Who Killed A&P?

Introduction

In the summer of 2015, the Great Atlantic and Pacific Tea Company (A&P), the nation's first supermarket chain, declared bankruptcy for the last time, sold off as many of its stores as it could, and liquidated its remaining assets. A&P's downfall played out in slow motion over decades, but its ultimate disappearance happened at breakneck speed in a matter of weeks, with tragic consequences for the 7,000 workers who lost their jobs.

Managers for the company – and some of the press – blamed A&P's bankruptcy on the costs of union workers' wages, pensions, and health care. As one editorial put it, "the real reason for A&P's demise: unions."[1] Managers claimed the company could not afford to pay living wages and decent benefits. These "burdens," they claimed, restricted A&P's operational and financial "flexibility," meaning the company could not make the investments and operational changes necessary to win customers and grow.

But were workers and their union-negotiated wages and benefits really to blame for the iconic brand's disappearance?

The short answer is an emphatic "No." As this report will illustrate, union workers were the flexible ones, making sacrifices – including losing their jobs – to keep the company afloat, while executives kept receiving bonuses as the company went through two bankruptcy procedures in four years. A&P ownership and management – not union workers – bear responsibility for the company's failure. Their decisions – not the costs of union labor – left the company saddled with debt, burdened by aging stores, and offering an unattractive product mix. Management -- not union workers – allowed stores to deteriorate, refused to bring in new products, and failed spectacularly to attract customers. As a result, A&P lost revenue, market share, and, ultimately, its life.

Long Struggling

A&P's decline took decades. From the early 1970s to the early 1980s, the company went from over 4,400 stores to fewer than 1,000. Though the company experienced short periods of growth in the 1980s and 1990s, by the early 2000s the company had shrunk to fewer than 400 stores. Then, in 2007, management decided to purchase the Pathmark chain of about 140 stores for $1.4 billion in cash, stock, and debt. That transaction left A&P with 450 stores, but more than $1 billion in debt and dozens of struggling locations, just as the 2009 recession hit and sales plummeted.[2] By the fall of 2010, the company was losing millions of dollars each month and struggling under massive debt of more than $1.2 billion, plus $147 million owed to workers' pensions and $232 million own on leases for stores it was not using.[3]

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1 "Unions, Not Competition, Sank A&P," *Investor's Business Daily*, July 22, 2015, via *Nexis.*
2 Mike Spector, "Everything You Need to Know About the A&P Bankruptcy," December 13, 2010, *Wall Street Journal*, http://blogs.wsj.com/deals/2010/12/13/everything-you-need-to-know-about-the-ap-bankruptcy.
3 Declaration of Frederic F. Brace (A) In Support of Debtors' Chapter 11 petitions and First Day Pleadings and (B) Pursuant to Local Rule 1007-2 2 of the Local Bankruptcy Rules for the Southern District of New York, *In Re The Great Atlantic & Pacific Tea Company, Inc., et al.*, case No. 10-24549, Docket #7, filed 12/12/2010.

Even before the recession hit, A&P was losing market share. In the year before the 2007 merger with Pathmark, market share in the New York City area dropped to 13.1% from 14.5%. After the merger, the combined company continued to lose market share in all its large markets. Between 2008 and 2014, market share fell every year in New York City, from 25.1% to 15.4%, in Philadelphia from 11.7% to 7.7%, in Bridgeport and Stamford from 6.7% to 2.9%, and in Allentown from 8.5% to 4.6%.[4]

To escape its financial burdens, A&P filed for its first bankruptcy in December 2010, with a plan to shed liabilities and keep operating. In a year under bankruptcy protection, the company closed 75 stores, dismissed 5,000 workers, shed its unneeded leases, restructured its supply agreement, and reduced its debt to about $490 million.[5] In addition, A&P management demanded and received concessions from its union workers. The workers agreed to wage cuts, a wage freeze, reduced sick time, and reduced vacation. In total, the union givebacks were worth $625 million over five years.[6] In return for the cuts, the workers insisted that management invest $100 million each year into the company, whether in the form of price cuts for groceries to attract customers or in construction and renovations. Management agreed.[7]

A&P emerged from its first bankruptcy in March 2012 in the hands of private investors. For the first six months of 2012, A&P lost $28 million per month. In the second half of 2012 and through 2013, the company sold assets to reduce its debt and generated $121 million in operating income. Yet, sales were down 7.6% in 2013, and, after including all the expenses related to its debt, the company lost $68 million that year. The situation got worse in 2014, with a 6% sales decline and a net loss of $305 million.[8]

Despite management's pledge, A&P invested barely $50 million per year in price cuts or store improvements, a drop in the bucket with total sales greater than $5 billion. As management later admitted, A&P had "fallen behind with respect to technology and other related areas—placing the [company] at a competitive disadvantage when compared to [its] traditional and non-traditional peers."[9]

A&P was caught in the vice of falling sales and high debt. On the one hand, falling sales meant that the company could no longer generate enough income to pay its debts. On the other hand, the burden of all that debt meant that the company could not invest enough in the stores to make them attractive enough to keep and grow sales.

A&P's situation continued to deteriorate in 2015. It burned through $14.5 million per month from March through June, and in July the company started to miss payments to suppliers and other creditors. Facing the reality of defaulting on its debts and losing control of its assets, the company had no choice

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4 Metro Market Studies, various years.
5 "Burkle Era Begins As A&P Exits Chapter 11; Martin Remains CEO Of Revamped Chain," *Food Trade News*, March 2012, http://best-met.com/news/burkle-era-begins-a-martin-remains-ceo-revamped-chain/
6 Maria Panaritis, "How A&P Emerged from Bankruptcy," *The Philadelphia Inquirer*, December 11, 2011, via *Nexis*; David Willis, "Workers Approve Concessions in Deal with A&P, Pathmark," *Asbury Park Press*, December 1, 2011, via *Nexis*.
7 Maria Panaritis, "How A&P Emerged from Bankruptcy," *The Philadelphia Inquirer*, December 11, 2011, via *Nexis*.
8 Declaration of Christopher w. McGarry Pursuant to Rule 1007-2 of the Local Bankruptcy Rules for the Southern District of New York, *In Re The Great Atlantic & Pacific Tea Company, Inc., et al.*, case No. 15-23007, Docket #4, filed 7/20/15.
9 Declaration of Christopher w. McGarry Pursuant to Rule 1007-2 of the Local Bankruptcy Rules for the Southern District of New York, *In Re The Great Atlantic & Pacific Tea Company, Inc., et al.*, case No. 15-23007, Docket #4, filed 7/20/15.

but to declare bankruptcy, again. This time, however, the plan was to sell as many stores as possible and close the rest.

The Disappearance of A&P

When A&P filed for bankruptcy protection in July 2015, management had given up any hope of saving the A&P brand or any of its subsidiary brands, including Pathmark, Food Emporium, Waldbaum's, Food Basics, and SuperFresh. Instead, management hoped to sell as many stores as possible for as much money as possible. Proceeds from the sales would go to creditors in a complex hierarchy established by bankruptcy law and the bankruptcy judge assigned to the case. At the top of the hierarchy sat banks and investors; at the bottom were the employees. Only after the banks and investors got their payouts would the employees receive theirs.

Through a complicated auction process that took place in less than five months, A&P sold 199 stores to new owners who would keep them open. Ninety-six stores closed. And A&P, once the oldest and largest grocery chain in the United States, disappeared.

The Impact: Workers

The auction process broke A&P into many pieces, with stores sold to a number of different grocery chains, including Stop & Shop, Best Yet, Acme, and Allegiance. The new owners of 109 stores negotiated new union contracts, saving wages, healthcare, pensions, and other benefits for 11,000 workers. In the end, of the 29,000 employees at A&P when it entered bankruptcy, 7,000 lost their jobs.

Throughout the bankruptcy process, the UFCW did what it could within the law to aid A&P workers. For workers who lost their jobs, the union convinced the bankruptcy judge to increase severance payments from the company, which meant a few hundred dollars more for the workers.

Executive Windfall

Top A&P executives also lost their jobs in the bankruptcy, but they were able to cushion the blow in advance. In addition to awarding themselves high salaries and bonuses, they created an unusual $6 million "trust" that made payments to executives 10 weeks before the bankruptcy. Greg Mays, chairman of the board of A&P, received $2.5 million from the trust and a total of $4.6 million in the year before the bankruptcy. On top of his $750,000 salary and $225,000 bonus, CEO Paul Hertz received $1.5 million from the trust. Chief restructuring officer Christopher McGarry received a $1.5 million payment from the trust, on top of his $250,000 salary, $225,000 bonus, more than $20,000 in holiday and vacation pay, and $700 per month car allowance.[10]

By comparison, workers laid off from A&P as a result of the bankruptcy received an average severance of $5,000.[11]

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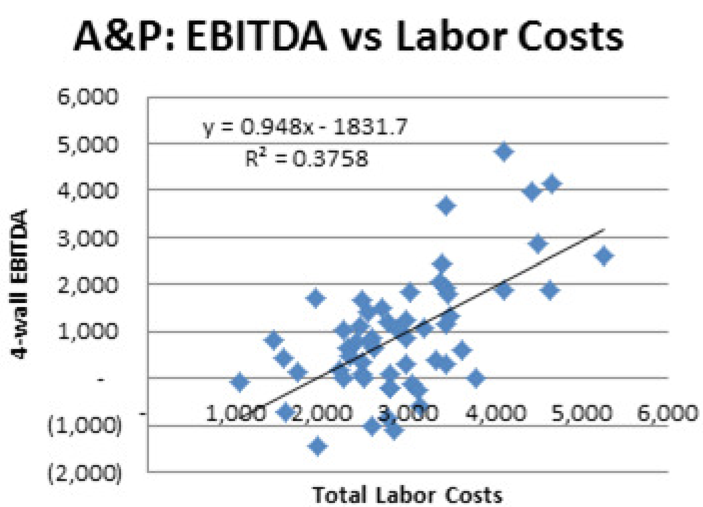
10 Statement of Amended Financial Affairs, *In Re The Great Atlantic & Pacific Tea Company, Inc., et al.*, case No. 15-23007, Docket #1121, filed 9/30/15.
11 Statement of Amended Financial Affairs, *In Re The Great Atlantic & Pacific Tea Company, Inc., et al.*, case No. 15-23007, Docket #1121, filed 9/30/15; Joan Verdon and Kathleen Lynn, "Payouts to A&P Bosses Criticized; Chairman Got $4.6M Before Bankruptcy, *The Record*, October 1, 2015 (available at http://www.northjersey.com/news/a-p-discloses-execs-who-received-millions-in-payments-before-bankruptcy-filing-1.1422990).

The Myth of Unsustainable Union Costs

The heart of the argument that unions caused the A&P bankruptcy rests on the assertion that the high expense of union wages and benefits eroded the company's profitability. A corollary to this argument is the claim that union work rules tied management's hands and undermined labor productivity.

At A&P, the evidence does not support these claims. Quite the opposite. For the most part, stores with ***higher*** labor expenses on a per-square-foot basis had ***higher profits*** than stores with lower labor expenses. There were a few exceptions, but, for the stores as a whole, profitability increased as labor costs increased. [12]



This suggests that union labor is not a wasteful burden. In fact, union labor would seem to be quite productive. Where A&P spent more on labor, that labor produced profits that more than offset the higher labor expense and produced a greater level of profit.

Management's Failures

Responsibility for A&P's demise lies with the men and women who owned and managed the company over the years. Chief among their mistakes was their failure to respond to the changing marketplace, including the emergence of warehouse superstores, dollar stores, convenience stores, and specialty grocers. A&P managers admitted this in their bankruptcy filing: while our "competitors realized new technology platforms, remodeled and enhanced their stores, and implemented localization strategies geared toward tailoring each store to specific neighborhood needs, [we] have not been able to invest in creating an operational distinction between [our] various 'banners' and tailor stores to customer needs."[13]

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12 We examined total labor expense and earnings before interest, taxes, depreciation, and amortization on a square foot basis for all A&P stores in the fiscal year before it declared bankruptcy. More detailed data for more years would have allowed for multi-variate analysis that would have allowed us to test various hypotheses with more certainty.
13 McGarry Statement

Industry experts agreed. “They got caught in a downward spiral of sales declines that forced them to cut costs,” said Jim Hertel, a grocery industry consultant at Willard Bishop LLC. That led to problems hiring enough qualified staff, chronic product shortages, and an inability to match heavy discounts at rivals. “You have higher prices, but the stores are dirty and have empty shelves, so they lose all value proposition,” he said.[14]

"A&P really did nothing to combat the new and stronger competition," said Matthew Casey, an analyst with Matthew P. Casey & Associates. "Their store volume and amount of business they do (now) was a fraction of what it once was."[15]

Another industry expert, Burt Flickinger, managing director of retail consultant Strategic Resource Group, blamed A&P's problems on poor supply-chain operations, haphazard merchandising, weak hiring practices, and, above all, poor corporate management. He noted that in 2010 A&P hired a chief executive from United Airlines with no experience in grocery. “"He didn't understand the rhythm of retail," Flickinger said.[16]

Competition

As A&P was losing sales and market share, several of its competitors gained sales and market share. In many cases, these competitors had labor costs as high, or higher, than A&P. For example, as A&P’s market share plummeted in the New York Metro area from 30% in 2006 to 14.8% in 2015, the biggest gainers were Shop Rite (+10.8 percentage points), Stop & Shop (+3.5), Fairway (+2.9), and Key Food (+2.2), all of whom are unionized grocers. [17] Other gainers included Trader Joe’s (+1.5) and Whole Foods (+1.2), which have labor costs that are higher than average. This strongly suggests that labor costs were not the main driver of A&P’s lost market share.

Conclusion

The data demonstrates that the costs of the union contract did not lower profits and did not constitute a competitive disadvantage. Unions did not cause A&P’s bankruptcy. A&P disappeared because it did not keep up with its competition. Management and ownership did not make the investments and marketing decisions necessary to keep up with competition. So who killed A&P? Management and ownership.

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14 Annie Gasparro and Joseph Checkler, “A&P Bankruptcy Filing Indicates Likely Demise,” *Wall Street Journal*, July 20, 2015 (available at http://www.wsj.com/articles/a-p-files-for-chapter-11-bankruptcy-1437391572).
15 Clyde Hughes, “A&P Bankruptcy: Supermarket Chain Enters Chapter 11 for Second Time,” Newsmax.com, July 20, 2015 (available at: http://www.newsmax.com/TheWire/ap-bankruptcy-supermarket-closings/2015/07/20/id/658017/).
16 Joel Wee, “A&P Bankruptcy to Shutter Local Pathmark, Super Fresh Stores,” *Philly.com*, July 22, 2015. (available at: http://articles.philly.com/2015-07-22/business/64687811_1_bankruptcy-filing-pathmark-bankruptcy-process); see also Burt Flickinger, “The Flickinger Files Part 3: H-E-B, Bi-Lo Holdings, A&P,” Strategic Resource Group Insight, May 15, 2015 (available at: http://srginsight.com/the-flickinger-files-part-3-h-e-b-bi-lo-holdings-ap/).
17 Data from Metro Market Studies.