CORPORATE TRANSFORMATION SERVICES
FROM THE INSIDE OUT

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Shop Space: Cost Control is King

Controlling the cost of physical stores is key to retail transformation

Retailers are in the thick of their most crucial trading period of the year, yet many face a great deal of uncertainty over how many of their stores will still be in business in years to come. In the UK for example, store-based profit margins have more than halved over the last decade, and large retail chains occupy as much as 20 percent more space than they can financially justify, according to research by Alvarez & Marsal and Retail Economics.

Over-expansion in earlier decades and the disruption caused by the shift to online shopping has left retailers in many countries struggling to meet the day-to-day costs of rent, paying store staff and servicing debts. Notable names include Forever 21, which filed for Chapter 11 bankruptcy protection in the U.S., and Debenhams, the UK department store chain which went into administration in April.

When profitability is falling, the crucial first step for retailers is to get their operating costs under control, says Erin Brookes, Managing Director with Alvarez & Marsal in London. However, to transform the business for the future, this must be accompanied by a real understanding of who their customer is and how they spend. "The cash has to be there to pay rent, salaries and other operating costs – retailers don't have to be in administration territory to be concerned," she says. "Companies under pressure over their costs can often lose their sense of what's going on with their customers, and the competitive landscape is always changing."

Light on the horizon

The pressure on stores is not letting up – in addition to rents that increase each year, often agreed when chains were competing for best spots in malls or on desirable shopping streets, UK retailers also face higher property taxes and staff costs which online-only rivals don't incur. Retail chains have closed more than 7,000 stores over the last six years, and landlords are finding it increasingly difficult to find new tenants for empty sites – vacancy rates reached 13.6 percent in UK shopping centres and 7.1 percent in retail parks in the second half of 2018.

Yet, there are bright spots. Physical stores are still expected to account for 65 percent of all sales in the next five years, according to A&M and Retail Economics' research. Somewhat surprisingly, the age groups which value bricks and mortar stores most highly are Generation Z and millennials – digital natives aged under 22 and under 38 respectively, according to the research.

Recent store closures have also created an opportunity for retailers to negotiate on rent, which is the biggest fixed cost for most.

"The relationship between tenant and landlord is changing," says Ms. Brookes. "Retailers are no longer fighting prime sites, and the landlord does not want stores to go dark. In the past, these conversations were not happening at all, but this has become a fundamental issue for the sector."

In its work with retail clients, A&M has successfully helped companies reduce rents, she adds. "If you're a reasonably profitable retail business in a shopping centre that has been weakened by closures, then you might be responsible for delivering a lot of the footfall and vitality in the centre. That creates an opportunity to have a discussion around rent."

Better use of space

Alongside fixed overheads such as rent, having too much store space as a result of inflexible lease structures is the other drag on retailers' ability to transform their businesses to match changing consumer behaviour. "If you offered most retailers a magic wand, they would reduce their space by 20 percent," says Ms. Brookes. "The way people shop now is convenience and enjoyment-led. Consumers don't want to navigate large stores with too much choice."

Assessing sales, margins and costs in each store, and its location, size and format is a key part of A&M's transformation work with retail clients, to eliminate loss-making stores.

Grocery chains are trying to take the initiative by offering space to concessions for clothing and homewares, and department stores have in some cases given up floors to shared office space companies. A&M's research with Retail Economics identified the following key changes to the way retailers expect to use their store space to try and keep pace with changing demand:

- Using stores as a place for consumers to experience the brand and its values, even if they go on to make their purchase online
- Strategic partnerships with online-only brands, allowing physical retailers to use excess store space and online brands to reach customers with lower delivery costs
- New business models: renting goods and services as part of the sharing economy, as well as utilizing subscription models which automatically re-order products for customers and mass personalization
- Using data to blur the boundaries between online and offline customer interactions, e.g. video analytics to track the way customers behave in-store in the same way online 'views' are analysed, to build up a rounded picture of customer behaviour for targeted marketing

Fit for the future

To move ahead with using their store portfolio in a way that works for shoppers now, A&M works with retail clients to ensure costs are sustainable first.

"When sales and profitability start to soften, the costs have got to be looked at, but without losing sight of 'are we relevant?'" says Ms. Brookes. "Stabilizing profitability gives the business confidence to go and address the broader issues, and it can be done relatively quickly while leaders get to grips with what customers really want."

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