A brave new world
The retail profitability challenge

A six-fold increase in e-commerce in the last decade has squeezed profits and rendered many retailers with larger store portfolios than required. Due to a number of key negative cost pressures, operating margins could fall a further 3-5% in 2017.

1. Three year average profit margins have fallen between 2010-11 and 2014-15

<table>
<thead>
<tr>
<th>Year</th>
<th>Margin (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010-11</td>
<td>6.1%</td>
</tr>
<tr>
<td>2014-15</td>
<td>4%</td>
</tr>
</tbody>
</table>

2.5% decline

Source: Deloitte Analysis

2. Rising importance of e-commerce requires ongoing investment to stay relevant

<table>
<thead>
<tr>
<th>Year</th>
<th>Profit as a percentage of total retail sales</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nov 2006</td>
<td>2.8%</td>
</tr>
<tr>
<td>Nov 2016</td>
<td>16%</td>
</tr>
</tbody>
</table>

Source: Deloitte/Office for National Statistics (ONS)

3. Top line pressure as prices fall for past five years

Deflation in retail
British Retail Consortium Shop Price Index 2012-16

Source: Deloitte/ONS

4. Perfect storm of cost pressures present potential for a 3-5 percentage point fall in operating margins

FX

1.5% DOWN C. 15% AGAINST USD AND C. 10% AGAINST EUR

Business Rates

EQUIVALENT TO C. 6% RENTAL INCREASE IN LONDON

National Living Wage

EQUIVALENT TO BETWEEN 2%-4% INCREASE IN TOTAL WAGE BILL

Pension Costs

INCREASES IN DEFICITS EXPECTED TO CONTINUE INTO 2017

Commodity Prices

IMF PROJECTS 10% COMMODITY PRICE INCREASE IN 2017

As a consequence, it is likely that we will see greater differentiation in the market. Retailers are already responding to these challenges but the question is – are they moving fast enough in the digital age?

Working with our market-leading Deloitte Digital practice, we can assist retailers in restructuring situations (and more broadly) in ensuring their real estate footprint is future proofed, margins are maximised and their online offering is compelling.

Our innovative retail analytical tools are potential game changers:
• L3. At the touch of a button, drawing on public information, our data driven analysis tool can tell you what your optimal real estate portfolio should look like.
• Pricing Analytics. Our specialist ‘retail margin maximisation’ software can markedly improve the outcome in mark down situations, typically realising 7-10% of margin improvement.

Source: Deloitte Analysis

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