Congressional Briefing on Toys "R" Us

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I am Eileen Appelbaum, Co-Director of the Center for Economic and Policy Research and co-author of the award-winning book, *Private Equity at Work: When Wall Street Manages Main Street.*

Thank you for the opportunity to speak about the liquidation of Toys "R" Us and the loss of more than 30,000 jobs and the closing of hundreds of stores that are anchor stores on Main Streets and malls across the country. It is a privilege for me to stand here among Toys "R" Us workers from across America who have come to tell Congress and the nation what it means when Wall Street firms turn Main Street companies into their personal piggy banks.

The Wall Street owners want to point their fingers at Amazon and blame "disruption" for the demise of Toys "R" Us. Yes, Amazon has been a disruptor, but disruption is nothing new to retail businesses. Every downturn in the economy disrupts their business — consumers don't need a new suit of clothes or an expensive toy for their child if they are worried about losing their jobs. Every change in style is a potential disruptor since retail stores place orders well in advance of when items reach their stores. Every new business model — for example, Zara's where inventory turns over every few weeks — is a disruptor.

Retail stores learned long ago how to live with disruption. Keep debt levels low so interest payments are not a threat, and make sure the stores own their property and make the decisions about how the real estate is to be used.

Before private equity firms Bain Capital and KKR and real estate firm Vornado acquired Toys "R" Us, that was how the toy store chain operated. Its capital structure was 30 percent debt and 70 percent equity and it owned and controlled the real estate that housed its stores. This allowed the chain to muddle through downturns, respond to disruptions, and make a profit and expand in good times.

But when Bain, KKR, and Vornado bought the toy store chain in a leveraged buyout, they turned these operating principles upside down. Toys "R" Us was attractive to the Wall Street firms because its low debt meant they could load it up with lots more debt. And load it up they did. When the buyout was completed, Toys "R" Us had a capital structure that was a whopping 78 percent debt and 22 percent equity. When things got really bad, the owners of Toys "R" Us used the real estate that housed the stores as collateral for still more loans. The burden of all those interest payments is what really did in the toy store chain. Try finding money to invest in an online presence so you can compete with Amazon when your Wall Street owners loaded you up with $5 billion in debt when they bought you and kept adding on to as you paid the old debt down. The kicker is that the Wall Street firms don't have to pay back a penny of this debt — all of it is on the back of the toy store to repay.

And that's not even the whole story. When the Wall Street firms bought Toy "R" Us, they made the chain sign an agreement to pay millions of dollars in monitoring fees to their Wall Street owners. It's not clear what services, if any, were provided, but over the life of the agreement Toys "R" US paid Bain, KKR, and Vornado $61 million each. That's $180 million paid out that the toy store chain could have used to invest in a twenty-first century retail operation. For Bain, that amounted to a net profit on their investment of $17 million; KKR had a net profit of $14 million. And this does not include expenses and other fees these Wall Street firms charged to the company. Not the winnings the Wall Street firms were hoping for, but a very nice consolation prize.

It's no wonder that Toys "R" Us could not deal with "disruption" — all the resources for doing this went out the door in payments on its debt or in fees to its Wall Street owners.

The 30,000 workers who are losing their jobs are owed something for building an iconic toy store chain beloved by generations of parents and children. Toys "R" Us may be bankrupt, but the Wall Street owners that drove it to this sorry state clearly are not. They should be required to give these workers generous severance pay in recognition of their years of dedicated service and to provide a modicum of support for them while they regroup and figure out their paths forward. It's the very least Wall Street owes them.

Thank you.