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HUDSON’S BAY COMPANY: RESTRUCTURING IN A RETAIL DECLINE[[1]](#endnote-1)

[Kelly Whitehead](https://iveypubs.my.salesforce.com/003A000001vCjaB) and [Steven Campbell](https://iveypubs.my.salesforce.com/003A000001x69b2) wrote this case solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.

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In November 2017, Hudson’s Bay Company (HBC) was at a critical impasse. The company, although beloved in the Canadian retail landscape for its rich Canadian heritage, faced significant pressure from activist investor Land & Buildings Investment Management (LBIM) after recording a CA$201 million[[2]](#endnote-2) loss in the second quarter (Q2) of 2017, amid failures to monetize its real estate assets.[[3]](#endnote-3) LBIM alleged that HBC was withholding information about a potential offer from management to take the company private, while suggesting that HBC was waiting for an industry turnaround that, in the current retail environment, was unlikely to occur.[[4]](#endnote-4) HBC responded by focusing on cost-cutting measures, including the removal of 2,000 jobs in June 2017 and the renewal of its interest in its e-commerce portfolio.[[5]](#endnote-5) However, with the announcement that chief executive officer (CEO) Gerald Storch would be stepping down at the beginning of November 2017 after the high-profile battle with LBIM, it was clear that HBC’s efforts were doing little to assuage the activist’s concerns.[[6]](#endnote-6) How should HBC proceed to regain profitability in a Canadian retail environment that was increasingly pessimistic for brick-and-mortar department stores?

**HUMBLE BEGINNINGS**

HBC was the oldest retailer on the Canadian market and had risen from humble beginnings as a fur trading company in 1670, nearly two centuries prior to Canada’s Confederation. Although it initially targeted only the trading posts around James Bay and Hudson’s Bay, by the late 18th century, the company had expanded into the interior of Canada. The posts it developed along the river networks predated the major Canadian cities soon to follow, such as Winnipeg, Calgary, and Edmonton. HBC began its transformation into a department store retailer in the early 20th century, with a modernization program in 1912 resulting in what was referred to as the original six HBC department stores: Calgary, Edmonton, Vancouver, Victoria, Saskatoon, and Winnipeg.[[7]](#endnote-7) The company would later expand its department store presence, continuing its path toward becoming an iconic Canadian retailer.

**1970: A CANADIAN RETAILER IS BORN**

Although known as a Canadian brand, HBC was a British company until its Canadian incorporation in 1970, 300 years after its founding.[[8]](#endnote-8) The company then began an aggressive acquisition strategy in an effort to dominate the Canadian retail environment, purchasing the Shop-Rite catalogue stores; Ottawa retailer A. J. Freiman Ltd. in 1972;[[9]](#endnote-9) Zellers/Fields and Simpsons in 1978; and Robinson’s in 1979.[[10]](#endnote-10) As a result of the economic downturn of the 1980s, however, the company needed to rethink its acquisition strategy, and it chose instead to sell off non-essential assets, such as the fur trade, wholesale, and Northern Stores departments in 1987.[[11]](#endnote-11) This early turnaround strategy was successful, resulting in HBC’s continued dominance of the retail environment into the 1990s.

The 1990s saw HBC returning to its acquisition strategy with the purchase of the Woodward’s department stores in Western Canada in 1993 and Kmart Canada in 1998. The company opened three Bed, Bath, and More stores in the Greater Toronto Area in 1998 and renamed them Home Outfitters in 1999, a sign of further diversification of HBC’s presence in the Canadian retail market.[[12]](#endnote-12)

In 2000, HBC entered the e-commerce arena with the launch of HBC.com, followed by its entrance into loyalty programs with HBC Rewards.[[13]](#endnote-13) In 2005, the company’s Canadian identity was further solidified after it was selected as the official retailer of the Olympic and Paralympic Games,[[14]](#endnote-14) with the red “Canadian Olympic Team” mittens later becoming an iconic product associated with HBC at an affordable price of $15 per pair.[[15]](#endnote-15) It was clear that the company’s long Canadian history and resilience in the face of economic downturn was a significant strength in developing a sustained competitive advantage.

**GALERIA KAUFHOF: HBC’S EUROPEAN EXPANSION**

In 2015, HBC further diversified its retail operations, entering the European market with the acquisition of Germany’s Galeria Kaufhof and its Belgian subsidiary, Inno, for $3.9 billion.[[16]](#endnote-16) Since the acquisition, however, the sales at the German department store had consistently fallen, resulting in pressure from LBIM to sell off the acquisition. Concurrent with the resignation of CEO Gerald Storch, HBC received what it referred to as an “incomplete, non-binding, and unsolicited offer” of approximately $4.5 billion, from Austrian firm Signa Holding, resulting in a 9 per cent jump in HBC’s share price. Although HBC had indicated that it was uninterested in selling the Galeria Kaufhof acquisition in September 2017, the board later announced that it was intending to review the offer.[[17]](#endnote-17)

**2017: A YEAR OF FINANCIAL LOSSES**

HBC was plagued by fiscal challenges in 2017 (see Exhibit 1). Its first quarter (Q1) net losses reached a staggering $221 million, more than double the losses incurred during Q1 2016.[[18]](#endnote-18) Shortly thereafter, the company announced that the chief financial officer, Paul Beesley, had submitted his resignation effective July 2017.[[19]](#endnote-19) Standard & Poor’s Financial Services LLC then downgraded the company’s credit rating to a B, which, although negative, was consistent with a broad industry downgrade prompted by poor performance in the retail sector as a whole.[[20]](#endnote-20)

Q2 2017 was equally disappointing. Net losses for the period totalled $201 million and were accompanied by a reduction in the dividend rate from $0.05 per share to $0.0125 per share. In light of these difficulties, HBC announced the launch of its “Transformation Plan” (see Exhibit 2), which included a focus on its digital operations and the reduction of approximately 2,000 positions across North America. This major restructuring was presented with the expectation that it would bring $350 million in annual savings following its completion in 2018[[21]](#endnote-21) and included a plan to separate leadership teams for the iconic HBC brand from that of its newer acquisition, Lord & Taylor.[[22]](#endnote-22) Richard Baker, governor and executive chairman of HBC, commented on the release of the plan:

We are re-allocating resources to accelerate the opportunity we see online, as we run our brick and mortar operations more efficiently. Our team is taking the right steps to optimize our North American business and create efficiencies by leveraging the scale of our company. At this critical moment of change in the retail industry, I believe in the future of our all-channel model and we are adapting to meet the evolving needs of our customers.[[23]](#endnote-23)

However, the company’s turnaround plan was unable to alleviate concerns from industry analysts, as Moody’s Corporation mirrored the earlier decision by Standard & Poor’s and downgraded its credit ratings for HBC from B1 to B2. Turnover in top management continued, as Don Watros, the president of HBC International, chose to vacate his position effective September 2017.[[24]](#endnote-24)

HBC’s misfortunes reached a nadir in October 2017 when Gerald Storch, CEO of HBC, joined the exodus of top executives from the company.[[25]](#endnote-25) His exit was not entirely unexpected, given rumours of continual disagreement between company leaders regarding the future direction of the firm.[[26]](#endnote-26) However, his sudden departure after less than three years at the helm and the concomitant optics of such rapid leadership turnover did little to alleviate investors’ fears. In response to this development, Richard Baker was chosen to serve as the interim CEO while an executive search firm looked for a permanent replacement.[[27]](#endnote-27)

**ESCALATING TENSIONS WITH LBIM**

Exacerbating these financial concerns was the escalating tension between HBC’s top management and its activist investor, LBIM. LBIM wrote its first public letter to HBC shortly after the company’s annual shareholder meeting in 2017, urging HBC to redevelop its Saks Fifth Avenue flagship store and tap into the value of its real estate holdings.[[28]](#endnote-28) Specifically, LBIM was concerned that the value of the company’s real estate holdings was estimated to be $6.4 billion, translating to $35 per share, a far cry from the sub $11 trading price.[[29]](#endnote-29) While Baker had been successful in monetizing real estate deals in the past, he had yet to spin off a significant proportion of HBC’s real estate assets.[[30]](#endnote-30) As it had a nearly 5 per cent ownership stake in HBC, LBIM stated that if it did not see “substantive progress on a plan to close the gap to underlying asset value,” it would have to call for a special shareholder meeting.[[31]](#endnote-31)

A second instance of public disagreement surrounded the sale of Galeria Kaufhof. After the offer from Signa Holding, LBIM penned a letter to shareholders stating that the company should “seriously consider” the offer, as the bid was higher than the $3.9 billion purchase price paid by HBC in 2015.[[32]](#endnote-32) Furthermore, LBIM criticized HBC about its lack of transparency surrounding possible offers by management to take the company private.[[33]](#endnote-33) Although lenders had become cautious about financing leveraged buyouts in the retail sector, due to the rapid disruptions occurring in the industry, LBIM believed that HBC would be an exception, given the potential for monetizing its disproportionately large real estate holdings.[[34]](#endnote-34)

**CONTINUED CONCERNS FROM THE COMPETITION BUREAU**

These difficulties were compounded by the Competition Bureau’s concurrent investigation into the company’s allegedly deceptive pricing practices in relation to sales of its mattress sets. Early inquiries into HBC’s pricing for its sleep sets claimed that it “grossly inflated regular prices” and advertised enormous discounts to encourage consumers to buy the products based on the mistaken belief that they had found a deal. The Canadian *Competition Act* prevented retailers from misleading the public about ordinary selling prices, providing a strict criteria that was based on the volume of sales for determining the selling price from which sales discounts could be calculated.[[35]](#endnote-35)

HBC was under fire for having failed to adhere to this policy, and the Competition Bureau alleged that several of HBC’s advertisements fell into the category of deceptive marketing practices. For example, a 2013 flyer advertised a Beautyrest TruEnergy Brooklyn queen-sized mattress at a $1,800 discount from its regular $3,098 price. Given that HBC had sold only a single set at the full price in the months prior to the 2013 sale, it did not meet the volume requirements set by the Competition Bureau to determine a regular sale price. In addition, the mattress set had not been sold for long enough to satisfy the “good faith” aspect of the Bureau’s other standard for establishing a regular sale price, otherwise referred to as the “time test.” As a result, the Bureau was seeking payment from HBC of a significant monetary penalty; if successful, this application would further impact the company’s negative financial performance.[[36]](#endnote-36)

**“DISRUPT OR BE DISRUPTED”: THE CANADIAN RETAIL ENVIRONMENT[[37]](#endnote-37)**

Although the Canadian retail industry was projected to increase in value by 17.7 per cent by 2020,[[38]](#endnote-38) the breakdown of industry growth represented a threat to HBC’s long-term success. While this growth rate was strong, it was primarily driven by the e-commerce segment, which held a 15 per cent projected growth rate in comparison to the mere 3 per cent forecasted for brick-and-mortar retailers.[[39]](#endnote-39) In addition, Canadian consumers continually held higher expectations for shipping and service standards for online sales, which HBC was only just beginning to address with the changes to its digital operations in the “Transformation Plan.”[[40]](#endnote-40)

Trends toward digitizing the store experience and continued threats from big-box online retailers such as Amazon placed pressure on HBC in its restructuring process.[[41]](#endnote-41) HBC’s main competitors in the industry included Sears Canada Inc. (Sears), and Nordstrom Canada, both of which directly competed in the department store environment.

Sears Canada

Sears began serving the Canadian market in 1952 under the banner of Simpsons-Sears Ltd., quickly attaining a strong foothold in the Canadian retail industry[[42]](#endnote-42) through its mail-order services. After HBC acquired the Simpsons company in 1978, the Simpsons-Sears partnership was dissolved, and the company formally changed its name to Sears Canada Inc. as of 1984. Sears’s performance peaked in the late 1990s with the acquisition of the T. Eaton Company Ltd., providing the department store with coveted real estate locations, such as the high-traffic tourist stop of the Toronto Eaton Centre.[[43]](#endnote-43) At that time, many expected Sears to take over Eaton’s market share in the Canadian retail sphere.[[44]](#endnote-44)

Sears began struggling in 2009, initially laying off 300 workers, which, at the time, represented less than 1 per cent of its workforce.[[45]](#endnote-45) The company’s struggles were well-illustrated through the considerable turnover in its top management team, with former CEO Calvin McDonald (2011–2013) abruptly stepping down from the position in the middle of a three-year turnover strategy, and former CEOs Douglas C. Campbell (2013–2014) and Ronald Boire (2014–2015) each spending only a year in the position.[[46]](#endnote-46) Although Sears made considerable efforts to stay solvent, including the sale of three leases to Cadillac Fairview Corporation Ltd. in 2012[[47]](#endnote-47) and a rebranding in 2016,[[48]](#endnote-48) the company continued to face financial difficulties in the years preceding 2017.

Then came 2017, which represented the culmination of years of financial struggles for the company. Sales had declined from $6.7 billion in 2001 to $2.6 billion in 2016, primarily due to the company’s failure to adapt to the changing retail landscape, specifically in the e-commerce arena.[[49]](#endnote-49) Sears began the 2017 fiscal year by recording a loss of $144 million, with top management voicing strong concerns for the liquidity of the company in the Q1 report.[[50]](#endnote-50) Financial struggles worsened with the June 2017 announcement of the closure of 59 stores and the layoffs of 2,900 employees without severance in a court-supervised restructuring.[[51]](#endnote-51) Liquidation sales at these locations began in mid-July, and as of October 2017, the company requested court approval to liquidate its remaining locations, leaving 12,000 employees without jobs.[[52]](#endnote-52) It was clear that Sears had been unable to adapt its role as a mail-order retailer to the e-commerce arena.

Nordstrom Canada

While other companies struggled, Nordstrom emerged as a leader in the Canadian retail space.[[53]](#endnote-53) Unlike Sears and HBC, the company’s third-quarter (Q3) 2017 earnings were positive, with net sales increasing 2 per cent over the same period in the previous year.[[54]](#endnote-54) Nordstrom entered the Canadian market in the immediate wake of Target’s failure in 2014, allowing the U.S. retailer to learn from Target’s mistakes.[[55]](#endnote-55) Target introduced 124 locations in mid-2013, prompting complaints of empty shelves and high prices, resulting in its swift exit from the Canadian market within two years of its entrance.[[56]](#endnote-56) Nordstrom, in contrast, chose a slow-and-steady approach, choosing to introduce its first six stores over two-and-a-half years in an attempt to ensure that the company fully understood the Canadian retail environment.[[57]](#endnote-57)

Known for its exceptional customer service,[[58]](#endnote-58) Nordstrom further experimented in the retail sphere to stay at the forefront of the industry, introducing variations on its traditional department store offerings such as Nordstrom Rack, which offered discounted luxury goods,[[59]](#endnote-59) and Nordstrom Local, which were stores without inventory, where personal stylists were employed to curate and acquire outfits for shoppers.[[60]](#endnote-60) The company also allowed customers to buy products online and pick up the orders in-store, providing a further diversified experience for their consumer base.[[61]](#endnote-61) As a result of these initiatives, Nordstrom had shown a unique ability to stay abreast of industry developments and successfully adjust to the demands of a dynamic retail environment.

**THE ONLINE THREAT**

Although HBC had launched its e-commerce site in 2000, predating many other competitors, its online performance still lagged behind other e-commerce giants.[[62]](#endnote-62) Sales rose by 11 per cent in Q3 2017, showing relatively strong performance in the e-commerce sector, with online sales worth $2.5 billion across the HBC chains and subsidiaries. However, a basic comparison between Amazon, as an online retail giant, and HBC, as an early mover in the online retail space, showed significant disadvantages for HBC. A 2017 article in the *Globe and Mail* quoted Baker’s assertion that he had heard plenty of complaints regarding HBC’s online presence:

This Hudson’s Bay Co. can’t get it right—why does Amazon’s order come in one day and I have to wait three days [for HBC], and I’m on the call centre for eight minutes instead of two minutes at Amazon? Because the amount of money we’re able to spend solving these problems is less, because our shareholders—rightfully—want a return on their investment.[[63]](#endnote-63)

Although Baker noted that Amazon shareholders were happy to not receive a return on their investment, he did not address the declining dividend at HBC amid the financial troubles in 2017.[[64]](#endnote-64) However, HBC’s “Transformation Plan” was intended to streamline the digital operations, with a notable change including the integration of HBC’s digital group into the firm’s logistics and supply chain operations, aiming to improve the fulfillment process for products ordered online.[[65]](#endnote-65) Although HBC lagged behind major competitors in the online sphere, the company was clearly making strategic moves to improve its positioning.

**MOVING FORWARD**

HBC’s continued struggle in the Canadian retail environment proved to be challenging, and the cost-cutting measures of the Transformation Plan proved insufficient to manage the complexities of the industry changes. On the one hand, its history, which predated Canada’s Confederation, showed HBC’s resilience in the face of multiple economic downturns in the past and represented a significant strength for the company. On the other hand, HBC appeared to be overextended, as it managed both a struggling e‑commerce portfolio and a European expansion through its ailing Kaufhaus branch. The company also needed to consider how best to respond to the concerns from LBIM. How should HBC proceed?

EXHIBIT 1: Hudson’s Bay Company FINANCIAL INFORMATION AT A GLANCE

|  |  |
| --- | --- |
| **Hudson’s Bay Company Overview** | |
| Trading Price (October 31, 2017) | $11.27 |
| Shares Outstanding (in millions) | $182.2 |
| Cash (in millions of CA$) | $112 |
| Short-Term Debt (in millions of CA$) | $1,206 |
| Historical Short-Term Interest Rates | 3.9–4.9% |
| Long-Term Debt (in millions of CA$) | $2,604 |
| Historical Long-Term Interest Rates | 3.25–4.39% |
| Total Tax Loss Carryforwards (2016) (in millions of CA$) | $1,656 |

Note: The interest rate ranges are based on historical borrowings, including revolving credit facilities, term loans, and mortgages.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Hudson’s Bay Company Financial Statements Summary (in millions of CA$)** | | | | |
|  | **2015** | **2016** | **2017 (26 Weeks)** | **2016 (26 Weeks)†** |
| Revenue | $11,162 | $14,455 | $6,494 | $6,555 |
| Operating Expenses | $10,704 | $14,173 | $6,600 | $6,502 |
| EBITDA | $458 | $282 | –$106 | $53 |
| Depreciation | $460 | $695 | $346 | $312 |
| EBIT | –$2 | –$413 | –$452 | –$259 |
| Net Capital Expenditures | $376 | $657 | $342 | $339 |
| Changes in Net Working Capital | –$250 | $184 | –$215 | –$267 |

Note: The 2016 26-week data are included as a reference for the comparable 26-week period in 2017; EBITDA = earnings before interest, tax, depreciation and amortization; EBIT = earnings before interest and taxes.

Source: Created by the authors using information from “Hudson’s Bay Company,” Google Finance, October 31, 2017, accessed December 28, 2017, https://finance.google.ca/finance?q=TSE:HBC; Hudson’s Bay Company, *2017 Q2 Interim Condensed Consolidated Financial Statements*, Investor.hbc.com, September 5, 2017, accessed December 28, 2017, http://files.shareholder.com/downloads/AMDA-1ETYKL/5769895658x0x955781/430FF6F6-B09F-4A04-A8A3-F91101E7900E/HBC\_Financial\_Statements\_Q2\_2017\_FINAL.pdf; Hudson’s Bay Company, *Annual Information Form for the Fiscal Year Ended January 28, 2017*, April 28, 2017, accessed December 28, 2017, http://files.shareholder.com/downloads/AMDA-1ETYKL/5799757931x0x940084/8E853084-DB87-498F-AD00-C308E7D38C49/AIF\_FY\_2016\_FINAL\_FILING\_VERSION.pdf.

EXHIBIT 2: THE Hudson’s Bay Company TRANSFORMATION PLAN

The Hudson’s Bay Company Transformation Plan was designed to increase operational synergies, sharpen capabilities, and reduce expenses. It also included the following changes:

Leadership teams: Create two distinct leadership teams to drive market-specific strategies, one focused on Hudson’s Bay Company and one dedicated to Lord & Taylor. The Hudson’s Bay Company leadership team would focus on accelerating plans to build on its successful transformation in Canada, while the Lord & Taylor leadership team would focus on increasing the pace of change at that U.S. banner, with an emphasis on driving digital opportunities while operating its stores more efficiently.

Digital Portfolio: Integrate digital functions throughout the organization to develop and maximize the impact of all-channel solutions for marketing, operations, and technology in an effort to deliver the most seamless in-store and online experience for Hudson Bay Company’s customers.

Alignment of Resources: Realign company resources, including Information Technology (IT) and Digital; Store Operations & Visual Merchandising; Buying & Planning; and Marketing to increase efficiencies and leverage scale, with world-class centres of excellence that support banners while preserving differentiation among the businesses.

In-Store Service: Optimize in-store service and enhance sales training for store associates to better serve Hudson Bay Company’s customers.

Job Cuts: Reduce the employee base by approximately 2,000 positions, including those previously announced in February, which would both streamline the decision-making process and flatten the organization by removing layers to make Hudson’s Bay Company more nimble.

Procurement Savings: Fully leverage the size and scale of the company to optimize procurement and generate additional savings.

Source: Created by the authors using “HBC Announces Transformation Plan for North American Operations to Deliver Best-In-Class All-Channel Customer Experience,” news release, Business Wire, June 8, 2017, accessed December 28, 2017, https://www.businesswire.com/news/home/20170608006311/en/HBC-Announces-Transformation-Plan-North-Aerican-Operations.

endnotes

1. This case has been written on the basis of published sources only. Consequently, the interpretation and perspectives presented in this case are not necessarily those of Hudson’s Bay Company or any of its employees. [↑](#endnote-ref-1)
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21. Hudson’s Bay Company, *Management’s Discussion and Analysis of Financial Condition and Results of Operations for the Thirteen and Twenty-six Weeks Ended July 29, 2017*, September 5, 2017, accessed December 28, 2017, http://files.shareholder.com/downloads/AMDA-1ETYKL/5799757931x0x955782/ED408D88-D534-464F-A87E-80735BE2B78B/HBC\_MDA\_Q2\_2017\_FINAL.pdf. [↑](#endnote-ref-21)
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