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Joanne Coulombe leaves a Target store in Saint-Eustache, Que., on Thursday, Jan. 15, 2015. (Ryan Remiorz/THE CANADIAN PRESS)
Joanne Coulombe leaves a Target store in Saint-Eustache, Que., on Thursday, Jan. 15, 2015. (Ryan Remiorz/THE CANADIAN PRESS)

How Target botched a $7-billion rollout

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Target Corp.'s first foray outside of its U.S. home market has ended in disaster.

The Minneapolis-based discount retailer, known to fashionistas as Tar-zhay, said on Thursday it will leave this country after having launched its first stores here nearly two years ago and invested an overall $7-billion in the Canadian rollout.

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In a botched strategy by overly confident executives, Target grappled with shoppers who complained of too-high prices and bare shelves. The retailer never ran an e-commerce site here and operated stores in former Zellers locations that often looked much like the ones of the faltering Canadian chain it replaced, in the same red and white hues.

As Brian Cornell, chief executive officer of parent Target Corp. since August, said in throwing in the towel: "In my time here at Target, I've developed a better understanding of just how deeply our entry disappointed Canadian shoppers."

In a surprise move on Thursday, the Ontario Superior Court of Justice granted Target Canada protection from its creditors for an initial 30 days, giving the money-losing chain the green light to liquidate its 133 stores and let go 17,600 employees. The outlets are all expected to be closed within 16 to 20 weeks, a Target spokesman said.

It's a far cry from March, 2013, when Target arrived here with everything going for it: Many consumers were familiar with its brand, had shopped in its U.S. stores and couldn't wait for them to come to Canada.

But Target's massive missteps will now inevitably become material for a case study in business schools of what not to do in entering a new market.

Retail incumbents in Canada can feel some relief in seeing a big foreign rival with deep pockets leave this market. But Target's closing also will put pressure on smaller retailers as large, savvy ones such as U.S. discount giant Wal-Mart Stores Inc. look to expand here by acquiring Target leases.

And landlords will be left with lots of empty stores to fill among the 133 that Target is abandoning. Many of the sites are undesirable for alternative retail tenants, industry insiders said. It could force mall landlords to search for new, more productive uses for the space, such as spas or call centres, they said.

"Landlords will be working like mad to come up with a 'backfilling' strategy," said Rick Pennycooke, president of retail real-estate specialist Lakeshore Group. "It's not going to be easy because there are very few players who will want/need that amount of space."

Along with Wal-Mart, Canadian Tire Corp. Ltd., Loblaw Cos. Ltd. and Rona Inc. are among retailers that will probably consider buying some Target leases, industry observers said. Smaller retailers may take portions of Target's store space. "But there will remain a lot of floor space that will be dark," Mr. Pennycooke predicted.

Target's exit is also a cautionary tale for other foreign retailers that may be mulling coming to Canada.

"Target is an exceptional retailer and company – this may emphasize how difficult it is to succeed in foreign markets," said Mitchell Goldhar, president of mall landlord SmartCentres Inc., which houses many Wal-Mart stores. "From a real-estate perspective it may at first look negative, but ultimately it is positive."

Target stumbled in Canada from day one. It made a fatal mistake in not realizing the power of Wal-Mart Canada and its low prices, said Jamie Tate, president of retail specialist Tate Economic Research. Target even, essentially, gave Wal-Mart a boost by selling it 39 former Zellers store leases that Target didn't want, he said. Target came to Canada by buying most of Zellers's leases from Hudson's Bay Co. for $1.8-billion.

Target moved too quickly by opening more than 124 stores in its first nine months here, Mr. Tate said. It underestimated Canadian competition, such as Canadian Tire, which geared up for Target's entry by improving operations. Mr. Tate also pointed to Target's "arrogance," which he said is typical of U.S. retailers such as the Sports Authority Inc., which also retreated from Canada more than 15 years ago.

In doing its deal to buy Zellers leases, Target was stuck with many poor store locations, he said. And he questioned Target's decision to stage its grand opening party with celebrity Sarah Jessica Parker in a "flagship" store on Danforth Avenue in Toronto. "This store is in a strip mall built in 1962. ... Not the best starting point for the launch of a chain."

Still, Target recognized the extent of its problems last spring after it had lost nearly $1-billion in its Canadian operations in its first fiscal year here. The retailer let its then-CEO Gregg Steinhafel go and, soon after, the president of Target Canada was replaced with a Target veteran.

But the red ink continued to flow. Until the end of January, Target Canada's pretax operating losses will exceed $2.5-billion, the retailer projects in a court filing. That's more than triple its initially expected loss for that period, it says. It said it has invested more than $7-billion (including the operating losses) in the expansion into Canada since the start of 2011, when it first announced its deal to buy Zellers stores for $1.8-billion. It poured money into renovating the stores and hiring staff.

Mr. Cornell said Target's research indicated it wouldn't make money in Canada for at least another five years.

Next month, the company expects to report about $5.4-billion (U.S.) of pretax losses on its discontinued operations in Canada in its fourth quarter of 2014. The losses cover mainly the writedown of its investment in Target Canada, along with costs tied to its exit or "disposal activities" and operating losses in Canada before Thursday's filing, it said. As well, Target expects to post about $275-million (U.S.) of pretax losses on the discontinued operations in fiscal 2015.

Mr. Cornell told analysts that Target Canada undertook a "massive effort" to recover in the crucial holiday season. "But the harsh reality is that both sales and profits continued to fall short of our expectations," he said. "And we have not realized the significant improvement in Canadian consumer sentiment that we believe is necessary. Put simply, we have not seen the step change in performance we told you we needed to see."

He said his team considered alternative scenarios, including closing its worst performing stores and operating with fewer distribution centres. But in going ahead with the alternative options, Target would have needed to invest billions of dollars more in its supply chain, technology and setting up e-commerce in Canada, he said.

Instead, Target is focusing its resources on improving its U.S. operations, which is starting to recover from a 2013 data breach, a lagging digital strategy and other challenges. "Bottom line, given these needed investments and a lack of step change in performance, we are unable to map out a scenario which would allow Target Canada to generate positive profits or cash flow until at least 2021," Mr. Cornell said.

By the numbers:

133: Target stores closing

17,600: Employees losing their jobs

$70-million: Target's financial package for employees that will provide a minimum of 16 weeks compensation including wages and benefits

$5.4-billion: Expected pretax losses on discontinued operations in Q4, 2014

$275-million: Projected pretax losses on discontinued operations in fiscal 2015

681 days: Total number of days in operation before announcing closing

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