Dean&Francis
ISSN 2959-6130

Bed Bath & Beyond: Reevaluating Capital Structure for Sustained Shareholder Value

Chaoxuan Zhang[1, *]

[1]Guangdong Country Garden School, Guangdong, China
*Corresponding author: zhangchaoxuan@gcgsedu.com

Abstract:

This paper focus on the how Bed Bath & Beyond (BBBY), a key player in the home goods retailing industry, optimize its capital structure to solve the inefficiency of its cash-heavy, without debt strategy and rebuild the positive relationship between capital structure and shareholder value. The main goal is providing feasible measures for BBBY and similar retail companies that facing parallel financial situation with long-term shareholder value growth. The study adopts a case-focused research approach. Firstly, analyze BBBY's business model and current capital structure characteristics to identify its issues; then evaluate the potential of strategic adjustments; and use cross-industry corporate cases to illustrate common challenges in capital structure management. Key research results include identifying the inefficiency of BBBY's conservative capital structure and verifying that targeted adjustments can enhance indicators like EPS and reverse return dilution. The research concludes that BBBY's capital structure requires dynamic optimization based on market conditions, and similar retail enterprises should balance liquidity with capital efficiency—offer practical references for managers in retail and consumer-facing sectors to improve capital structure decision-making.

Keywords: Bed Bath & Beyond; capital structure; shareholder equity.

1. Introduction

In the contemporary corporate landscape, the relationship between a company's capital structure and shareholder value is a topic of utmost importance. The capital structure, which refers to the mix of debt and equity financing a company uses, can significantly impact its financial health, risk profile, and ultimately, the value delivered to shareholders.

There are two specific real world example that illustrate the methods to counteract the negative effect of inefficient capital structure. For example, Apple Inc. historically held substantial cash (similar to BBBY's) but strategically adjusted its structure: in 2013, it issued $17 billion in bonds 2.4%-4.8% interest to fund share repurchases and dividends, cutting capital costs and boosting EPS at a 10% compound annual growth rate (2012-2018), which lifted stock prices

ISSN 2959-6130

and shareholder value[1]. Beside the Apple, Starbucks uses balanced debt-equity financing: its 2019 $1.25 billion senior note issuance funded global store expansion and supply-chain upgrades, driving revenue and market share growth, while consistent dividends and scaled-back 2020 share repurchases (amid COVID-19) sustained EPS and long-term shareholder returns[2,3]. These cases, alongside BBBY's situation, highlight the need for capital structures tailored to business models and market conditions—an issue this paper explores in depth to offer actionable insights for value optimization.

Tim Vipond think a firm's optimal capital structure is technically characterized as the debt - equity mix that minimizes its weighted average cost of capital (WACC). Yet this technical benchmark is not universally adopted in real-world corporate decisions. In practice, many firms shape their ideal capital structure based on strategic considerations—such as aligning financing with long-term growth plans, competitive positioning, or risk tolerance—or philosophical stances, like preferences for financial conservatism or aggressive leverage to amplify returns[4]. Notably, WACC remains a pivotal factor in capital structure decisions, as minimizing it stands as a core pathway to boosting shareholder value. Achieving this minimization, however, requires careful trade-offs: while debt typically comes with a lower cost, equity tends to be more costly due to investors' expectations of higher returns to compensate for greater risk—a balance that underscores the complexity of capital structure optimization [5,6] Modigliani and Miller pointed out that in a perfect market with no taxes and no bankruptcy costs, the capital structure does not affect the enterprise value. However, the imperfection of the real market necessitates the modification of this conclusion (followed by the 1963 revision theory) [7,8]. Many companies face the challenge of finding the optimal capital structure that balances the disadvantages and benefits of debt and equity, while also adapting to market conditions and business strategies.

In order to understand the relationship between the capital structure and the shareholder value deeply, and how to balance the two, the following example of BBY might help explain this question. BBBY is an interesting case. Once a famous retailer, BBBY has faced significant challenges in recent years, making a reevaluation of its capital structure crucial for its survival and the preservation of shareholder value. By analyzing the enterprise like BBBY company, which can provide templates and inspirations for other companies that are also facing issues related to the company's capital structure, in order to obtain solutions.

2. Bed Bath & Beyond Financial Condition

2.1 Bed Bath & Beyond's Capital Structure Dilemma

BBBY becomes an outstanding business in the home goods retail sector, boasting a decades-long track record of consistent growth and financial stability. Since its 1992 IPO, the company has increased from 34 stores to 575 locations in 2003, with net sales $4.5 billion and net income with $339 million. The unique business model—large-format "big box" stores, decentralized management, and everyday low pricing—paired with a conservative capital structure: it means no long-term debt and a cash balance of $867 million by February 2004, $400 million more than operational needs. However, this model is actually a double-edged sword. Although the surplus funds can ensure its flexibility, shareholders believe that the board of directors has not efficiently utilized the funds, thus resulting in a decline in the ROE. This article advocates introducing debt to optimize BBBY's capital structure.

2.2 BBBY's Business Model and Financial Foundation: A Pillar of Success

First of all, a foundation for confidence BBBY's success derives from a business model that prioritizes customer experience and operational efficiency. Its superstores (averaging 33,000 square feet) stock over 30,000 SKU, enabling one-stop shopping, while decentralized management empowers store managers to tailor inventory to local demand—reducing stockouts and boosting sales per square foot[9]. This, paired with a low-cost structure, drives industry-leading margins: 41.9% gross margin and 14.3% operating margin in 2003, far exceeding direct competitor Linens' n Things (5.1% operating margin). Financially, BBBY's performance is equally impressive. It has never missed an earnings estimate, and its stock price has grown forty time since 1992. Critically, its balance sheet is robust: $1.99 billion in shareholders' equity, no long-term debt, and $867 million in cash and short-term securities—providing a buffer against market volatility. This strength positions BBBY to consider strategic capital structure adjustments without compromising stability.

2.3 The Dual Nature of BBBY's Cash-Heavy Capital Structure

Secondly, BBBY's cash-heavy structure provides obvious advantages. However, BBBY's excessive reliance on internal cash has diluted shareholder returns, pointing out the urgent for dynamic adjustment of the capital

structure. It eliminates interest expenses (unlike Target, which incurs $559 million annually), enhances flexibility for expansions (80–90 new stores planned for 2004) and acquisitions (2003's $200 million purchase of Christmas Tree Shops), and insulates the company from credit market fluctuations. As industry journalist Don Hogsett noted, this debt-free status "generates interest income as opposed to the interest expense that choked so many other companies." However, this structure has drawbacks. With interest rates at historic lows (1% Federal Reserve Funds rate in 2004), cash earns minimal returns, lowering ROE—from 32.2% in 1995 to 23.2% in 2003. Analysts project cash could balloon to $3 billion by 2007, further diluting returns. Investors increasingly question why capital sits idle rather than being returned to shareholders, highlighting a misalignment between liquidity and value creation, the analyse is consistence with the pecking order theory, which holds that enterprises prefer internal financing.

3. Methods for BBBY to Balance Capital Structure and Shareholder Value

3.1 Stock Repurchases with Excess Cash and Targeted Debt

In 2004, BBBY held $867 million in cash and short-term securities, with $400 million exceeding its operational and growth needs. Given the historically low interest rate environment in early 2004—including a 1% Federal Reserve Funds rate and a 4.5% blended interest rate for BBBY's potential debt issuance—the company should adopt a 40% debt-to-total capital structure. Specifically, it can combine $400 million in excess cash with $636.3 million in newly issued debt to fund a $1.036 billion stock repurchase program. This method generates three key benefits for shareholder value. First, it directly boosts diluted earnings per share: repurchasing 28 million shares will reduce diluted outstanding shares from 304.7 million to 276.7 million, and the tax shield from annual interest expenses ($28.6 million on $636.3 million debt at 4.5%) will save approximately $11 million in taxes annually (based on 2003's 38.5% effective tax rate). Together, these factors lift diluted EPS from $1.31 to $1.37. Second, it change the erosion of ROE: BBBY's ROE had declined from 32.2% in 1995 to 23.2% in 2003 due to idle cash, but the repurchase reduces shareholder equity from $1.99 billion to $954.5 million, while the tax shield enhances net income—effectively halting ROE dilution. Third, it preserves operational flexibility: $466 million in cash will remain post-repurchase, sufficient to cover the $134.8 million in expenses for 2004's planned 80–90 new stores (including $79.9 million for inventory and $43.1 million for fixtures).

3.2 Issuing Mixed-Term Debt to Lock in Low Rates and Support Expansion

BBBY has historically relied on internal cash flows for expansion, such as the $200 million all-cash acquisition of Christmas Tree Shops in 2003, which has led to excessive cash accumulation. Instead, the company should issue a mix of short-term and long-term bonds at the 4.5% blended rate available in early 2004 to fund 30% of its 2004 expansion costs $134.8 million total, replacing approximately $404 million in internal cash. This approach aligns with the urgent need to lock in low rates—market speculation in 2004 indicated imminent Federal Reserve rate hikes, which would increase future borrowing costs.

The effects of this method are twofold. For capital structure optimization, it slows the growth of idle cash: analysts projected BBBY's cash balance could surge to $3 billion by 2007 without adjustments, but debt-funded expansion reduces annual cash outflows for growth, preventing further ROE dilution (since cash earns minimal returns compared to the company's 14.3% operating margin). For shareholder value, the freed-up $404 million in cash can be redirected to additional repurchases or retained as a liquidity buffer, reinforcing investor confidence. Critically, the strategy maintains BBBY's investment-grade credit profile: the resulting total debt-to-capital ratio of 30% is well below the 47% median threshold for BBB-rated firms, and its EBIT interest coverage ratio (22.5x, calculated as $644.8 million EBIT divided by $28.6 million interest expense) far exceeds the 3.9x requirement for BBB ratings, avoiding credit downgrades that would raise future financing costs.

3.3 Strategic Debt Inclusion: Tax Benefits and Enhanced Shareholder Returns

In terms of debt, tax shield and enhanced shareholder returns adding debt could address these inefficiencies, starting with tax advantages. Interest payments are tax-deductible, reducing taxable income. For example, if BBBY issues $636.3 million in debt at a 4.5% blended rate (40% debt-to-capital scenario), annual interest expense would be $28.6 million—lowering taxable income and saving $11 million annually (based on 2003's 38.5% tax rate) [2]. Debt could also boost ROE and EPS through share repurchases. Also using $400 million in excess cash plus $636.3 million in debt to repurchase 28 million shares would reduce diluted shares outstanding from 304.7 million to 276.7 million. This, combined with modest tax savings, would lift diluted EPS from $1.31 to $1.37—a 4.6% increase. Such a move aligns with investor demands

ISSN 2959-6130

for capital returns and reverses ROE erosion by reducing equity base.

3.4 Mitigating Risks: Prudent Leverage and Alternative Capital Returns

At last, risks and correspond approach. While debt offers benefits such as the debt gearing can amplify the returns on equity which is benefit to the shareholder[10], risks exist. Rising interest rates could increase borrowing costs, and higher leverage might trigger credit rating downgrades. Using S&P's median ratios, a 40% debt-to-capital structure would result in total debt/capital of 30%—well below the 47% threshold for BBBY ratings—preserving investment-grade status. Management's conservatism (cash as king and debt as bad) is another hurdle, but data suggests prudence: even a 40% debt ratio would leave $466 million in cash, maintaining operational flexibility. Additionally, tax law changes in 2003 eliminated dividend tax disadvantages, making a special dividend a viable option to return cash.

When considering a shift towards a more debt-intensive capital structure, BBBY must be aware of and manage the associated risks. One of the primary risks is interest rate fluctuations. If interest rates rise significantly, the cost of servicing the debt will increase, the company's profitability pressure increase. To lower this risk, BBBY could consider using fixed-rate debt instead of variable-rate debt. Fixed-rate debt locks in the interest rate for the duration of the loan, protecting the company from interest rate hikes.

Another risk is the potential impact on the company's credit rating. More debt increases the company's financial leverage, which may lead credit rating agencies to lower the company's credit rating. A lower credit rating usually means that they can't afford the high interest rates associated with the capital they are seeking to fiance[11]. A lower credit rating can make it more expensive for the company to borrow in the future, as lenders will demand a higher interest rate to compensate for the increased risk. To avoid this, BBBY should maintain a good credit profile by ensuring that its debt-to-equity ratio remains within a reasonable range and that it has a strong ability to meet its debt obligations. This may involve careful financial planning, like maintaining a healthy cash flow.

4. Discussion

this study proposes four interrelated capital structure optimization methods, all tailored to BBBY's operational realities and strategic goals. The first method combines excess cash with targeted debt issuance for share repurchases. This approach not only activates idle capital by reducing the scale of low-return cash holdings but also increases EPS and reverses the dilution of ROE by reducing the equity base, while ensuring sufficient cash reserves to support daily operations and expansion plans. The second method involves issuing hybrid-term debt to lock in favorable interest rates and replace internal funds for expansion. By taking advantage of the low-interest-rate market window, the company can slow down the accumulation of idle cash, avoid further reduction in capital utilization efficiency, and ensure that growth investments do not overly deplete precious liquidity. The third method utilizes strategic debt to maximize tax benefits. By leveraging the tax-shield of debt interest, the company can reduce its tax burden, increase shareholder profits, and allocate capital based on its operational profitability advantages to amplify the positive impact of debt on value. The fourth method involves prudent management of leverage to control risks. By setting a appropriate debt scale in line with credit rating requirements and choosing an appropriate debt maturity structure, the company can avoid interest rate fluctuation risks and credit rating downgrades, ensuring that capital structure adjustments do not compromise its long-term financial stability [12].

These four methods are not independent solutions instead an integrated optimization framework: they center on "activating idle capital," use "debt leverage" as a tool, and follow the principle of "balancing returns and risks," effectively addressing the root cause of BBBY's capital structure inefficiency. For BBBY, implementing these strategies means transforming its capital structure from a passive "liquidity buffer" to an active "shareholder value driver," converting its existing financial strength into a competitive advantage rather than a constraint.

5. Conclusion

This paper focuses on the core issue of how BBBY optimize its capital structure to address the contradiction between its conservative liquidity and the decline in shareholder returns. It further explores the fundamental problem for similar retail enterprises to adjust their capital structure to improve shareholder value. Through a comprehensive analysis of BBBY's business model properties, the dual nature of its cash-rich capital structure, and the mismatch between financial strategies and shareholders value demands, this study points out the inefficiency of BBBY debt-free strategy, this capital structure and optimization paths. These paths are effective by considering the company's operational advantages and market environment constraints.

Firstly, the study indicates the core capital structure issues of BBBY: its debt-free strategy once help the company

expand after going public and kept it from worrying about interest costs. However, as cash reserves exceeded operational needs, this strategy started holding back shareholder value growth. Over-reliance on internal cash didn't just leave money sitting idle-it also caused the ROE to decline gradually, creating a gap between the company's pursuit of liquidity safety and investors' expectations for capital efficiency. This problem is not only to BBBY but a common challenge faced by many mature retail enterprises: how to balance the stability that comes with conservative financing and the value growth that brings by utilizing capital efficiently.

To address this dilemma, this study points out four interactional capital structure optimization methods. The first method combines excess cash with targeted debt issuance for share repurchases. The second method involves issuing hybrid-term debt to lock in favorable interest rates and replace internal funds for expansion. The third method is utilizing strategic debt to maximize tax shield. The last method involves prudent management of leverage to control risks.

This study has broader implications for retail and consumer-oriented enterprises facing similar issues of cash surpluses and capital inefficiency. It emphasizes that capital structure is a dynamic strategy that must adapt to changes in the company's development stage, market environment, and investor demands. Mature enterprises with stable operations should not be confined to a single conservative financing model but should adjust the debt-to-equity ratio based on their operational advantages to achieve the best balance between capital security and value creation.

Although this study has achieved the goal of linking BBBY's capital structure with shareholder value, it also acknowledges certain limitations. This analysis focused on the company's specific development stage and market environment at that time, and the proposed optimization methods may need to be adjusted in light of long-term changes.

References

[1] Apple Inc. Annual Reports. (2012 - 2018). [Online]. Available at: apple.com/investors

[2] SEC Filings. Starbucks Corporation. 2019. [Online]. Available at: sec.gov

[3] Starbucks CorporatioN. Annual Report, 2020.[Online]. Available at: starbucks.com/investors

[4] Corporate Finance Institute. Capital Structure. 2020. Retrieved from: https://corporatefinanceinstitute.com/resources/accounting/capital-structure-overview/

[5] AB Academies. Optimizing capital structure: Strategies for balancing debt and equity in corporate finance. https://www.abacademies.org/articles/optimizing-capital-structure-strategies-for-balancing-debt-and-equity-in-corporate-finance.pdf

[6] Myers, S. C. (2001). Capital Structure. Journal of Economic Perspectives, 15(2), 81 - 102.

[7] Modigliani, F., & Miller, M. H. The Cost of Capital, Corporation Finance and the Theory of Investment. American Economic Review, 1958, 48(3), 261 - 297.

[8] Modigliani, F., & Miller, M. H. Corporate Income Taxes and the Cost of Capital: A Correction. American Economic Review, 1963, 53(3), 433 - 443.

[9] Ailawadi, K. L., & Keller, K. L. Understanding Retail Branding: Conceptual Insights and Research Priorities. Journal of Retailing, 2004, 80(4), 331-342.

[10] AccountingInsights Team. Understanding Financial Gearing: Types, Ratios, and Performance Impact, 2024.

[11] Julia Kagan. Credit Rating: Definition and Importance to Investors, 2025.

[12] Goyal, V. K., & Welch, I. A Comprehensive Look at the Capital Structure of Mature Firms. Journal of Financial Economics, 2008, 87(2), 258-273.