

Reinterpreting the great US department store bankruptcies of the 1980s - a catalyst to strategic structural change

Abstract

Purpose –The financial restructuring of the US department store industry is commonly interpreted as a time of corporate excess, value-destruction and ultimately collapse. This research aims to re-analyse these events using qualitative methods to understand the background to the leveraged transactions and to review the implications that their failure had for the longer term strategy and structure of the US department store industry.

Design/methodology/approach – The research is based on two extensive periods of fieldwork in the United States when the author interviewed (n=28) many of the protagonists of the 1980s restructuring period and those who inherited the management of the bankrupt businesses in the 1990s. By adopting a qualitative perspective, we are accessing social and human perspectives of these developments as well as their wider effects.

Findings – The leveraged transactions were conceptually an appropriate attempt to centralise the structure of the industry but their execution was not possible under such extreme financial distress. However, bankruptcy protection provided the environmental conditions to realise the benefits of more efficient strategic and subsequent wide-ranging structural change.

Originality/value – This research differs from economic readings of the period that analyse changes in market value of the constituent firms and the more reactionary journalistic accounts. The paper re-casts the failed financial restructuring in a new light, underlining the regenerative effects of Chapter 11 Bankruptcy Protection in promoting firm revival, alongside visionary leadership.

Keywords - leveraged buy-outs; corporate restructuring; department stores; retail history; qualitative research

Paper type - Research paper

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Steve Wood

School of Management, University of Surrey, Guildford, Surrey GU2 7XH

Tel: +44 (0)1483 686344

Fax: +44 (0)1483 686346

E-mail: sm.wood@surrey.ac.uk

About the author

Dr Steve Wood is lecturer at the School of Management, University of Surrey, UK as well as an Advanced Institute of Management (AIM) Scholar. He completed his PhD on the restructuring of the US department store industry at the University of Southampton, UK. His research focuses on issues related to retail strategy and decision-making and has been published in a wide range of journals that sit on the management and retail interface.

INTRODUCTION AND OBJECTIVES

Alfred Chandler's classic historical 1962 study 'Strategy and Structure' examined the crucial link between a company's strategy and its internal structure. For Chandler, the multi-divisional structure that emerged in the early 20th Century had proved successful because 'it clearly removed the executives responsible for the destiny of the entire enterprise from the more routine operational activities, and so gave them time, information, and even psychological commitment for long-term planning and appraisal' (Chandler, 1966, p 382). This view played an influential role in the decentralisation of many leading corporations in the 1960s and 1970s (Rodrigues, 2002). However, from the 1980s onwards, there 'was growing scepticism about the role of diversified multi-divisional firms' (Toms and Wright, 2005, p 275). This scepticism solidified into major deconglomeration as the decade progressed with an increase in highly leveraged transactions across American industry as acquirers restructured, extracted surplus value and improved firm performance (Holmstrom and Kaplan, 2001).

While many of these transactions were successful, increased shareholder value and the operating effectiveness of the corporations (Cotter and Peck, 2001; Jensen, 1993), one sector in particular - the US department store industry - was seemingly left devastated by a number of high profile bankruptcies. Casualties, amongst numerous others, included the Allied/Federated conglomerate, which was acquired and consolidated by the Campeau Corporation, and the world renowned, RH Macy, both of which entered Chapter 11 bankruptcy protection in 1990 and 1992 respectively (see **Table 1**). These "failures" become notorious and 'came to symbolize the folly of leverage in an overheated market for corporate assets' (Baker and Smith, 1998, p 124).

This paper revisits these attempts to recast the structure of the US department store sector and focuses on understanding the longer term implications of events from the executives who experienced them and were left with the task of reworking the strategies and structure of the constituent firms. There are two aims of this research. Firstly, this paper seeks to understand the *background* to the leveraged transactions, the motivations for them, and the wider environmental circumstances in which they occurred. Secondly, and more substantively, we aim to analyse the *implications* that the transactions had for the strategy and structure of the US department store industry. In particular, the paper seeks to uncover the contradiction that while leverage was conceptually appropriate in terms of extracting improved efficiency within the acquired retailers, it ended up actually constraining synergy realisation and led to bankruptcy. However, the very efficiency-generating and structural centralisation argument that was the driving force behind justifying leverage was only realised during the post-bankruptcy period as Chapter 11 Bankruptcy Protection insulated the operators as they

emerged from restructuring and instigated the necessary strategic and structural adaptation to the new retail environment.

This paper is unique because it extends beyond purely financial analyses of the transactions in terms of changes in market value (e.g. Kaplan, 1989; 1994) or the journalistic accounts (e.g. Rothchild, 1991; Tranchtenberg, 1996). It is based on corporate interviews with a wide array of US industry executives and analysts, both past and present¹, that are triangulated with a wide range of secondary material including press and analyst reports. The advantage of analysing the 1980s is that there is scope to interview the primary actors and analysts involved before, during, and after the buy-outs, accessing social and human perspectives and thereby avoiding a key concern of one historian who suggested that ‘much of what we know about the history of American retailing comes from secondary sources, all too often accepted as part of the discipline without adequate confirmation’ (Savitt, 1989, p 350). An obvious contribution of such retail history lies in reflecting experience and understanding on the contemporary industry - using the past ‘to help inform the present and the future’ (Lamond, 2006, p 9).

The paper first briefly analyses the strategy and structure of the US department store sector in the 1980s and the mismatch between the two given the increasingly competitive retail environment of the period. Second, in the light of these structural challenges we analyse the theoretical basis for the leveraged buy-outs of these operators. The third and fourth sections introduce two case studies that were central to the restructuring of the sector: Federated/Allied and RH Macy’s. These are developed in the fifth section of the paper by examining an array of data collected in our semi-structured interviews with the executives and analysts involved in the sector, before forming some brief conclusions.

¹ This paper is based on an extensive period of fieldwork in the US during 2000 and 2001 when the author interviewed a wide array of industry executives and analysts, both past and present (n = 28). These included: Jim Zimmerman and Allen Questrom, both former CEO’s of Federated Department Stores; Terry Lundgren, current CEO of Federated; Phil Miller, then Chairman of Saks Fifth Avenue; Hal Khan, then Chairman of Macy’s East; Don Eugene, former CFO Macy’s; Michael Gould, President of Bloomingdale’s; Peter Sachse, Chief Marketing Officer, Macy’s; Carol Sanger, former Vice President of Federated Department Stores; Harry Frenkel, Senior Vice President & Chief Financial Officer, Federated Merchandising Group; and Daniel Barry, Managing Director of Merrill Lynch, New York. The material was coded and analysed in accordance with conventional qualitative research practice.

THE STRATEGY AND STRUCTURE OF THE US DEPARTMENT STORE SECTOR IN THE 1980s

Inefficient structures, diversification and the need for efficiency

Chandler's work (1966; 1977) charted the profitable decentralization of major US corporations between 1850 and 1920 'through greater diversification or at least divisionalization' (Acar et al., 2003, p 1228). For Chandler the business environment affected strategy, which in turn developed structure, and ultimately led to economic efficiency. While the interplay between strategy and structure remains less linear than Chandler suggested – reality 'is a mess in which strategy and structure mix madly' (Rodrigues, 2002, p20) – it is clear that the firm has to create a strategic fit with its requisite environment (Porter, 1985).

By the start of the 1980s the US department store industry possessed a structure that was highly inefficient. The sector had not adapted to an environment where its discount and speciality store competitors were increasingly centralised, lean and technologically advanced, which permitted rapid responses to industry demands and saw them increasing their market shares of GAF (general merchandise, apparel and furniture sales) at the expense of department stores (McNair and May, 1978).

Although appearing to consist of a relatively centralised industry following the mergers of formerly independent department stores to form holding companies in the 1920s, the major operators such as Allied Stores, Carter Hawley Hale, RH Macy and Federated possessed highly decentralised organisational structures. Each fascia or division remained remarkably independent in operation, neglecting the potential realisation of economies of scale through pooled buying for example (Raff, 1991). As Paul Nystrom argued at the time of the 1920s consolidations, 'merely changing the ownership without changing the service, merely results in deflecting retail net profits, such as they are, from private owners to co-operative owners' (Clark et al., 1926, p 257). This meant that consolidations 'have unified ownership, but, for the most part, these seem to have gone but a small way toward achieving the advantages of group management' (Griffen et al., 1928, p 27).

By the 1950s this inefficient structure was noted with concern as 'Each store still maintains its individual departmental buyers. Hence if we were to use language strictly, the common application of the term "chain" to such organizations is a misnomer' (McNair, 1950, p 136). Contrasted with the chained department stores such as Sears and JC Penney that had successfully adopted a more centralised, chained structure (Tedlow, 1996), McNair noted that with 'department store holding groups like Federated, Allied, and so on, we find that the total

expense rates of ownership groups is some 20% of sales higher than that of true chains' (McNair, 1950, p 136).

The department store sector's inefficiency was exacerbated by its participation in the wider conglomerate wave in Anglo-American industry in the 1960s and 1970s (cf. Goold and Luchs, 1993; Toms and Wright, 2005). Instead of concentrating on its core business, department store firms pursued growth in other retailing sectors that lacked commonality and synergy with its core business (Laulajainen, 1987 - see **Table 2**). This diversification was often ill-judged and generated poor returns. Allen Questrom, former CEO of JC Penney, Barneys and Federated Department Store, reflected:

...in some cases the management of Federated felt that the department store was a problem and that they would focus on other strategies – speciality stores ... supermarkets [and] discount stores... They were never really that successful. And meanwhile they weren't putting the attention on the department store concept (Allen Questrom, Personal Interview).

As economist Michael Jensen has repeatedly argued, by the 1980s such conglomeration initiatives were proving to be an inefficient way to deploy capital and failed to produce adequate shareholder returns (Jensen et al., 2006, p 17-18).

Agency theory and the potential for leverage

In Chandler's terms, there was a mismatch between the strategy, structure and the operating environment within the department store companies. As core department store growth slowed the sector's inefficiencies became more pronounced. Hal Kahn, former Chairman of Macy's East reflected:

...in the 1980s, for the first time, department stores started to experience single digit growth and malls were not being opened as aggressively as they once were...Department stores had to come to grips with how you run a business with single digit growth because before that, the volume would absorb all the expenses...[they] had to become much more financially [astute] (Hal Kahn, Personal Interview).

This period coincided with concerns by financial economists, most notably Michael Jensen, who sought to explain the mismatch between conglomerate management's strategy and the interests of its shareholders (Jensen and Meckling, 1976). He argued that when ownership is separated from control in a large corporation, the agent or manager who acts on behalf of the owner may not always pursue investments and strategies that are to the advantage of that owner (see Jensen, 2005 for a summary). The solution was to align the interests of owners

(shareholders) and management with the re-emergence of active investors that were recognised as ‘individuals or institutions that simultaneously hold large debt and/or equity positions in a company and actively participate in its strategic direction’ (Jensen, 1993, p 867). This was executed via a number of highly leveraged transactions (principally leveraged buy-outs [LBOs] and leveraged recapitalisations), and more generally, an astounding number of mergers and acquisitions throughout the US economy (see **Figure 1**). Many of the highly leveraged transactions were realised through the evolution of a new type of financial instrument - so-called ‘junk’ bonds. These were high yield, noninvestment-grade securities, pioneered by the investment bank Drexel Burnham Lambert, reflecting greater risk as the credit rating was classified as below investment grade (Frick, 2001). In definitional terms, a leveraged buy-out occurs when third party investors and/or managers of a firm offer to pay a premium over the prevailing market price of the firm and finance the exchange of corporate control by taking on a significant amount of debt (Jensen 1989). Such strategies rested on the premise that pressures created by the need to service high debt levels would concentrate management on cash flow and efficiency rather than unproductive investment (Peck, 2004; Wright et al., 2005). These buy-outs were conceived by third party organisations such as Kohlberg Kravis Roberts (KKR) that would capitalise on the increased value generated from the efficiency gains after a number of years of ownership where they took on an essential governance role on the board which is a key component of ensuring value creation (Baker and Smith, 1998; Braun and Latham, 2007; Nikoskelainen and Wright, 2007).

The department store companies appeared excellent targets for such acquisition due to their outdated strategy and structure that could yield value through reorganisation. In this decade of low department store sales growth, the stock market placed a low valuation on these historically trusted companies that provided reliable, if rarely surprising, returns for investors. Such low valuations allowed potential predators to unlock the often considerable real estate values inherent within the conglomerates’ store portfolios at relatively low prices. Furthermore, numerous LBOs were proving successful in other retail sectors. For example, in the food market, the Safeway leveraged buy-out by the specialist LBO firm KKR in 1986 for \$4.3 billion (Denis, 1994). In addition, Kroger, the second largest US grocer, undertook a successful \$4.1 billion leveraged recapitalisation in 1988.

The following two case studies, briefly presented and subsequently analysed in depth, are the two most notable of the period: the Campeau Corporation’s acquisition of Federated and Allied and the highly leveraged transaction of RH Macy.

CASE STUDY CONTEXT: FEDERATED, ALLIED AND THE CAMPEAU CORPORATION

During the 1980s, Federated and Allied, two of the largest and most high-profile department store holding companies in the United States, were central to the financial re-engineering of the retail sector. The saga centred on Canadian real estate developer Robert Campeau who used relatively little of his own capital as proportions of the purchase prices. First, Campeau purchased Allied Stores Corporation in October 1986 for \$3.6 billion, plus assumed debt and fees - \$4.4 billion in all. As this was at the height of the junk boom, it was financed almost exclusively through Citibank and First Boston, with Campeau only providing \$150 million himself (Rothchild, 1991).

In common with other leveraged transactions, there was immediate divestiture as the firm, constrained by its crippling debt burdens, had to dispose of its most unproductive assets or divisions not central to its core business operations (cf. Wright et al., 2005). In this manner Allied, sold 16 of its smaller units for \$1.16 billion in 1987 but still held prestigious divisions such as Brooks Brothers which was widely regarded the jewel in Allied's crown (Hallsworth, 1991).

Difficulties emerged when Campeau turned his attention to acquiring Federated Department Stores, which offered the potential for synergistic benefits as he would be able to open new malls and, as the owner of the key anchor department stores, pick and choose his mall designs to exclude stores he did not own (Hallsworth, 1991). However, a year and a half after the acquisition of Allied, Campeau was still reorganising the new firm into a stable enterprise when a bidding war commenced with RH Macy for control of Federated. This was eventually won by Campeau at \$73.50 a share compared to the earlier price of \$33. The overall purchase price has been calculated at \$8.17bn, representing a bid premium of \$3.3bn, financed by 97% debt (Kaplan, 1989). There is little wonder that *Fortune* magazine called it 'the biggest, looniest deal ever' (Loomis, 1990).

Market confidence was crucial to both transactions in keeping the Campeau Corporation liquid, in particular, the retention of Brooks Brothers in the Allied portfolio gave the company's backers confidence. However, the divestiture of Brooks to finance the Federated deal led Allied backers to conclude that their assets were being sold off to fund the Federated shareholders, who had seen their company double in value over four months. The rising valuation sparked concern over what else would need to be sold to fund the costly acquisition, and confidence fell (Rothchild, 1991). Campeau responded by divesting further chains from newly acquired Federated to reduce short-term debt – notably I. Magnin and Bullock's to

Macy for \$1.1 billion, and Foley's and Filene's were offloaded to May Department Stores for \$1.5 billion in July 1988 (Kaplan, 1989). Despite these measures, the price for which Federated was purchased was simply too high and the crippling debt burden finally caught up with the Campeau Corporation when it filed for Chapter 11 bankruptcy protection in January 1990.

CASE STUDY CONTEXT: THE R H MACY LEVERAGED BUY-OUT

The RH Macy experience of the late 1980s parallels the ill-fated financial restructuring of the Campeau Corporation. In 1986, the CEO of Macy's, Edward Finkelstein, led a \$3.5 billion leveraged buy-out. Prior to the buy-out, Macy's had \$144 million debt and \$1.48 billion in shareholder equity (c. \$1 of debt to every \$11 of equity). Following the takeover, the firm had \$290 million in equity, as the ratio became \$10 of debt to every \$1 in equity (Trachtenberg, 1996). Despite this, the transaction was well-received by the financial markets. The rationale of the LBO was underpinned by a number of case-specific factors:

First, there was the opinion that taking the company private through an LBO would offer a safe haven from Wall Street's earnings expectations. As the Director of Stores for Macy's East reflected, the view of the firm was that it would no longer 'be subject to the quarterly whims of the stock market' (Peter Sachse, Personal Interview). Theoretically, the low valuation of the department store stocks provided the opportunity for the LBO to realise the 'real' value of the firm, if privately owned.

Second, the Macy LBO was motivated in part by a hostile takeover threat from elsewhere in the retail industry. A number of precedents had been set by the mid-1980s. In the late 1970s, West Coast department store operator, Carter Hawley Hale aggressively pursued Marshall Field, the Chicago-based luxury department store, for a potential hostile takeover. Field responded by leveraging its capital structure through organic expansion (Laulajainen, 1990). Moreover, Carter Hawley Hale itself faced the threat of a hostile takeover in 1984, when Columbus-based women's apparel retailer, The Limited Inc., made a bid at 25-35% above its going market price. The corporation succeeded in fending off the tender, but only by disposing of its Weinstocks division and ceding 37% of the voting power to a single shareholder, General Cinema Corporation (Laulajainen, 1987). Furthermore, in 1986, partly responding to similar pressures, May Department Stores acquired Associated Dry Goods Company operators of Lord & Taylor amongst others for \$2.5 billion (Simpson, 2001). The impact of these threats for the department store industry cannot be overemphasised. As Walter Loeb, special advisor for Morgan Stanley, reflected, department stores 'looked at themselves and said size mattered and that they had to get bigger' (Walter Loeb, Personal Interview). The

alternative, of course, was to LBO and go private because ‘size and performance would no longer be enough to guarantee the independence of any company’ (Trachtenberg, 1996, p 28).

Finally, and most importantly, the rationale of the Macy’s LBO was driven by the premise that investors in the buy-out stood to extract considerable personal gain as a result. The prospects were good: Macy’s was a national institution and had grown significantly through the 1970s and early 1980s under the skilled merchandising leadership of Edward Finkelstein and the transaction would retain the current management.

The Chapter 11 filing and the capital structure bankruptcy

It is clear that Macy’s eventual filing for bankruptcy protection in 1992, like the Campeau Corporation’s before it, was fundamentally a capital structure bankruptcy rather than reflecting any failure of the department store concept per se. As Holmstrom and Kaplan (2001) reflect more generally for the period, the ‘reason for the defaults was not that profits didn’t improve, but that they didn’t improve enough to pay off the enormous quantities of debt that had been taken on’ (p 128). It is ironic that the Macy 1986 LBO was partially motivated by the urge to avoid the pressures of Wall Street, yet was replaced by the unforgiving form of debt. A senior Macy executive reflected:

... the focus that we thought we would be relieved of – that we could run a business on a long term basis and we didn’t have to worry about this month’s results...[was incorrect as] actually the opposite happened because we became so focused on comp [comparative] store sales which drove cash and paid the debt (Peter Sachse, Personal Interview).

The financial distress that followed the LBO was however exacerbated by a number of issues. First, the late 1980s/early 1990s was a time of harsh recession for the retail industry causing a severe reduction in anticipated free cash flow provision (Walters, 1994). Second, the Macy’s franchise was being run in a more price promotional manner than was suited to its market positioning due to the pressure to service debt in the short term. The final, and most fundamental factor, was the over-inflated \$2.2 billion which Finkelstein paid for the two chains from debt-ridden Federated (I. Magnin’s and Bullock’s). By the early 1990s, as *Fortune* magazine reflected, ‘Macy’s bonds were marked down like ugly sweaters in a one day sale’, and the firm capitulated (Serwer, 1996).

LESSONS FROM THE FINANCIAL RESTRUCTURING PERIOD

Understandably the late 1980s financial restructuring for the department store sector has been characterised almost exclusively by the use of adjectives such as ‘looniest’ and ‘crazy’ (see for example Loomis, 1990), while *Business Week* classified the Campeau acquisition of Federated

as one of the ten worst deals of the 1980s (Business Week, 1990). It is clear that the corporate control mechanism failed as the bidding wars, especially that between Robert Campeau and Edward Finkelstein for the ownership of Federated, spiralled out of control and were based on ego rather than any relationship to firm value or the ability to pay the capital back. Both retailers were heavily debt burdened and faced considerable challenges in paying down initial levels of leverage, regardless of adding to these deficits.

In the following sections, by accessing the views of a wide array of executives and analysts at the forefront of these developments through personal interviews, we seek to deepen our understanding of the consolidations and their wider implications for the strategy and structure of the US department store industry.

A prompt to structural change and the role of Chapter 11

Our key finding is that although the financial restructuring of the late 1980s was poorly executed, the efficiency imperative of strategic and structural change was essential for the sector – though the capital was not immediately available to realise it. It was only during Chapter 11 Bankruptcy Protection that the impetus and partial debt write-off came together and these efficiencies were realised with any conviction. It is notable how positively the management of the time viewed the Chapter 11 bankruptcy filing with a clear sense of relief amid Federated, and to a lesser extent at Macy's. This was largely due to the nature of US bankruptcy legislation that 'does not require that a debtor be insolvent in order to qualify for reorganization, and it includes a strong presumption favoring retention of management throughout the reorganisation process' (Bradley and Rosenzweig, 1992, p 1044).

Chapter 11 protects the firm from its creditors whilst allowing the company to continue trading. The softening of the US bankruptcy protection can be charted back to the Bankruptcy Reform Act of 1978 (and its subsequent revisions) which had the effect of encouraging 'pre-packaged' bankruptcies (McDowell, 2004). In this arrangement, the firm is compelled to produce a reorganisation plan to present before the court, in which the debt and organisational structure can be reworked whilst 'reasonably satisfying' creditors rather than a liquidation of the company as such (Hotchkiss, 1995). Indeed, research has found that larger firms such as Federated are more likely to prosper following bankruptcy (Dawley et al., 2003).

The impact of Chapter 11 status on Federated is a classic example of the benefits of the bankruptcy process for a retailer, which remained there for a little over two years from January 1990 to February 1992. As one prominent retail analyst suggested, the bankruptcy process was:

...made for somebody like a Federated that had excellent properties, and excellent franchises....[and] brand names with consumers, especially with Bloomingdale's and Macy's (Pam Stubing, Personal Interview).

The procedure allowed the firm to cancel leases that it was tied to prior to the filing; selling or closing 41 unprofitable locations, and renegotiating debt with creditors (Kaplan, 1994). This led Kaplan to conclude, 'the post-bankruptcy Federated appears to be a better run than the pre-distress and pre-Campeau company' (Kaplan, 1994, p 135). Perversely then, for some financial economists, 'financial distress, even bankruptcy, did not necessarily mean that a highly leveraged investment had failed to create value – far from it' (Baker and Smith, 1998, p 125).

Conversely, Macy's bankruptcy process was a lengthy procedure in which construction of a re-organisation plan proved problematic. It languished in Chapter 11 protection from January 1992 until its acquisition by renewed Federated in December 1994. Federated undertook this transaction through the purchase of a proportion of Macy's debt, in doing so becoming the principal creditor in Chapter 11 proceedings and hence acquiring control (Anson, 2002). This was followed by the acquisition of the post-bankruptcy Broadway Stores (formally Carter Hawley Hale) that was once again struggling. This gave a newly revitalised Federated an increased national presence and an organisational structure ripe for substantial reorganisation.

Jim Zimmerman, until recently the CEO of Federated, reflected on the added compulsion Chapter 11 bankruptcy brought:

In many ways it was the best thing that ever happened to Federated because the amount of change that arguably was needed in the way that the business was being run, probably could not have come gradually. Or would not have come fast enough had it come gradually, and the take-over and the trauma that surrounded that, made it very clear what the focal point was and changed a whole lot of people... It was an era that a lot of the traditionally bad things happened, or things happened that would traditionally be called bad, but it was also a period of time that really catalysed the corporation and caused and allowed it to make change that made it a viable entity, whereas it might not have been without that (Jim Zimmerman, Personal Interview, emphasis added).

It is important to note that Zimmerman had no reason to put any positive gloss on the experience. It is widely known across the industry, and in journalistic records of the episode, that he was vehemently opposed to what Campeau was doing. In addition, Allen Questrom,

Federated's CEO from 1990-1997, who had previously left the firm in 1988 in protest at the conduct of the Campeau Corporation's running of the conglomerate, retrospectively suggested that 'the reorganisation because of the bankruptcy allowed them to do a lot of things that [they]... should have done perhaps before' (Allen Questrom Personal Interview). Harry Frenkel, CFO of Federated Merchandising Group similarly admitted that much of the organisational restructuring in centralising merchandising was prompted by the Chapter 11 procedure: as 'it would have happened naturally I think just because of competitive forces, but I think this pushed us quickly' (Harry Frenkel, Personal Interview). Another corporate executive revealed the sense of empowerment felt by Federated's senior management at the removal of the parent Campeau conglomerate on Chapter 11 filing suggesting:

It was wonderful. It was a good thing for us. It is the opposite of what you would think. You would think that when you file bankruptcy that everything is gloom and doom but for us it was like we were casting off a yoke of this [man]... that had come in here and saddled the company with all of this huge debt that no matter how successful the stores were, and they continued to be successful through all of this, it didn't matter – you couldn't pay off that amount of debt. When we filed Chapter 11 it was regaining control of our own destiny (Carol Sanger, Personal Interview).

The financial distress of debt and then the spur of bankruptcy was the catalyst to vital organisational restructuring and to the divisional centralisation across the industry. **Table 3** compares the industry structure between 1985 and 1995. The degree of divisional centralisation is notable – a trend that was especially evident at Federated Department Stores where the pace of restructuring to focus on core brands was ramped up following its emergence from bankruptcy (see **Table 4**).

Bankruptcy, and restructuring following Chapter 11 Protection, allowed the key players to establish themselves and, by the start of the 1990s, 'forced a re-evaluation of dire predictions about the fate of the department store industry' (Forsyth, 1993, p 29). As a result, the decade was a period of organisational restructuring and divisional centralisation in these large players with the provision of shared administrative services, the concentration of buying and merchandising and the consolidation of formally autonomous divisions. By the mid 1990s Federated had developed a centralised merchandising group that 'scouts the market and determines what...[individual divisions] ... should look at....and makes some decisions based on economies of scale....but allow the divisions, where the customers see it, to have their own identity' (Carol Sanger, Personal Interview). Similarly Terry Lundgren, current CEO of Federated, explained the rationale for the developments:

Every division used to have their own separate organisation – we don't need that anymore....All of our technology, all of our systems, computer operations – every

division used to have their own set up for that. Now there is one state of the art organisation outside of Atlanta that services all of the systems needs for our stores. One credit facility in Ohio services all of them (Terry Lundgren, Personal Interview).

The ultimate impact of Chapter 11 was facilitating a change in industry structure and thus these newly reinvigorated department stores started to operate in an integrated, technologically inter-linked manner, resembling the discount and speciality stores that were stealing so much of their market share (Wood, 2002). Gradually, a centralised model of organisation has emerged, albeit with sensitivity to local markets; so as 'to enable the store management to maintain links to the buyers and strategists in head office as well as to the customers but within the structure of a very large firm' (Dawson, 2000, p 125).

Cash flow and executing organisational centralisation under debt constraints

Our findings also suggest that conceptually the structural centralisation that accompanied leverage was appropriate; it was the *degree* of leverage of the department store companies that was poorly judged. Further exacerbating this issue is that luxury retailers are characterised by highly cyclical cash flows (and disproportionately affected by economic downturns) so unsuited to very high leverage. Allen Questrom, former Federated CEO, noted that many of the organisational restructuring strategies attempted by Campeau in the Allied/Federated acquisitions *were* appropriate but the lack of funding due to servicing debt burdens constrained their realisation:

Bob's strategy was a right strategy. He was going to consolidate the businesses of Federated and Allied, take advantage of consolidating the businesses of Federated – the corporate offices and divisions – try to get some commonality between the stores and make cost savings. And then he was going to use those savings to obviously pay the debt. His proforma to buy was conceptually right [but] was tactically all wrong. He had to [have] higher sales increases, higher margin increases and bigger expense savings to make this thing all work (Allen Questrom, Personal Interview).

The efficiencies that the Campeau Corporation was seeking were set against the lack of room for manoeuvre set by the debt burden which could not tolerate negative synergies in the short term. The critical period following the leveraged acquisition was further impacted by an economic downturn. As Goldman Sachs retail analyst, George Strachan explained:

My read on it is that this is still a relatively cyclical business and it is very dangerous to over-leverage the company because as soon as you go into a cyclical downturn, any operating issues that you may have are aggregated 10 fold and suddenly you find yourself illiquid, especially if you take on all this high yield debt (George Strachan, Personal Interview).

Instead, successful leveraged transactions ‘tend to be heavily concentrated in industries with relatively stable demand and relatively static technology’ (Thompson and Wright 1995, p 699). While the amortisation schedules of the loans can be structured to accommodate cyclical flows, an ‘industry prone to cyclical demand cycles, hence irregular cash flows and unpredictable working capital requirements, or whose fate is linked to that of a few suppliers or buyers, may not be a fit candidate for aggressive leveraging’ (Sharma, 2004, p 40). As such, the LBO financiers were arguably too focused on finance monitoring rather than possessing a deep understanding of department store retailing with remuneration focused on deal construction rather than on the basis of medium/long term success (cf. Baker *et al.*, 1998).

Further complicating the execution of efficiency-seeking structural is that such organisational restructuring requires some facilitating investment that cannot be achieved under such crippling leverage. As recent research has noted, ‘an important aspect of realizing synergy may be to invest in additional resources and maintain slack’ (Gary, 2005, p 660) – exactly what was not possible in the Macy and Federated buy-outs.

Investment in networked computer systems to facilitate data processing and sales interpretation with divisional consolidation was not viable during such financial distress. As a former Macy East Chairman acknowledged:

When we were cash strapped, our biggest challenge from our customers was that you were never in stock so we went from a 12% stock-out at bankruptcy to about a 3%. We just didn’t have the systems...we didn’t have the technology...giving buyers computers? We didn’t have the money to do all those things so we weren’t investing in the new technology (Hal Kahn, Personal Interview).

Even when divisional consolidation did occur, department stores were often unable to fully utilise synergistic benefits. The merger of Macy’s New Jersey and New York divisions was only partially successful, with one division owning IBM cash registers, and the other NCR registers. This prevented the integration and interpretation of sales and inventory information, with little finance to invest in communal technology. Indeed, while the financial distress of high corporate debt does reduce investment in ill-judged projects, ‘it is not clear whether investment cuts eliminate poor projects or value-enhancing investments’ (Servaes, 1994, p 254).

Resistance, knowledge and leadership in the organisation

Another key issue that prevented successful restructuring of the retailers during the periods of financial distress was internal resistance to change. Contemporary management literature has

underlined the role of individuals in driving and executing corporate strategy, while also emphasising how employees may possess different value asymmetries to that of the firm (e.g. Schoenberger, 1997). There is considerable evidence that such perspectives were overlooked as the Campeau takeovers differed from conventional leveraged buy-outs by not offering management an equity stake (Kaplan, 1989; cf. Jensen, 1989). As one former-President of Allied Stores' International Division testified, there was considerable resistance within the firms to the divisional consolidation and organisational centralisation brought about by financial restructuring – there were endemic values of independence:

Well, if I'm at Bloomingdale's, why should I talk to A&S? Why should I talk to Lazurus? There was no reason why Abraham and Strauss, Rike Kumler, Shillitos and Lazurus and Rich's *couldn't* talk to each other (Howard Biederman, Personal Interview).²

The reluctance to centralise divisions in the Allied/Federated Campeau Corporation, in part, contributed to the downfall of the venture, as Allen Questrom confirmed:

He [Campeau] couldn't get the Federated and Allied organisations to work together. In many ways they conspired against him.... I think most of the people in Federated... saw him as some kind of a kook. They were very autonomous already so here was a company with a history of being very autonomous and they were not about to let this guy run the show (Allen Questrom, Personal Interview).

The experience of the financial restructuring consequently underlines the importance of organisational cultural considerations in executing post-acquisition restructuring (Meyer and Lieb-Dóczy, 2003).

The questionable quality of leadership during the periods of high leverage was also fundamental to failure. The executives managing the two corporations, Campeau and Finkelstein, could not have been more divergent in their expertise. Campeau was essentially a real estate developer who had no background in retailing. What is more astounding is that very few people in the Campeau organisation possessed any such experience and were in fact essentially experts in finance and large deal formulation.

This meant that the cash projections developed for the department stores under high leverage were overly optimistic and not grounded in department store economics. As Marvin Traub, the ex-President of Bloomingdale's (a division of Federated), acknowledged:

I realised that all of the Campeau projections... had been totally done within First Boston and the Campeau Organization....No banker ever...came to Bloomingdale's to ask if I thought we could deliver those numbers (Traub, 1994, p 293).

Conversely, Macy's senior management was made up of department store merchants who had an intricate knowledge of the department store business in terms of effective merchandising, but lacked expertise in generating efficiencies in operation to increase cash flow and alleviate financial distress. After all, the department store industry had become a target for high leveraging *because* it was inefficiently run, yet in the Macy case the *same* executives took control. It was inconceivable that they could generate a new organisational structure without minimal previous experience of doing so. As the former Chairman of Macy's East reflected:

Macy's management, which I was part of then, never knew how to run the business as a financially astute operator as Federated [now] does, so we made all sorts of mistakes getting deeper in debt, building up the inventories – it really is really naive looking back in terms of how do you approach an LBO (Hal Kahn, Personal Interview).

In contrast, the leadership of the post-bankruptcy Federated/Macy's organisation was outstanding. As Brockman et al. (2006) note, positive bankruptcy strategic change is highest for firms hiring an outsider, giving him duality, retaining a top management team and giving him a long tenure (see also Hotchkiss, 1995). This is exactly what occurred with the appointment of Allen Questrom from Neiman Marcus.

CONCLUSIONS

This paper has analysed a period in US retailing that is renowned for failure and financial collapse. The wave of financial restructuring in the US department store sector was clearly disastrous, even if its imperative of centralised strategic and structural change was appropriate. More interestingly though, by using qualitative interviews with many of the leading actors involved in the sector at the time and since, we have been able to build up an understanding of the more positive longer term implications of the leveraged transactions beyond media portrayals and strict economic studies of value creation.

In particular, the failed leveraged transactions and the retailers' subsequent entry into Chapter 11 bankruptcy reorganisation ultimately laid the foundations for the department store industry's re-emergence in the 1990s with an aligned structure and strategy. This underlines the view of Kalay et al. (2007) that Chapter 11 provides net benefits to firms. The role of

² Abraham and Strauss, Rike Kumler, Shillitos, Lazurus and Rich's were separate divisions of the Allied/Federated conglomerate at the time.

leadership proved critical here too. The post-bankruptcy appointment of a new CEO, Allen Questrom, who had previously left the company to take up as CEO of Neiman Marcus, was crucial as 'the continued involvement of original management in the restructuring process is strongly associated with poor postbankruptcy performance' (Hotchkiss, 1995, p 4). More significantly, Questrom was proactive in implementing a revised strategy that fed directly into structural change - placing an emphasis away from promotion towards divisional consolidation, eliminating poorly performing stores, remodelling rather than opening new stores and centralised shared back office systems. Indeed, we should adopt a more entrepreneurial view of the recovery of the US department store sector where leadership was instrumental (cf. Wright *et al.*, 2001). The nature of Chapter 11 thus allowed Federated to turn around quickly and refloat. The revitalised retailer acquired Macy's in 1994, as it itself languished in Chapter 11 restructuring and the financially struggling Broadway Stores (formally Carter Hawley Hale) in 1995. Most recently, during 2005, the strategy of portfolio restructuring recommenced with the merger of the two leading department store companies, Federated and May Department Stores, which saw further organisational reorganisation and structural change in search of greater operational efficiencies (Wood and Wrigley, 2007). The turbulence of the LBO wave thus *ultimately* led to a more efficient and centralised department store sector, better prepared to face the competitive threats of the 1990s.

FIGURES/TABLES

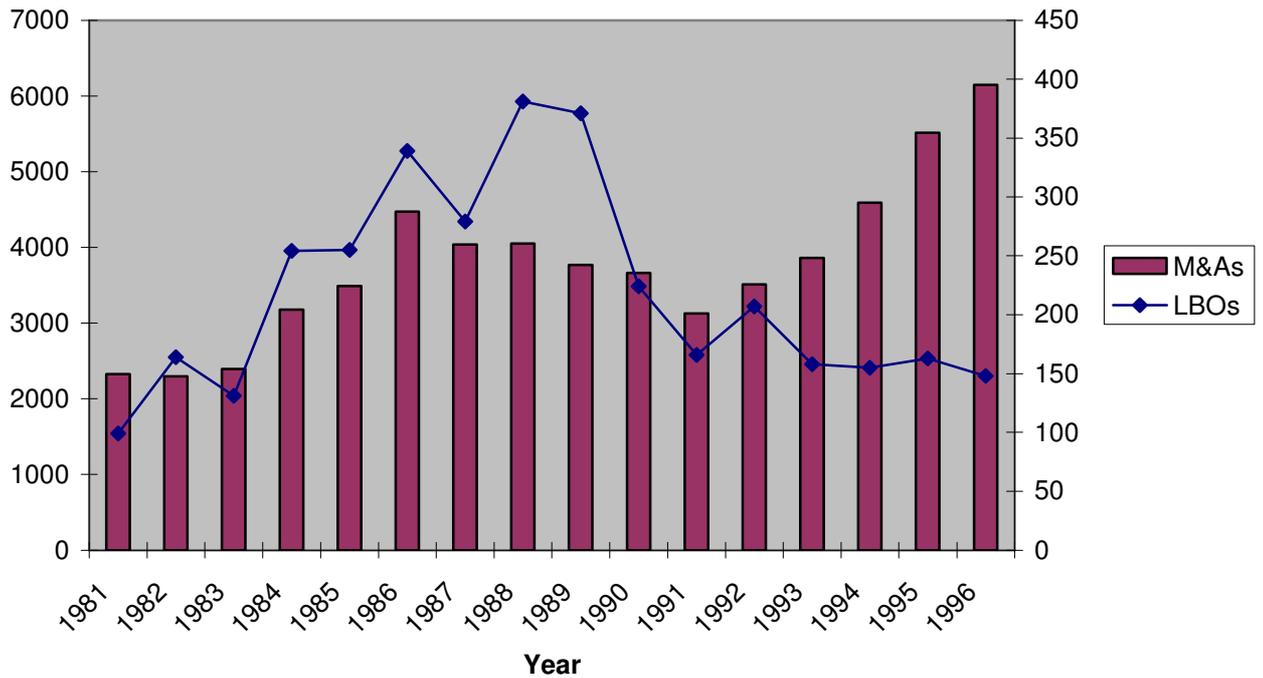
Table 1 Department Store Bankruptcies Following the Financial Restructuring Period

Date of Chapter 11 Filing	Retailer
January 1990	Allied/Federated Department Stores
April 1990	Ames Department Store
February 1991	Carter Hawley Hale
January 1992	R H Macy
June 1994	Woodward & Lothrop Department Stores

Source: author's own database

Figure 1

Completed U.S. mergers and acquisitions and leveraged buy-outs, 1981-1996



Source: data manipulated from Baker and Smith (1998)

Table 2 Diversification of Major US Department Store Companies

Dept. Store Corporation	Non-department store sales 1983 (%)	Major entry into:			
		Discount retailing Years	Example fascias	Speciality retailing Years	Example fascias
Allied	15	1961-1978	N/D	1979-early 1990s	Bonwit Teller Brooks Brothers.
Associated	35	1972-1976	Caldor Loehmann's	1916- acquired 1986	N/D
Macy's	0	1987- 1994 (acquired)	N/D	1970s/80s-1994 (acquired)	I Magnin Aeropostale Charter Club
Federated	28	1968-early 1990s	Gold Triangle (home furnishings) Gold Circle (off-price apparel) Main Street	1982-early 1990s	Children's Place
May's	29	1970-early 1990s	Volume Shoe	1979-early 1990s	Venture (shoe chain)
Dayton Hudson (now Target Corp.)	79	1962-present	Target Mervyn's	1966-N/D	N/D
Carter Hawley Hale	30	None	-	1969-acquired 1987	Contempo Casuals Holt Renfrew & Co. (Canada) Sunset House (mail order)

N/D – No data

Source: adapted, with modifications from Laulajainen, 1987, p 235. Additional data from various historic company reports

Table 3 Major Conventional Department Store Rationalisation, 1985-1995

Fiscal 1985			
Company	No. of Divisions	Sales (\$ millions)	Per Avg. Division/ \$ millions
Federated Dept. Stores	11	6,685	608
RH Macy	4	4,368	1,092
Carter Hawley Hale	6	3,979	663
Allied Stores	17	3,349	197
May Dept. Stores	10	3,327	333
Associated Dry Goods	10	2,724	272
Batus	5	2,300	460
Mercantile Stores	13	1,880	145
Dillard Dept. Stores	5	1,601	320
Dayton Hudson	2	1,448	724
<i>Subtotal</i>	<i>83</i>	<i>31,661</i>	<i>381</i>
Nordstrom	1	1,302	1,302
Total	84	32,963	392
Fiscal 1995			
Company	No. of Divisions	Sales (\$ millions)	Per Avg. Division/ \$ millions
Federated Dept. Stores	7	14,820 (a)	2,117
May Dept. Stores	8	10,612	1,327
Dillard Dept. Stores	5	5,918	1,184
Dayton Hudson	1	3,193	3,193
Mercantile Stores	5	2,892	578
<i>Subtotal</i>	<i>26</i>	<i>37,435</i>	<i>1,440</i>
Nordstrom	1	4,114	4,114
Neiman Marcus	2	1,888	944
Saks Fifth Avenue (b)	1	1,496	1,496
Total	30	44,932	1,498

(a) Includes results from acquired Broadway units; excludes Macy's Speciality and Close-Out operations

(b) Full-Line and Resort stores only; excludes Off 5th operations

NB Nordstrom, Neiman Marcus, Saks Fifth Avenue are categorised as speciality department stores and thus not included in the conventional department store industry.

Source: Goldman Sachs (1996) *Department Stores: Rediscovering the Reinvented*, Goldman Sachs Investment Research, New York, May 3, 1996, p 30.

Table 4 Federated Divisional Consolidations, 1982-1996

Year	Divisions	New Division Name	Comments
1982	Rike's (Dayton)	Shillito Rike's (Cincinnati)	
	Shillito's (Cincinnati)		
1986	Shillito Rike's (Cincinnati)	Lazarus (Cincinnati)	
	Lazarus (Columbus)		
1987	Block (Indianapolis)	Lazarus	Block acquired from Allied Stores
	Lazarus		
1988	Goldsmith's	Rich's	Memphis area retains Goldsmith's nameplate
	Rich's		
1992	Abraham and Strauss	Abraham and Strauss/Jordan Marsh	
	Jordan Marsh		
1994	Joseph Horne Co.	Lazarus	Acquisition
	Lazarus		
1994	Macy's East	Macy's East	Acquisition
	Abraham and Strauss/Jordan Marsh		
1995	Rich/Goldsmith's	Rich's/Lazarus/Goldsmith's (Atlanta)	
	Lazarus		
1995	Broadway (Broadway, Emporium and Weinstocks nameplates)	5 stores: Bloomingdale's 56 stores: Macy 21 stores sold	Acquisition of 82 stores
1996	Jordan Marsh	Macy East	Loses autonomy in Macy East Division
1996	Bullock's	Macy West	Loses autonomy in Macy West Division

Source: Various trade press literature and discussions with company executives

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