Channel Mastery Podcast, Episode #98: Kristin Carpenter Interviews Richard Kestenbaum, founding partner at Triangle Capital

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Kristin: Welcome back everybody, to another episode of The Channel Mastery Podcast. I am so, so delighted to introduce Richard Kestenbaum to you, who is partner, Triangle Capital, LLC, and a Forbes contributor, and one of the first guests ever, on the Channel Mastery podcast, over 100 episodes ago.

Kristin C.: It is so wonderful to have you back on the show, Richard.

Richard K.: Thank you so much, Kristin, it's so great to be here. You have such a great podcast.

Kristin C.: Oh, thank you so much. There are so many reasons that I love having you on the show, but one of them, and I know we'll get into this a little later is, the fact that you attend the specialty shows that my company, Verde Brand Communications attends in the outdoor active lifestyle market, but you also have a presence at a much broader I think, purview if you will, of broader market retail shop talk, all kinds of different thought leadership panels that you're involved in.

Kristin C.: You just are a fantastic resource. You can really see the broader picture, and also help tie it back to specialty, so I'm very excited to share your insights with my audience here today.

Richard K.: Thank you so much. It's great to be with you again.

Kristin C.: We have such an interesting topic, so we've been going back and forth on what would make a great next show for us I think, for quite some time, and the perfect topic emerged, I think. Here we are, heading into September of 2019. Obviously, holiday and budgets for 2020, everything is really ... we're at a lot of different precipices I think right now, in our businesses. In July of this year, Andria Cheng, who is also a Forbes contributor with you, one of your colleagues there, published an article titled, Study Highlights: The High Cost of Private Equity Firms' Retail Buyouts. That was in late July of 2019.

Kristin C.: I think that this is a great point, counterpoint for us to talk through today, because I think there are some misconceptions out there. Through this conversation, you're going to be revealing I think, some super interesting insights into how retail is evolving right now. Thank you so much for taking this on with me. I wanted to just ask, what was your thought on Andria's article? Obviously Amazon is usually the entity that we are using as a scapegoat in the quote, evolution of retail, and the correction of retail, but now, we're looking at private equity, so what are your thoughts on this, Richard?

Richard K.: Well, Andrea's article, and a lot of articles were generated at that time, about a report that had been issued, that described the number of retail jobs that had been lost at entities that were owned by private equity, because they had gone out of business.

Richard K.: It attributed the loss to the nature of private equity, and how private equity was driving these jobs away, so almost 600,000 of them in retail directly, and with the other businesses that were dependent on those companies that went bankrupt, and liquidated, almost 1.3 million jobs.

Richard K.: That's a serious and big thing, and I guess my problem with it is, I don't agree about the causality, the causal relationship that's implied by the structure of private equity, and the loss of those retail jobs.

Richard K.: My business is the mergers and acquisitions business. We represent companies, primarily retail, and consumer-related businesses, in the sale of their businesses, and sale of their companies, and generally, those transactions are between $10, and $250 million. Those are very often companies that are bought by private equity groups, so we have a lot of experience dealing with private equity firms, and we sit across the table from them every day.

Richard K.: You know, they're easy to dislike, and they're easy to make into the bad guy, because they're often rich, they're successful, they're ivy educated, they're based very often on the coasts, and their business is unemotional and rational.

Richard K.: Wall Street generally is a cutthroat place, and private equity is no exception to that, so it's comfortable to make a group of people like that, the scapegoat for problems in an industry. I understand why people say it's right. Their job is to put a lot of debt on a company, and acquire it with a small amount of equity. When you do that, it hampers a company's ability to adapt.

Richard K.: I understand how they got to where they got, but I don't agree with the conclusion of the report, or Andrea's article, and the many articles that were written in many publications, when that report came out, and I'll tell you why.

Richard K.: It's not secret that retail is in an upheaval, and so many companies are challenged. There are a few interesting data points that make us say that the report is wrong.

Richard K.: One is, it's almost impossible to find an established retailer who has adapted successfully, to the way the world is now. The changes in our culture, and the changes in our technology have been almost impossible for legacy brands, and retailers to adapt to.

Richard K.: What we are seeing instead is, young companies that have very few resources, being able to attack, and chip away at the market position of established brands and retailers, and they haven't been able to figure out a way to fight back.

Richard K.: Into that mess, comes private equity, to say, "We'll use our bag of tricks, to buy these companies inexpensively, because they are declining, and we'll reverse it."

Richard K.: Well, it turns out they were wrong, and they haven't been able to fix it. As a result of the high level of debt on those companies, they have been among the first to go bankrupt, and liquidate.

Richard K.: But, if they had, had a sustainable and good business, they might have gone into bankruptcy, but they would not have liquidated. When you see people like Toys 'R' Us, who at one point, were the largest seller of toys in the country, but it has been about 20 years since that was true. They have been in a decline in market share, since Walmart surpassed them.

Richard K.: When you see companies like that, being unable to turn it around, and Payless Shoe, and RadioShack, all of whom have been crippled, and now liquidated by the change in our culture, and technology, it's not really fair to blame it on private equity.

Richard K.: What's more true is that, those companies, like almost all retailers, have not been able to adapt to the way the world works now, and private equity fell victim to it.

Richard K.: If they had a plan, or there was an underlying good business there, what would have happened is, they would have gone bankrupt, and the private equity investors would have lost all their equity. The debt holders would have taken over the company, and they would have fixed it, and gone forward. They would have raised capital, in order to fix whatever problems there are, and they would have been able to repair the company, and build a great future.

Richard K.: What we are seeing now is that, legacy retail is such a questionable business, that even the biggest, greatest, highest level companies in the industry, have been unable to raise meaningful amounts of capital, or find acquirers. That's why Toys 'R' Us, and Payless Show, and RadioShack don't exist anymore.

Richard K.: Neiman Marcus put itself up for sale, and found no buyers. Nordstrom tried to raise capital, to buy out the public shareholders, and couldn't find a partner. Barney's is on the market, and there's no buyer that's emerged yet. They have until October 31st. JC Penny has a questionable future. Those things are not private equity deals. Actually, some of them are, but not all of them are, and private equity is not a cause of their problems.

Richard K.: I don't buy the idea that private equity is responsible for the loss of all of these jobs or the destruction of all these companies. I think the company's strategy has been unable to adapt.

Kristin C.: It seems like it's continuing to evolve. From what I'm hearing you say, we're going to see less and less private equity plays in trying to, I think, hoist these companies back to a healthy business. Would you agree with that?

Richard K.: Yeah, and it's not just private equity. We are not seeing any major investors going into traditional legacy retailers at this time.

Kristin C.: That's really interesting. At the same time, Richard, I'd love to hear if you have seen something more current, but I still have seen that between 80% and 90% of all sales are still happening in retail, but it's almost as a last mile solution, it sounds like, not so much a place where people go to shop and what they did historically within retail, in these legacy retailers at least.

Richard K.: Well, I think there's truth and not so much truth to that statement. It's so interesting, millennial consumers like stores a lot less than their parents did, but Gen Z consumers like stores more than millennial consumers. Stores have an important function, and they will continue to have an important function. But stores have a different purpose now because we are seeing buy online, pick up in store. We're seeing buy online, return in store. We're seeing events in stores. Stores have to act in different ways. For that, we need new ways to measure what we want in stores.

Richard K.: It used to be true that every store owner would look at very similar metrics like store profitability, and sales per square foot, and growth in sales per square foot. Those things are still critically important, but they don't tell the whole story because if what you're looking for is a store to stimulate sales in its catchment area of online sales and mobile sales, then that's harder to measure. We need different metrics to decide what a store does. Every store is different than every other store. You may want a store that sells footwear to perform a different function than a store that sells jewelry. Within a larger store that sells multiple classes of product, you may need to measure the way a store performs in their jewelry sales different than the way you measure their performance in footwear. We're getting into a very complex area in a complex time, and it's not clear how now to measure the effectiveness of a retail store.

Kristin C.: I wonder when that will become more clear and if that has anything to do with the fact that the way that entities are investing in retail is changing. Obviously they had probably a framework they looked at with a timeline to try and create some sort of a risk assessment around it. It sounds like that's all changing of course as the consumer continues to evolve.

Kristin C.: One of the things we talked about before we hit record, which I think is so important to mention, is Amazon obviously used to be the main scapegoat and I think still is in many conversations. But as you said to me in our call prior to us pressing record here, Amazon doesn't have to make money. It does seem like we're in a little bit of just a gap jump here because I think that retail is important. We're just seeing a lot of forces upon that as it continues to evolve and correct. Here we are heading to the end of 2019, going into

2020, and I just feel like I don't have a lot more clarity than I did a year ago, frankly, you know?

Richard K.: I would understand if people blamed Amazon more than they blamed private equity for the demise of retail jobs because not having to make a profit on trying out a new idea is really hard to compete against. If Amazon is your direct competitor, they're very hard to beat. That's not true of private equity. One of the legitimate concerns about private equity is if your competitor has been bought by a private equity firm, it's going to be hard for them to make major changes in the first couple of years because they're going to be burdened by debt. One of the things that private equity counts on is that there is a plan locked and loaded that will work that doesn't require additional capital when the company is all leveraged up. Amazon can throw money at problems, and challenges, and opportunities that other people can't do.

Richard K.: Coming back to your subject, if I may, about stores and where to open them, one of the things that's important is heat maps. That is to say if you look at a map of where online and mobile sales occur and you find the reddest areas, those are often places that are great venues to drop a retail store. The other thing that's important about a heat map is measuring the heat map around a store. Are your stores being effective communicating to their community that they can buy and be serviced in the store? It of course varies by the type of product that you're selling, but the heat map is something that didn't really figure in in retail store location in the past. But now it's very important because it reflects what's going on around a store location in online sales and marketing.

Kristin C.: That's a great point. I always like to bring Channel Mastery back to specialty. You're very familiar, which I'm so grateful for, with the markets that this podcast was launched for, obviously those markets that my agency serves, which are the outdoor active lifestyle markets. But it's now starting to be picked up and shared by other specialty markets as well. I feel like what you could share could help a lot of different sectors out there. Where do you see the focus? Where should the focus be for smaller stores like that?

Richard K.: If we can talk about active outdoor, which is just a sector I love working in because I love the subject matter of the retail, it's hard because they can never have the resources of their larger competitor. What they lack in resources, they compensate for in passion. That's important not just for the store owner and the people who work in the store, but it's important for the customers. What we're finding about the change in culture that has been so challenging for legacy retailers is we used to find that people found identity in family, and extended family, and traditional religion. That's less true over time, and it's less true by age. People are looking for identity, association, and ultimately meaning in the things they buy. Active outdoor sports is very well-suited for people to find meaning in. That is why the passion of a business is so relevant, because people identify with it.

Richard K.: Why do I say that about active outdoor sports? Because so many of the people who are customers of specialty stores in active outdoor are people who have good incomes but very limited time, and they love their active outdoor sports. Because they love it, because it's one of the things that they feel differentiates them and brings pleasure to their life, it's one of the things they find identity and meaning in. Therefore, when they find the products and the people that resonate with them, they're willing to pay full price. They keep coming back, and they tell their friends who share their values. That's exactly the kind of thing that leads to success. It's exactly the kinds of things that people like Toys "R" Us, Payless Shoe, and Radio Shack were not able to create. When you're a specialty store, you're specialized because you have specialized knowledge and you have a specialized culture that revolves around your product or service. That's critically important for your customer to come and for your customer to come back.

Kristin C.: Let me ask you this. I love everything you're saying. Obviously it's exactly what we have been finding through the 100 episodes we've done. It's still true, which I'm super grateful for. It's true for pet, it's true for baby. There are different industries I think that are discovering that as well, that human to human connection, if you will, the identity and meaning. I totally agree with all of that. We still are working to gain favor with, earn the attention of a consumer that is used to a more sophisticated experience on some level. From what I hear you say, right now and looking at the world that you look through every day, which is editorial as well as your work at Triangle Capital, you're still seeing that this is playing in our favor even over tech because tech is something that I think stacks the deck, as you said, against us. There isn't a level playing field when we are not able to capture and deploy data to create customer experiences on the level that broader market retail does. Some of them I would consider specialty.

Kristin C.: REI obviously is very much in our zone, but they have, I think, the means to be able to invest in this more so the tech and the data. They have a membership, for example. I'm always worried what is the pivot point there. I feel like there's always in the DNA of the human being, they want the storytelling, and the tribe, and the human to human connection. That ultimately to me is what specialty is and should be tethered to. I'm just hoping that it remains as things become more and more sophisticated out there in terms of customer experience and what they're used to in all other facets of their lives.

Richard K.: Amazon is fantastic and they're almost impossible to beat. But buying tee shirts from Fruit of the Loom is not the same as buying an occasion dress from Oscar de La Renta. There is no substitute for knowledge in a store and guidance that you can give a consumer. And that creates great loyalty. You know, we have this idea now, I think the airlines have trained us all to believe, that the word loyalty means I give you points which are a substitute for money. I'm going to pay you to be loyal to me. There's another name for that, but it's not loyalty. Loyalty is about the same thing that happens when two humans are loyal to each other. They do things for each other that create a bond. When you give a consumer guidance, they are grateful. When they use the product or service you sold them, they remember you, and they think positively of you and they tell their friends about you. And they keep coming back.

Richard K.: And that's just not the same as going to Amazon and getting the diapers that you want, and you know exactly what you need. It's just not the same. That's where specialty has an advantage that's really hard to beat. Where specialty will suffer is if it tries to commoditize its product. If it loses focus on the customer experience in the store, and the relationship with the customer. So training, knowledge, critically important for specialty to continue to be important.

Kristin C.: Totally agree. Investing in humans. And also I think it is important as retailers in our space and brands in our space who are also retail are keeping track, close track, of what consumers are expecting today. But then again grafting on that loyalty which creates reciprocity ultimately. And that is, I think, our ace in the hole.

Richard K.: There's one more thing that's a challenge we tend not to talk about when we talk about knowledge and guidance. And that is wages. There's a lot of upward pressure on minimum wage and store talent. And there's no great answer because every dollar you pays is a dollar you don't have anymore. But as there's no substitute for continuing to invest in knowledge, there is no substitute for continuing to invest in quality people who are capable of interacting with consumers on a knowledgeable basis.

Kristin C.: I totally agree and I think that is something that is really important to bring to the forefront. Earlier in 2019 when I was doing my panels at a couple of the trade shows, it was focused on leveling the playing field, and finding some SaaS providers that serve specialty. And that's an investment too and it can really create fragmentation in your business if you're buying these bright shiny solutions, and not thinking about the integrated perception and experience that your consumers having, and I feel like the people are the ones that can really deliver that, especially when they're there for a long time, and they're invested in doing a great job. And really I think have buy-in on the heart and soul of what specialty is, especially in these industries that need specialty retail.

Kristin C.: I have one quick question before we wrap up here too. It may actually have a lengthier answer. We'll see where you think it might go. If you look at who might be investing in retail, especially in specialty, and obviously we've seen Walmart purchase Moose Jaw and we had kind of a crazy thing happened around that last year at this time. But then we also have Marcus Lemonus and his Good Sam Club and that's a big entity as well, having purchased Uncle Dan's and Rock Creek and I think a couple of other specialty, small chains. Are those the type of investors that we're probably going to see over private equity in the future for certain segments of retail? Ones that can actually create scale and leverage certain things to help these smaller shops, while also I think buying the community that the small shop created. What are your thoughts on that?

Richard K.: In general there are two types of acquirers. One is strategic and one is financial. The difference between them is, a strategic investor has a business that benefits in some way from the acquisition or combination of the business being acquired. A financial investor is someone who buys businesses the way you might buy an interest in a public company. You buy it, somebody else runs it. Hopefully they build it so that you can either sell it for higher value or get a big dividend at some point.

Richard K.: The way in which you find or choose the right acquirer depends a lot on the individual company. What it needs, what management talent it has, and what the goals of the company are. I don't think that will change. What will change is the players in the market. There's a lot of talk now about Walmart selling some of the things that it has acquired, and if that were to happen, then they would probably be less aggressive about acquisitions. That's just what history tells us. But people are coming into this market all the time.

Richard K.: One of the things that's always been true in good markets and bad is that there's an excess of capital and a shortage of opportunity. And you might then ask me, well then why didn't someone buy Toys R Us, Payless or Radio Shack? Because they don't perceive it as an opportunity. So, investors are very discerning about what they buy. Most strategic and financial investors look at hundreds, sometimes thousands of companies before they choose one to invest in. And it's true that sometimes they move in groups, where one buyer buys something, other people feel that they then have to have it, or they're going to miss out. And so you see like companies or related companies getting bought up in bunches.

Richard K.: But we will continue to see lots of capital available, but only for the right opportunities. Investors want growth and gross margin. When you have strong growth and strong gross margin, you get a very high price. Everything that detracts from having both those things is a ding on the price.

Kristin C.: Right. We'll have to see how that unfolds. And again, I asked about that entity specifically, because the work that we do in RV and overland and obviously outdoor and some of the other industries we're in, we're watching to see what pulling those companies together is going to do for the broader consumer, and what the opportunity in the portal is going to bring in, and change in terms of how other entities are running their businesses in these specialty markets.

Richard K.: Great question, great topic.

Kristin C.: It might be like a whole other book we could write together, Richard.

Kristin C.: And I wish you had a crystal ball. You brought a very close second to a crystal ball here today, and I really appreciate that. I'm proud of myself for not saying, well what's your thought on holiday? What's your thought on a 2020 trends? We kind of need to look at it right now. I think, in analyzing the point counterpoint that we did today, is a great jumping off point for understanding the landscape more so, and really kind of getting clarity on why things being purchased and why they're going bankrupt. And why we're still seeing things correcting it. I think that we're still probably over stored, would you agree?

Richard K.: Yeah, we're over stored, and we are wrongly stored. We have so many stores that are open that haven't adapted to what consumers want. They don't have the service and they don't have the events. And that's a huge opportunity for retailers who can get it right for their markets and products.

Kristin C.: Absolutely. Well, I think that again, is there anything that I missed in terms of our initial topic here with private equity and retail?

Richard K.: Kristin, you're a great interviewer.

Kristin C.: Oh, thank you.

Richard K.: And thank you for having me.

Kristin C.: Oh, you're so welcome. I'm really looking forward to having you back. It was wonderful to have you back on the show because literally, I remember last time I interviewed you, I was so, so nervous, just so you know.

Richard K.: Well it didn't seem that way.

Kristin C.: Thank you. But now that I've gotten to know you, and obviously, read all of your writing on Forbes, I'll put links to a few articles in the show notes. I just really can't believe the level of insight you bring. You've helped our community here at Channel Mastery so much. So anytime I can get you on the show, I will take advantage of that. So thank you so much for your time.

Kristin C.: All right. Until next time, Richard. Thank you.

Richard K.: Thank you.