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BLOG

Downfall of Brick and Mortar Retail – Is It All Online Driven?

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A lot has been written about how the growth of online retailers had led to the downfall of traditional brick and mortar retail. Since 2016, more than 36 retailers have announced/closed down more than 3,600 stores in the US alone.

A lot of it is definitely due to customer preference and the advent of technologies that make online shopping a lot more amiable. However, an often overlooked fact is the underlying dynamics and games being played by Private Equity (PE) firms and hedge funds in retail. Retail business has been particularly attractive to PE as it brings with them, apart from the retail business, a more valuable asset: *real estate.*

The modus operandi is to hold control of the real estate housing the retail chains. After buying into a retail chain, the PE splits the entity into two: *retail operator and real estate company* on whose real estate the retail chain operates. Often, the real estate company is then sold and the PE investors benefit from the sales proceeds.

On the other hand, the retail operator is made to pay inflated rent to the *real estate company*, even at the cost of pushing the retail operator down the path of failure. This might sound counter intuitive, but the fact remains that PE fund manager fees are not all performance-based (about two-thirds of their total fees are non-performance related).

Furthermore, PE firms have been buying into retailers and taking up a lot of debt over the last 10 years. In fact, many of the PE-backed retail companies are the worst-performers in the retail bonds market. PE firms had anticipated huge IPO sell outs in the future. But the global financial crisis and the emergence of online retail have been a setback for them. Not surprisingly, they have now shifted their focus to omni-channel retail.

The recent turn of events at the US department store chain Sears clearly reflects how the above mentioned trend plays out. Reeling under financial problems, Sears was forced to close its stores and hand them over to Seritage Growth Properties. Both Sears and Seritage Growth Properties are majority-owned by none other than the Chairman and CEO of Sears, Eddie Lampert, and his hedge fund.

The plan was to lease out the space to higher-profile businesses such as Whole Foods, Pottery Barn, Dick’s Sporting Goods, AMC, etc., and also get additionally paid in case Sears exits leases early. This showed how Seritage tried to profit from the Sears decline.

Thus, the fact that traditional retail is closing because online retail is growing may be just the exact opposite – online retail is growing because traditional retail is closing or being made to close!

We at Acuity Knowledge Partners have been helping companies in the consumer packaged goods and retail sectors navigate through the fast-changing landscape of business and technology. We help clients identify market trends in advance, thus providing them a differentiable head start.