Wealth Effects of Retail Store Closure Announcements

WHAT WAS THE RESEARCH QUESTION?

Retailers regularly make strategic decisions about the right mix of stores to serve their market. Store openings and closings form part of the rhythm of business in the retail sector.

When a retailer decides to close a store, the motivation is often to cut costs or stop losses. But what are the broader impacts of store closing? *How do store closures influence stock prices and company value?*

WHY IS THIS STUDY IMPORTANT?

Although store closures feature commonly in retail strategy, we know little about their repercussions. Because minimal research has been done in this area, retailers may be operating on false assumptions about how closures truly affect a company's overall financial picture.

To make sound decisions, retailers need to better understand the cost-benefit trade-off of the decision they're making when they shut a store.

HOW DID THE RESEARCHERS CONDUCT THE STUDY?

First, the researcher collected 194 store closure announcements, dated from 1984 to 2017. None of the closures were due to bankruptcy or liquidation.

For each closure, the study tracked the retailer's stock price within three days of the announcement (the day before, the day of, and the day after the announcement). This three-day window accounted for any news leaks that may have anticipated the official closure announcement as well as any delayed reactions from the shareholders.

Second, for each store closure announcement, the study examined the stock prices of 157 close competitors, within the same three-day window. For example, Walmart's 2016 announcement that it would close 269 stores globally was linked with stock prices for Target.

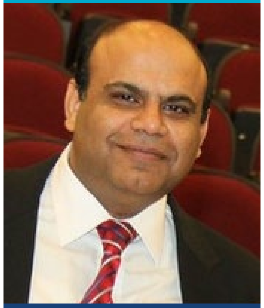
WHAT WERE THE MAIN FINDINGS?

When a retailer decides to close a store, they assume that the benefits to the organization as a whole will outweigh the costs. They act on the theory that making a visible strategic choice will increase investor confidence.

However, this study found that store closures produced the opposite effect: investor confidence decreased, resulting in a market capitalization loss of $168 million for an average company in the sample, over the three-day window.

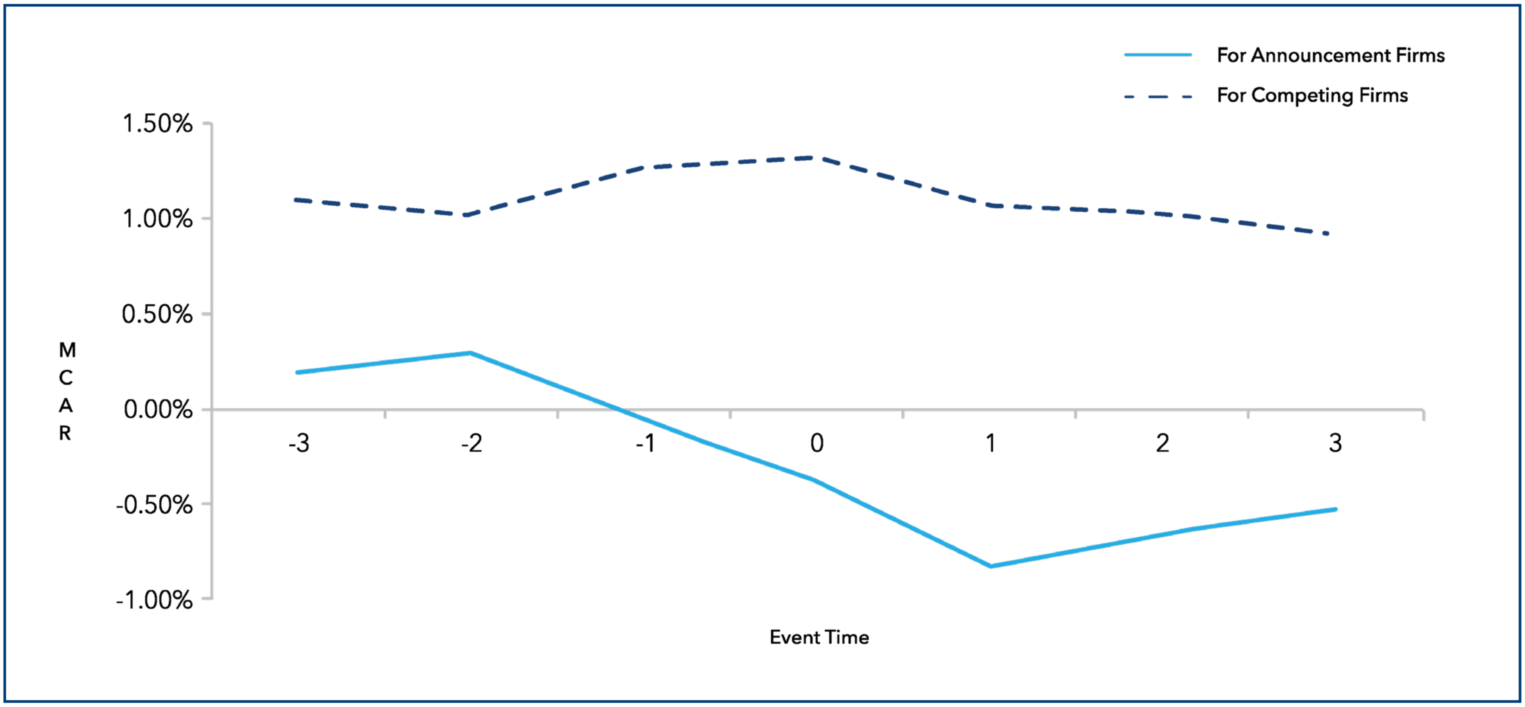
At the same time, the store closure announcements correlated with increases in the stock prices of the competitor firms. Over the three-day period, the average increase in value for competitor companies was 1.83%, compared with a 0.65% decrease for the firms announcing closures.

Abdul-Rahman Khokhar, "Wealth effects of retail store closure announcements," Review of Pacific Basin Financial Markets and Policies (forthcoming)



Stock market response to store closure announcements

The table below shows the change in stock returns (the Mean Cumulative Abnormal Returns, or MCAR) for announcement firms and their close competitors. Day 0 on the timeline is the day of the announcement.



HOW CAN YOU APPLY THE FINDINGS IN YOUR BUSINESS?

The next time your organization is reviewing a list of stores that could be closed, hit the pause button and reflect on the overall financial consequences that could result:

- Take into account the potential impact of store closures on the company valuation.
- Consider how closing a store might increase the valuation of your competitors.
- Evaluate possible effects of the market response to a closure, such as market share and cash flow issues.
- Brainstorm marketing strategies to mitigate losses to your valuation and maintain your competitive edge.

On the other hand, when you notice a competitor closing stores, think about how you can seize that opportunity to increase your firm's valuation.

While store closures may seem routine, viewing them in terms of a firm's overall wealth can offer strategic advantages to all market players, no matter which side of the closed door you find yourself on.