Bankruptcy Trends and Developments in the Retail Industry

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The retail industry is dynamic and changes quickly. Although dramatic headlines referring to retailers in bankruptcy (e.g., "retail apocalypse") may be overstated, the retail industry is at an important stage in its history. Retail bankruptcies are frequent and they experienced an increase in volume in 2018. Big changes are occurring in the retail industry. Accordingly, this discussion examines bankruptcy in the context of the retail industry. This discussion broadly examines the retail industry. This discussion identifies current developments and important indicators associated with the retail industry. This discussion summarizes important operational attributes of retail operators. This discussion examines how the unique attributes of retail affect industry debtors in bankruptcy. Finally, this discussion describes several specific areas of the bankruptcy process relevant to retail debtors and identifies trends in retail bankruptcies.

Introduction

The retail industry is dynamic. It is highly volatile, currently undergoing significant changes, and consists of companies with visible brands designed to capture the attention of consumers. As a result, when a large retailer files for bankruptcy, it can garner disproportionate attention and grab headlines. For example, while Sears Holding Corporation ("Sears") was debatably the most familiar bankruptcy of 2018, it was not the largest: iHeartMedia, Inc., a media company, had over double the amount of debt as Sears at the time of filing.[1]

Similar in size to Sears was FirstEnergy Solutions Corp., an energy product company, which had comparable amounts of debt to Sears at the time of its bankruptcy filing in 2018 (that is, approximately $2 billion less in debt).[2]

However, neither iHeartMedia, Inc., or FirstEnergy Solutions Corp. generated as much interest as the Sears bankruptcy did.

It would be inaccurate to underplay the current significance between the intersection of the retail industry and bankruptcy. While terms such as "retail apocalypse" can be misleading when describing the recent state of retail industry bankruptcies, 2018 did represent an uptick in the number of retailers filing for bankruptcy. It is an important time for retailers.

This discussion develops a clear picture of the retail industry today, and then examines the trends and developments of retail companies in the context of bankruptcy.

Retail Industry Overview

Before beginning our discussion of retail bankruptcies, let's understand the retail industry more broadly.

First, let's define the retail industry for the purposes of this discussion. For this discussion, we define the retail industry as encompassing the majority of Division G (retail trade) of the Standard Industrial Classification ("SIC") system.

Specifically, we define the retail industry as consisting of the companies classified in the following SIC codes:

- 5230 (paint, glass, and wallpaper stores)
- 5250 (hardware stores)
- 5260 (retail nurseries, lawn and garden supply stores)
- 5300 (general merchandise stores)
- 5400 (food stores)
- 5600 (apparel and accessory stores)
- 5700 (home furniture, furnishings, and equipment stores)
- 5900 (miscellaneous retail)

Practically, we define retail as the industry that is made up of companies whose operations involve the purchase (from suppliers) and sale (most often to consumers) of merchandise, or finished goods.

Retail Industry Environment

The retail industry is a mature industry. Market concentration in the retail industry is generally low. Despite the magnitude and prominence of certain retailers, namely Amazon.com, Inc., and Walmart, Inc., the majority of retail activity is carried out by smaller operators. According to IBIS*World*, 65 percent of retailers in the U.S. employ less than 10 employees.[3]

Given that the retail industry is mature and fragmented, specializing in a particular market niche, brand, or market segment can be beneficial for retailers. Specialization may increase a retail operator's customer base and brand loyalty, and it may also increase the quality and consistency of an operator's revenue.

Retailer operations are also subject to macroeconomic and consumer trends, which relate to and support retailers' strategy of specialization.

Per capita disposable income (the amount of discretionary income an individual has for purchasing goods and services) is a particularly significant macroeconomic indicator. As consumer discretionary income increases, so too do purchases of goods by consumers increase. Disposable income varies directly with the macroeconomic cycle.

Generally, as disposable income increases, demand for premium goods increase, while demand for discount goods (or inferior goods) decrease. This can have an effect on retailers, particularly when their merchandise is related to premium or inferior goods.

Prices represent another demand determinant—both in a broader macroeconomic sense (e.g., if the prices of all goods and services across the economy are rising) and in a product-specific sense (e.g., if the price of a particular good has risen). Consumer demand for goods decreases as prices increase (1) across the economy and (2) for the specific goods that retailers sell.

Cultural and sociological trends can also play into retail consumer preferences. Some additional consumer preferences are discussed below.

- E-commerce. This trend involves the increased preference for shopping via e-commerce mediums by consumers. This trend is somewhat related to consumers' responsiveness to price, as shopping online generally saves consumers time and money.

  In addition, the increased prevalence of online shopping is expected to continue to mitigate consumers' preference for physically viewing products before purchase.

  According to IBIS*World*, e-commerce sales were expected to increase at an annualized rate of 12.8 percent through the five-year period to 2018. Amazon.com, the largest e-commerce retailer, grew at an annualized rate of 30 percent through the same period.[4]

  These e-commerce sales trends provide a broader narrative relating to consumer preferences: e-commerce has increasingly become more prevalent and consumers appear to choose the conveniences of online shopping in many situations.

- Intangible experiences versus tangible consumer goods. Increasingly, new generations of consumers value intangible experiences over tangible consumer goods. While this trend is hard to define, such a change in mentality can affect the strategies, brands, and channels in which retailers choose to conduct business.

  Such a trend can lend itself well to retailers who disrupt the traditional conventions and norms of how to sell and define an existing product. Conversely, such a trend can make it hard for a retailer whose operations are built on obsolete strategies or merchandise.

- Specialty retail versus general merchandise. This trend further describes the preferences for where consumers choose to purchase items. Specialty retailers focus on a particular product or market niche, while general merchandisers sell a diversified array of products across many categories.

  Under consideration here are previously discussed factors including price, the ability of a retailer to brand or differentiate

its customer experience, and how consumers prefer to purchase their goods (e.g., online, in person, or at a mall).

Takeaways

While the retail industry is a broad classification, we can deduce some common characteristics. Generally, retailers deal in the selling of merchandise to consumers. Therefore, revenue earned by retailers is subject to the preferences of, and the associations by, consumers. Retailers are also subject to macroeconomic cycles. The intricacies that affect the revenue of retailers have important implications for retail bankruptcies.

Macroeconomic cycles and consumer preferences contribute to the unpredictability of, and volatility in, revenue for individual retailers over the long term. Consumer preferences are fickle and are significantly affected by prices and the economy.

Retailers invest in the cultivation of their brands and market niches, as well as the channels in which they use to deliver their merchandise to consumers. However, if retailers do not dynamically adapt to consumer preferences, adjust to macroeconomic conditions, or invest in the right channel of distribution, then they can see their revenue affected negatively as a result.

Operational Characteristics That Define Retailers

In addition to factors and trends that drive demand and in turn sales, let's also consider certain operational characteristics of retailers. This discussion considers some of the characteristics of retail operations and examines some of the nuances of retailers facing bankruptcy.

Importance of Inventory

One of the defining characteristics of retail operators is their inventory. Given that retailers sell predominantly to end consumers, inventory typically represents finished goods, or merchandise. Pure-play retailers do not generally produce or manufacture their merchandise, but instead purchase their supply of goods from vendors and suppliers.

Management of inventory, therefore, is one factor for the operations of a retailer. When operating as a going concern, retail companies must ensure they implement sound inventory management—that is, the level of inventory is efficiently maintained.

When inventory is efficiently maintained, retailers minimize inventory storage costs while also minimizing the lost sales of certain products due to lack of inventory. Balancing these lost sales and storage costs achieves the right level and mix of products to sell and hold.

As discussed later, inventory is significant when a retailer files for bankruptcy. When a retailer is engaged in the bankruptcy process, inventory can have important implications for reorganization, liquidation, or asset sale considerations.

Given the significance of inventory, it is also important to note that for many retailers, operations are seasonal and fluctuate throughout the year. Specifically, many retailers see increased sales in the fourth quarter of the calendar year as a result of the holiday season.

Seasonal fluctuations were historically a more important consideration for (1) retailers intending to file for bankruptcy and (2) retail debtors in bankruptcy. However, due to the changes in the Bankruptcy Code associated with the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), which are discussed below, seasonality in revenue and cash flow is a lesser consideration than before.

Trade Payables and Vendor Relationships

Similar to the significance of inventory, relationships with vendors and suppliers can be important

factors for retailer operations. Just as inventory is one of the defining factors in retailer operations, the payment to suppliers and vendors for such inventory is also key.

Trade payables contribute to an efficient cash conversion cycle. Just as efficient inventory management leads to the conversion of inventory to sales (and in effect, cash), so too is it important to elongate trade payables from suppliers and vendors.

Effectively, trade payables from suppliers represent a form of informal, unsecured credit. This trade credit plays a role in bankruptcy. We discuss the way trade credit affects retail debtors in bankruptcy in a later section.

In short, retailers under normal circumstances might seek to elongate the time it takes to satisfy trade payable obligations. If a retailer is considering bankruptcy however, it might make sense to minimize the amount of trade payables a retail debtor owes immediately prior to filing a petition for bankruptcy.

Unimportance of Accounts Receivable

Another working capital area that defines retailers is the general unimportance of accounts receivable. In most (but not all) cases, sales are made to consumers. Accordingly, retailers receive cash consideration for the sale at the time of the transaction.

The lack of accounts receivable is typically a benefit to a retailer in the bankruptcy process, as cash tied up in receivables means less liquidity for debtors to satisfy creditor obligations.

Potential for Extensive Lease Obligations

Large lease portfolios are another characteristic of retailers. Lease obligations are likely only material for retailers whose business strategy involves significant brick-and-mortar operations.

Obligations related to leases can represent a sizeable cash outflow and can also weaken the ability of a retailer to satisfy all its financing obligations. While some retailers may not carry large amounts of debt on their balance sheets, certain off-balance-sheet obligations, including operating leases, may significantly reframe the effective leverage of an operator. Lease obligations can pose a potential risk for retailers as they are sticky in the short term.

As discussed below, retailers in the bankruptcy process often have some options for relief from certain lease obligations.

Labor-Intensive Operations

Retailers, specifically ones with large brick-and-mortar operations, generally have labor-intensive operations. As traditional retailers rely on a strategy of maintaining physical store locations, quantity and quality of employees are vital to operations.

Unlike lease obligations, retailers can typically eliminate employees from their payrolls in the short term in times of financial distress.

Next, this discussion considers how these operational characteristics affect retailers in bankruptcy.

Retail Debtors in Bankruptcy: Areas of Focus, Considerations, and Trends

Now that we identified certain operational characteristics important to retailers, in the following section we identify certain trends and developments in retail bankruptcies. This discussion considers areas of the Bankruptcy Code relevant to retail debtors, as well as some associated considerations.

To provide further insight into how certain industry characteristics affect retailers in bankruptcy, we examined a data set comprised of companies that filed for bankruptcy.

We used the S&P Capital IQ database to screen for companies that filed for bankruptcy—Chapter

7 or Chapter 11—over the period from January 1, 1999, to September 1, 2019. To obtain meaningful information about the financial characteristics of debtors, we only selected companies that had publicly available financial statements.

While our screening results returned companies with public financial statements, some companies did not have updated financial information that was publicly available (e.g., a company that filed for bankruptcy as of May 25, 2017, whose latest available financials were as of December 31, 2015).

In our data set, approximately 45.1 percent of companies had available financial information within one year of filing, while approximately 79.3 percent of companies had available financial information within two years prior to filing.

Finally, for purposes of obtaining meaningful information, we selected companies that had assets or liabilities greater than $100 million at the time of the initial filing. Narrowing the scope of our data set to a specific asset and liability threshold allowed us to narrow in on a more precise sample of debtors, as well as control for other variables that could affect the data (specifically, size).

While we conducted our analysis independently, we used as a guideline the screening criteria from "Why Are U.S. Retail Reorganizations So Hard?" found in the October 2016 edition of the *American Bankruptcy Institute Journal*.

We supplement the following sections with analysis from our data set.

Bankruptcy Code Section 365(d)(4)

One section of the Bankruptcy Code that is often discussed in the context of retail bankruptcy is Section 365(d)(4):

> (A)
>
> Subject to subparagraph (B), an unexpired lease of nonresidential real property under which the debtor is the lessee shall be deemed rejected, and the trustee shall immediately surrender that nonresidential real property to the lessor, if the trustee does not assume or reject the unexpired lease by the earlier of—
>
> > (i) the date that is 120 days after the date of the order for relief; or
> >
> > (ii) the date of the entry of an order confirming a plan.
>
> (B)
>
> > (i) The court may extend the period determined under subparagraph (A), prior to the expiration of the 120-day period, for 90 days on the motion of the trustee or lessor for cause.
> >
> > (ii) If the court grants an extension under clause (i), the court may grant a subsequent extension only upon prior written consent of the lessor in each instance.

Section 365(d)(4) deals with leases of nonresidential real property. Specifically, Section 365(d)(4) limits the amount of time—up to 210 days at most—that debtors may assume or reject their lease portfolios. The outcomes of decisions made relating to Section 365(d)(4) have important implications for retail debtors in the bankruptcy process.

On the one hand, the rejection of a lease before it is assumed under Section 365(d)(4) essentially creates a general unsecured claim. On the other hand, the rejection of a lease after it is assumed under Section 365(d)(4) creates an administrative claim above senior lenders.

Given this, it is typically in the best interest of a retail debtor to reject any leases in the 210-day period under Section 365(d)(4) that it does not intend to ultimately assume.

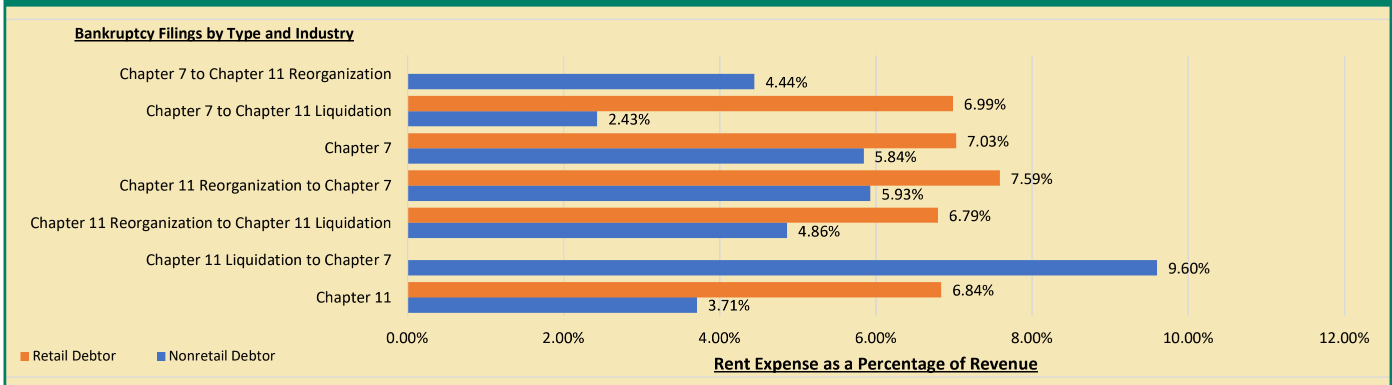
Retail debtors can often have sizeable brick-and-mortar operations. These brick-and-mortar operations typically involve significant lease obligations. As a result, discerning and differentiating the profitable and unprofitable retail locations becomes an important consideration for determining which store locations the debtor should shut down or retain.

Our data set confirms how leases can be significant for retail debtors relative to nonretail debtors. From our data set, we observe trends that confirm the importance of lease obligations. In Figure 1, average rent expense as a percentage of revenue is presented.

For purposes of our analysis, we determined rent expense to be a metric tied to lease obligations. This is because many leases are classified as operating leases and are, therefore, reflected on the income statement as a rent expense.

The data set is bifurcated between retail debtors and nonretail debtors, and it is further disaggregated by the type of bankruptcy filing. Across all bankruptcy filings, retail debtors had a higher average rent expense as a percentage of sales. Retail debtors and nonretail debtors whose filings related to Chapter 11 bankruptcies or Chapter 11 reorganizations reported lower rent expense as a percentage of revenue than debtors whose filings related to liquidations or Chapter 7 bankruptcies.

Figure 1
Rent Expense as a Percentage of Revenue



The 210-day time period is generally considered a short amount of time for assuming or rejecting nonresidential property leases. Relative to the present situation, Bankruptcy Code Section 365(d)(4) previously afforded debtors more lenient options.

While Section 365(d)(4) used to require leases of nonresidential real property to be assumed or rejected within 60 days, courts also had the ability (and regularly exercised such ability) to extend the amount of time for determining the assumption or rejection of debtor lease portfolios through the confirmation of a Chapter 11 plan. Through the BAPCPA, Section 365(d)(4) was amended to its current form.

These changes to Section 365(d)(4) are often cited as a disadvantage for retail debtors. As noted in "Retail Bankruptcies: Threading the Needle in a Tattered Industry" published in the *Journal of Corporate Renewal*:

> retail debtors [prior to the implementation of BAPCPA] had time in bankruptcy to review and analyze their lease portfolios to ascertain and monetize any pockets of value without being subjected to overwhelming pressure from their lenders and landlords.[5]

Retail debtors used to have more time to determine which leases were linked to profitable operations. In contrast, the 210-day period may be unrealistic for retail debtors to assess profitability associated with their lease portfolio and make decisions accordingly.

In fact, arguments exist that cite the change in Section 365(d)(4) as one of the main reasons why liquidations are such a common outcome in retail bankruptcies. There may be some logic to this argument. In addition to the 210-day restriction, other practical considerations create an even shorter window that complicates decision-making for retail debtors. One practical consideration is the necessary time it takes to actually shut down operations—that is, close store locations.

According to the article titled "50/50: Why So Many Troubled Retailers Liquidate" as published in the *Journal of Corporate Renewal*, going-out-of-business sales for terminated store locations may take up to 90 days.[6] Given this, it is often the case that retail debtors assume or reject lease obligations within 120 days after filing.[7]

Such a tight time frame can be challenging for a retail debtor to sufficiently adjust its operations or reach an agreement for reorganization that would allow the debtor to continue to operate.

Another possible effect of Section 365(d)(4), according to the *Journal of Corporate Renewal*, is more unfavorable debtor-in-possession ("DIP") lending terms for retail debtors.[8]

These unfavorable lending terms include (1) shorter lending time frames and (2) more restrictive covenants in financing agreements.[9]

Such hindrances to receiving DIP financing make it harder for retail debtors to adjust their operations, make necessary changes, or realize exit opportunities. Impaired access and strict lending terms for DIP financing can also, therefore, contribute to an increased likelihood that retail bankruptcies end in liquidation.

Bankruptcy Code Section 503(b)(9)

Another important topic for struggling retailers is Bankruptcy Code Section 503(b)(9). Section 503(b)(9) states the following:

> After notice and a hearing, there shall be allowed administrative expenses, other than claims allowed under section 502(f) of this title, including—

(9)

the value of any goods received by the debtor within 20 days before the date of commencement of a case under this title in which the goods have been sold to the debtor in the ordinary course of such debtor's business.

Section 503(b)(9) involves the trade payables related to goods (or inventory) in association with the ordinary course of business for a debtor. According to the section, trade payables from transactions less than 20 days prior to a retail debtor filing a petition for bankruptcy constitute an administrative claim for retail debtors. As previously mentioned, administrative claims have priority above senior lenders.

In addition, satisfying administrative claims are a prerequisite for confirming a plan of reorganization in a Chapter 11 bankruptcy. Like Section 365 (d)(4), Section 503(b)(9) arose from the 2005 BAPCPA legislation.

While Section 365(d)(4) is significant for retail debtors due to the potential for large liabilities relating to leases, Section 503(b)(9) is significant to retail debtors because inventory can represent a large proportion of the assets of retail debtors. As a result, trade payables can play an outsized role in the operations of a retail debtor. If trade credit afforded to retail debtors abruptly stops, retail debtors can face operational issues that impair their operations (and cash flow) and inflame existing liquidity and solvency issues.

Exhibit 1 confirms the importance of trade payables for retail debtors. From our data set, we calculate the average accounts payable balance as a multiple of cash as well as the average cash ratio for retail debtors and nonretail debtors in our data set. The cash ratio is a liquidity metric computed as cash and equivalents divided by current liabilities.

As presented in Exhibit 1, accounts payable as a multiple of cash is almost twice as much for retail debtors than for nonretail debtors. Similarly, retail debtors hold about half as much cash relative to their current liabilities than nonretail debtors.

Given that trade payables represent, as administrative claims, a higher claim than senior lenders, the treatment of trade payables in bankruptcy essentially represents additional leverage that may not have been otherwise considered. Section 503(b)(9) treats trade payables as another level of obligations that must be paid off before a plan of reorganization is confirmed.

In some situations, trade payables can be so large that vendors can influence the bankruptcy process through the status of their credit as administrative claims after filing or by their significance to retail debtors. The case of Toys“R”Us, Inc. (“Toys“R”Us”), is one example that underscores the importance of trade payables in a bankruptcy.

Exhibit 1
Average Accounts Payable Cash and Average Cash Ratio By Debtor Industry

	Average Accounts Payable/Cash	Average Cash Ratio
Nonretail Debtors	12.53x	0.40
Retail Debtors	27.15x	0.21

In 2017, Toys“R”Us management was privately considering whether to file for bankruptcy.[10] Management plans were derailed, however, when the media began leaking that the company was examining filing for bankruptcy. Upon the release of reports that Toys“R”Us was considering a bankruptcy filing, a large constituency of Toys“R”Us vendors stopped offering the company trade credit.[11]

Eventually, most Toys“R”Us vendors refused to deliver any goods to Toys“R”Us without payment in cash.[12] As a result of its trade credit drying up, Toys“R”Us lost control of the bankruptcy process and ended up filing for bankruptcy sooner than it had originally anticipated.[13]

Toys“R”Us ultimately ended up liquidating and divesting the majority of its operations.

Such an example serves to demonstrate the significance of vendors and suppliers, and the credit they afford, to retail debtors in bankruptcy. Accordingly, we note that through Section 503(b)(9), the Bankruptcy Code places importance on the satisfaction of trade payables by debtors.

The Prevalence of Liquidations in Retail Bankruptcies

Given the characteristics of retail debtors, it is clear that Section 365(d)(4) and Section 503(b)(9) can have significant implications for retail debtors in bankruptcy.

In fact, it is a typical assertion that Section 365(d)(4) and Section 503(b)(9)—since BAPCPA legislation was enacted in 2005—negatively affect the outcomes of bankruptcies for retail debtors and increase the likelihood that retail bankruptcies end in liquidation.

There is logic behind the assumption that these Bankruptcy Code sections spur retail debtors into liquidation. In the case of Section 365(d)(4), the time frame for rejecting or assuming leases can be

so short (as previously mentioned, 120 days inclusive of going-out-of-business sales) that retail debtors may not have adequate time to determine the profitability of certain locations, and in turn struggle to make the right strategic decisions in relation to their brick-and-mortar operations.

Likewise, Section 503(b)(9) can give vendors and suppliers the power to prevent the confirmation of a plan of reorganization in the bankruptcy process, as well as potentially damage the liquidity of retail debtors.

Does the empirical evidence, however, support the assertions that the 2005 BAPCPA amendments to Section 365(d)(4) and 503(b)(9) have driven retail debtors to liquidation in bankruptcy? According to the *American Bankruptcy Institute Journal*, in the article titled "Why Are U.S. Retail Reorganizations So Hard?," the "statistics are not very persuasive."[14]

That article draws on bankruptcy data from S&P Capital IQ over an approximate 15-and-a-half-year period, both before and after the BAPCPA amendments went into effect. According to their data, they found only a slight increase—from 47 percent to 49—in liquidation outcomes for retail debtors before and after BAPCPA.[15]

Our data set also confirms that bankruptcies ending in liquidation were comparable for retail debtors before and after BAPCPA implementation. We confirm that liquidations for retail debtors are indeed more frequent relative to nonretailers, both before and after the BAPCPA changes were implemented.

As presented in Figures 2 and 3, it is more likely for a retail debtor over the period to liquidate or file for Chapter 7 bankruptcy than for nonretail debtors.

As presented in Figure 3, Chapter 11 liquidations or Chapter 7 bankruptcies for retail debtors comprised (1) at least a majority of all bankruptcies for a given year in nine of the years presented, (2) 50 percent of all bankruptcies in a given year for four of the years presented, and (3) less than 50 of all bankruptcies for a given year for eight of the years presented.

Overall, Chapter 11 liquidation and Chapter 7 bankruptcies represented 46.3 percent of bankruptcies for all retail debtors in our data set, while non-Chapter 11 liquidation and Chapter 7 bankruptcies represented 53.7 percent of retail debtors in our data set.

The data for retail debtors contrast with the trends seen for nonretail debtors. As presented in Figure 3, Chapter 11 liquidations and Chapter 7 bankruptcies were far less prevalent for nonretail debtors than they were for retail debtors.

In all of the 21 years (including 1 partial year) presented, Chapter 11 liquidations and Chapter 7 bankruptcies represented a majority of filings for nonretail debtors in only 1 year: 2007 (a recessionary period and a precursor to the Financial Crisis).

Overall, Chapter 11 liquidations and Chapter 7 bankruptcies represented 28.8 percent of nonretail debtors, while non-Chapter-11 liquidations and Chapter 7 bankruptcies represented 71.2 percent of all nonretail debtors in our data set.

In addition to this dichotomy between retail debtors and nonretail debtors, we note another trend. In our data set, we see that the percentage of retail debtors with Chapter 11 liquidation or Chapter 7 bankruptcies does not change significantly over the 21-year period.

While changes between years may be significant, no clear trend emerges for retail debtors that demonstrates Chapter 11 liquidations and Chapter 7 bankruptcies occurred less frequently prior to the implementation of BAPCPA in 2005, or that liquidations for retail debtors have been more common since 2005.

Despite this, we do not make assertions about relationships between (1) the prevalence of liquidations for retail debtors and (2) BAPCPA. We note that while our data set may be useful for gleaning observations, it is not a perfect data set. Our sample of retail debtors is relatively small, and our screening eliminated debtors with assets and liabilities of less than $100 million.

Such a data set could represent sampling bias; BAPCPA could, for example, disproportionately affect retail debtors that are smaller in size.

Logically, the effects of the implementation of the BAPCPA amendments to Section 365(d)(4) and Sections 503(b)(9) would imply that liquidation is a more likely outcome for retail debtors—this relationship, however, is not reflected in the observations made in our data set.

From our data set, we observe the following:

1. Liquidation is a more likely outcome for retail debtors than nonretail debtors.
2. The frequency of liquidation for retail debtors has been relatively consistent over the 21-year period.

Liquidation Values in Retail Bankruptcies

Another explanation that supports the increased likelihood of liquidation for retail debtors is the case that retail debtors might potentially realize higher value by liquidating relative to nonretailers. It might be the case that liquidation presents a

Figure 2
Retail Debtors
Percentage of Liquidations and Reorganizations
As a Percentage of Total Bankruptcies by Year

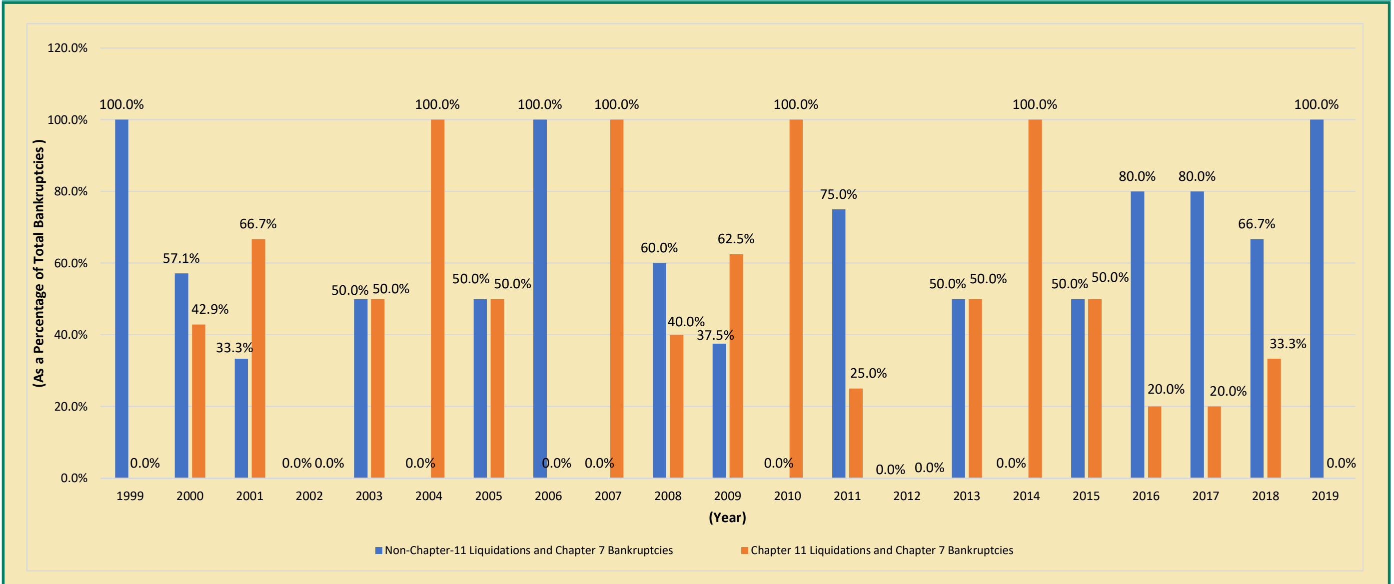
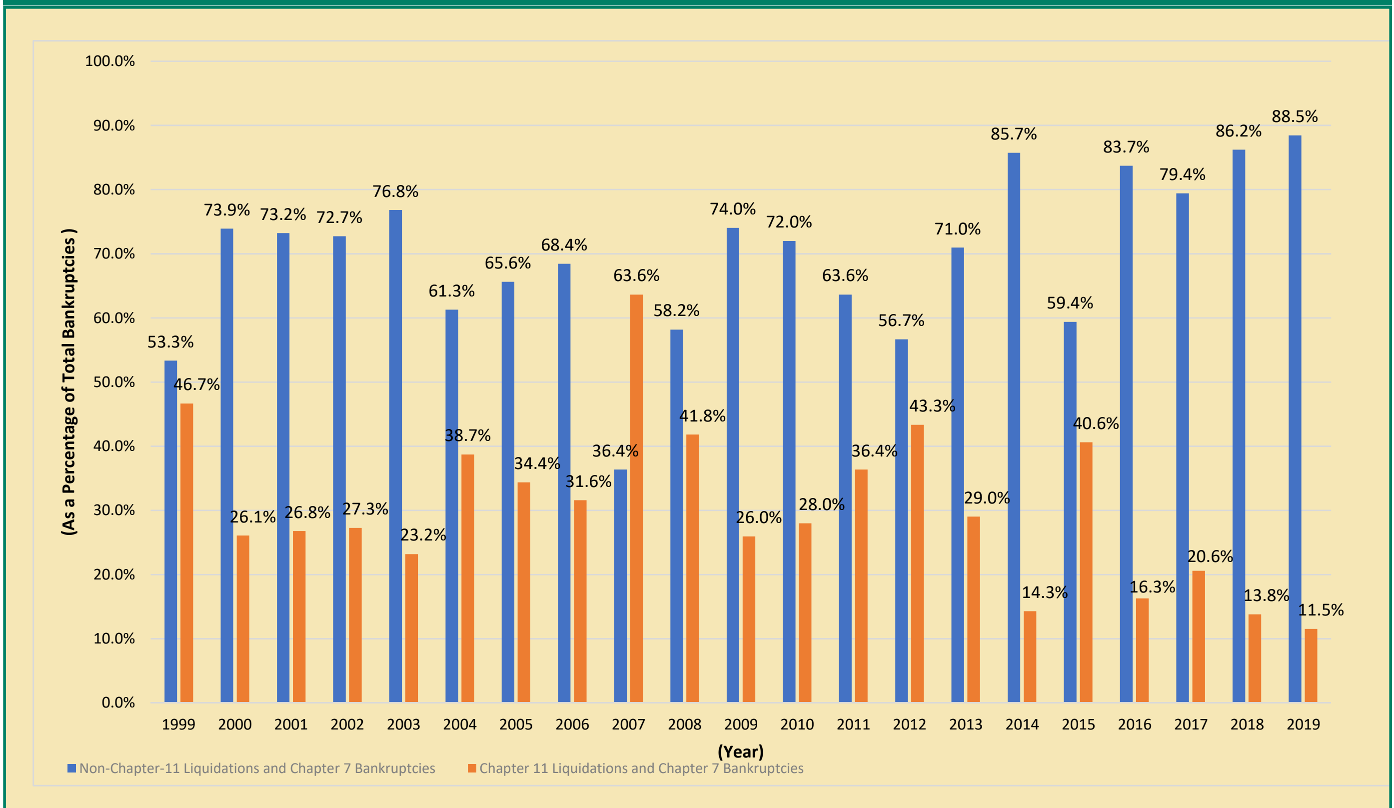


Figure 3
Nonretail Debtors
Percentage of Liquidations and Reorganizations
As a Percentage of Total Bankruptcies by Year



greater benefit, or at least a greater marginal benefit relative to reorganization, for retail debtors than for nonretail debtors.

There is support for such an explanation. Most often, retailers do not have large levels of property, plant, and equipment ("PP&E"). Additionally, retailers are not capital-intensive. As mentioned previously, retailers typically hold large amounts of inventory relative to total assets. Using our data set, Exhibit 2 confirms that retail debtors, on average, hold much greater levels of inventory than nonretail debtors.

A debtor that is both (1) inventory-intensive and (2) not capital-intensive can have implications for liquidation. Generally, it can be challenging to off-load PP&E, as it can be hard to sell certain land and buildings, as well as specialized equipment. Inventory, on the other hand, is relatively easy to sell. Inventory can be sold quickly, and at a relatively high value relative to its cost basis.

Basically, retail debtors often hold tangible assets that are more liquid in comparison to other debtors, and as a result they may realize a higher value for their assets, more quickly, upon liquidation.

In addition to relatively liquid tangible assets on the balance sheet, retailers also generally have sizeable intangible assets that may be easier to sell, namely customer lists and trademarks, including brands.[16]

The attractiveness of liquidation makes it harder for retail debtors to emerge from bankruptcy under a reorganization. This is due to the best-interests test. This test requires that debtors should prove that all classes of creditors would fare better under reorganization than liquidation in order for a plan of reorganization to be approved.

In many circumstances for retail debtors, continuing operations may not prove sufficiently beneficial, especially when compared to favorable liquidation values for existing assets.

Summary and Conclusion

The retail industry represents a broad constituency. This discussion attempts to find larger trends that could be applicable to retail debtors. While each bankruptcy case is a unique situation, there are lessons to be learned from previous examples.

In addition, unique industry considerations can be useful and lead to insights for company-specific considerations in the context of a bankruptcy. Understanding notable areas relevant to retailers in the bankruptcy process can allow for increased planning and awareness.

Finally, in the context of retail bankruptcies, financial and valuation issues can also surface. In these instances, the valuation analyst can be of service to the various stakeholders in the bankruptcy process and can contribute in multiple capacities.

Exhibit 2
Average Inventory as a Percentage of Total Assets

	Average Inventory as a Percentage of Total Asset
Nonretail Debtors	8.0%
Retail Debtors	33.6%

Notes:

1. S&P Capital IQ.
2. Ibid.
3. IBIS*World* Industry Report, "Retail Trade in the US" (June 2018).
4. Ibid.
5. Jennifer Feldsher and Mark E. Dendinger, "Retail Bankruptcies: Threading the Needle in a Tattered Industry," *Journal of Corporate Renewal* (November/December 2018).
6. Kent Percy, Luke Ericson, and Stephen Potts, "50/50: Why So Many Troubled Retailers Liquidate," *Journal of Corporate Renewal* (October 2017).
7. Ibid.
8. Feldsher and Dendinger, "Retail Bankruptcies: Threading the Needle in a Tattered Industry," *Journal of Corporate Renewal*.
9. Ibid.
10. Richelle Kalnit and Ben Kaplan, "Early Action is Crucial to Maximizing Retail Brand Value in Bankruptcy," *Journal of Corporate Renewal* (June 2018).
11. Ibid.
12. Ibid.
13. Ibid.
14. Chuck Carroll and John Yozzo, "Why are U.S. Retail Reorganizations So Hard?" *American Bankruptcy Institute Journal* (October 2016).
15. Ibid.
16. Carroll and Yozzo, "Why are U.S. Retail Reorganizations So Hard?" *American Bankruptcy Institute Journal*.

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