

How E-commerce Is Chipping Away at In-store Sales

The transformation of retail from a single brick & mortar channel environment with a finite, known competitive set to a more complex brick & mortar and online environment, with an ever-increasing competitive set, both from pure play and from traditional retailers with online operations is having a meaningful effect on retailer earnings.

Antony Karabus, CEO of HRC Advisory, recently conducted extensive primary and secondary research on three key retail sectors in order to better understand the economic impact that e-commerce is having on their Brick & Mortar sales and Operating Earnings.

Surveyed Retailers' Financial Demographics

Three key sectors were studied, namely

- 11 Luxury & Department Stores, with sales ranging from \$1.3B - \$27B, and aggregate sales of \$126B

2015 Online Sales ranged from 3% - 26% of total sales, versus 2.6% - 19% in 2011

- 4 Off-Price chains with sales ranging from \$1.5B - \$31B, and aggregate sales of \$49B

Online Sales is negligible for this sector, with less than 2% of total sales

- 22 Specialty Apparel and Beauty chains, with sales ranging from \$400M - \$16B, and aggregate sales of \$67B

2015 Online Sales ranged from 5% - 36%, versus 3% - 29% in 2011

Key Highlights

1. Karabus found that "e-commerce has been chipping away at in-store sales since 2011."

For 11 luxury and department store chains, the brick & mortar sales growth rate was negative 1% since 2011, with sales/store declining by 2.5%. On the other hand, online sales for this group grew by 178% since 2011, to reach 16.6% of sales in 2015 versus 6.5% in 2011.

This large online growth performance barely compensated from the decline in brick & mortar sales over this period as in-store sales still comprise 83.5% of sales (versus 93.5% in 2011).

For 22 specialty apparel and beauty chains, the brick & mortar sales growth rate was an anemic 3% since 2011, with sales/store declining by 5%. On the other hand, online sales for this group grew by 59% since 2011, to reach 17% of sales in 2015 versus 11.8% in 2011.

“AMAZON CONTINUES TO DOMINATE THE ONLINE WORLD GROWING AT TWICE THE RATE OF THE ONLINE INDUSTRY.”



“ RETAILERS NEED TO RE-EXAMINE THE COST STRUCTURES OF THEIR PHYSICAL STORES AND INFRASTRUCTURE, AND BECOME MORE EFFICIENT OMNI-CHANNEL OPERATORS TO GARNER ADDITIONAL SALES AND MITIGATE EXTREMELY HIGH ONLINE FULFILLMENT COSTS. ”



2. The pace of e-commerce growth has slowed markedly, only increasing in the luxury and department store chain sector by 17% in 2015 versus a robust growth rate of 39% in 2011. Similarly for specialty, e-commerce growth was 9.5% in 2015 versus 17.5% in 2011.

3. Retailers have invested aggressively to build the omni-channel and e-commerce capabilities to keep up with Amazon and meet the heightened expectations of the more digitally-savvy consumer.

The online giant Amazon continues to grow and dominate the online world and grow their online market share substantially with their north American sales growing by 139% (increasing again by a further 30% in Q1 of 2016), more than twice the growth rate of the online industry.

4. Retailers have made massive investments in supply chain upgrades, digital marketing, IT and talent, as they are grappling with the transition from a largely fixed cost predictable operating model to a more complex mix of fixed cost brick & mortar channel and a variable cost infrastructure in the online channel.

The impact of these investments, coupled with the significant channel shift has resulted in a decline of up to 25% in Operating Earnings as a percent of total sales. Incremental SG&A of as much as 2-3 percentage points of sales is being incurred, while the stores channel continues to experience wage and real estate inflationary cost pressures, which are adding as much as up to 2% points of additional store costs, even while top-line continues to erode or at best remain flat.

“ WHILE OMNI-CHANNEL IS VERY COSTLY IF IT IS LARGELY SHIFTING SALES BETWEEN CHANNELS, IT HAS THE POTENTIAL TO PRODUCE SIGNIFICANT INCREMENTAL SALES. ”





“ E-COMMERCE GROWTH HAS SLOWED MARKEDLY. ”

5. The consumer is the big winner from the Digital Transformation as they have more choices than ever as to how, when and where they can ship, receive or return product, with most of the extra choices coming at no extra cost to the consumer.

Although consumers are winning, for the most part, retailers are not seeing clear financial benefits, and while spending more, are experiencing little upside. The reality is they have no choice. The consumer and the emergence of the pure play competitors are driving the need for the increased capabilities. The Digital Transformation is here to stay.

“There are a number of ways retailers can strategically mitigate and ultimately offset the negative impact of e-commerce on their operating earnings and return to their historically higher brick and mortar performance,” Karabus outlined. “To start, retailers need to re-examine the cost structures of their physical stores and infrastructure, and become more efficient omni-channel operators to garner additional sales and mitigate extremely high online fulfillment costs.”

Most retailers haven’t yet figured out how to grow and maintain brick and mortar profitability while trying to keep up with the likes of Amazon in today’s increasingly digital environment,” said Antony Karabus, CEO of HRC Advisory. “Retailers need to recalibrate and fine-tune their economic business models to reflect today’s new variable cost-oriented online model. For those who can engage customers and meet their heightened expectations, while offering complete visibility of inventory availability, it can be lucrative in reducing markdowns and improving inventory productivity.”

Karabus makes the following recommendations to retailers as they work to protect their earnings, even while they work to enable the new required e-commerce and omni-channel capabilities:

- 1.** Maximize the value of their local assets – which is a huge advantage over Amazon and the pure play retailers.
- 2.** Re-calibrate their store fleet footprints and re-purpose weaker locations and outlets to provide additional fulfillment assets, thereby increasing their productivity and lowering variable costs.
- 3.** Objectively Examine Store and Support Infrastructure Costs and make choices as to where and how and when to invest.
- 4.** Re-examine breadth and depth of free shipping and return policies. Do not try and beat Amazon at its own game.
- 5.** Fine-Tune Price Matching Policies to reduce negative impact on margin without losing the sale.

Survey Methodology and Analysis

Antony Karabus, CEO of HRC Advisory, conducted a study that included interviews with 15 CEOs and CFOs across sectors to better understand the impact of e-commerce on operating earnings.

The study analyzed the financial data for retailers across three key sectors, including 11 department stores and luxury chains with aggregate sales of \$126 billion, 22 specialty apparel and beauty stores with aggregate sales of \$67 billion, and 4 off-price retailers with aggregate sales of \$49 billion.



To learn about how HRC Advisory has assisted retailers to improve profitability, please contact:

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