reliant on the distressed business as a major customer, incentivising them to support the ongoing business as their own revenue is put at risk.

Generally, some negotiation - and potentially a pre-payment as a show of good faith - is required to convince suppliers to continue to support a distressed business.

3.3 Control your IP

A distressed business entering a formal restructure will typically lose some of this goodwill because of the inherent negativity associated with the process. However, well-known and long-standing brands will have strong recall in customer's minds and therefore still retain some value (particularly to competitors) which, in the event the business cannot be turned around, may be realisable.

It is therefore critical to understand early in a restructure process:

- What IP (trademarks, brand names, domain names) are associated with the business
- Does the business own and control them?
- Is there a potential market for these assets?

3.4 Rightsizing the business model

A successful outcome for a distressed retailer will invariably require an element of physical restructuring or 'right-sizing' to optimise the business model going forward. This may include:

- Reviewing / downsizing the physical store network
- Renegotiating onerous lease contracts
- Renegotiating onerous supplier contracts
- Reviewing product and mix to change brand positioning in the market

With any of these initiatives, a level of working capital investment will be required, which necessitates the financial backing of a key stakeholder.

3.5 Know the baseline position

Scenario analysis is critically important to understand which restructure / wind-down strategy to pursue to maximise the chances of success or returns to creditors if the business cannot continue.

As inventory is typically the largest asset in a retail business, its realisable value in a worst-case liquidation (less costs) is an important piece of knowledge to have as it provides a 'floor' from which all other strategies and potential realisation scenarios can be compared. It is also important to understand the priority of payments that stand ahead of key stakeholders, e.g.

employee entitlements or suppliers with inventory retention rights and how that impacts the ultimate return to stakeholders.

As a restructure/wind-down evolves, this ‘floor’ may move (e.g. if inventory holdings are reduced as part of a right-sizing initiative). It is therefore imperative to continuously revisit these calculations and compare it to the current strategy being pursued to understand whether it is still the best and most viable option.

3.6 Stabilise the capital structure

Stakeholder certainty is a crucial part of developing a go-forward strategy for a retail restructure. In a distressed retail business, the major creditor is typically a financier or shareholder whose priority has likely shifted from wanting to support the ongoing business to wanting to recover their debt position.

Unless there is a strong financial backer in play to support the turnaround, restructuring a retail business can be at risk from day 1. With so many moving parts to a retail organisation, having a strong financial backer is a critical success factor.

4. Retail restructuring case study: Aeropostale

There is immense competitive pressure from pure-play online and fast-fashion retailers like H&M, Uniqlo and Zara that have effectively done away with the traditional “four-season” apparel calendar by introducing weekly clothing drops in stores. These competitive forces have proven too strong for the likes of Wet Seal American Apparel, and Delia’s in the US, which have all resorted to filing for bankruptcy protection.

Unfortunately, US teen apparel retailer Aeropostale found itself filing for chapter 11 protection in May 2016. However, its story differs in the way in which it is set to emerge from Chapter 11 – as a refined and restructured ongoing business owned by shopping centre landlords. This successful, albeit unusual, restructuring of Aeropostale potentially sets a precedent for the future of retail restructuring in the US, and perhaps even Australia.

A company that files for Chapter 11 bankruptcy protection and retains the power to run and restructure a business is known as a “debtor in possession” (DIP). In the US, filing for bankruptcy protection is a voluntary process. While it is not a viable long-term solution, it does give a business time to restructure, for example, focus - sing on becoming a leaner entity with a smaller base of profitable stores and a reduced cost base.

In Chapter 11 (DIP), directors retain the power to continue running the business. For Aeropostale, the directors continued running the business while it was restructured and sold as a going concern. The unlikely saviours of Aeropostale were their major landlords, Simon Property Group and General Growth Properties, along with brand curators Authentic Brands Group and stock liquidators Gordon Brothers Retail Partners and Hilco Merchant Resources. The consortium’s 11th-hour bid of US$243 million in August - almost four months after Aeropostale filed for protection - saved the retailer from likely liquidation.

The reason this restructure should be considered momentous is that it represents a significant shift in approach by major retail landlords on an international stage. In a liquidation scenario, retail landlords are usually a large unsecured creditor, exposed to outstanding pre-appointment rent, lost future rental income and costs associated with de-fitting and re-letting the vacant premises.

Simon Property Group held leases for 160 Aeropostale stores at the time of the bankruptcy filing. Had these stores closed, there was clear scope for lost revenue stream for Simon, which had already been impacted by a department stores’ announcement that it was closing 100 outlets within its portfolio.

Attracting and keeping long-term tenants is proving crucial for retail landlords in a market where digital disruption and online sales represent the new norm. As retailers feel the pressure of the growing preference by consumers for eCommerce, landlords are as equally burdened as retailers are forced to question and reconsider their physical footprint and the experience offered to the consumer.

Right-sizing Aeropostale's store footprint has been a crucial component in the brand's restructure. Of its 800 stores at the time of the bankruptcy filing, at least 229 are being retained, and its eCommerce business expanded.

Ultimately, thousands of jobs will be saved. Aeropostale's restructure shows that key stakeholders can work together to save a distressed retailer when their interests are aligned.

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