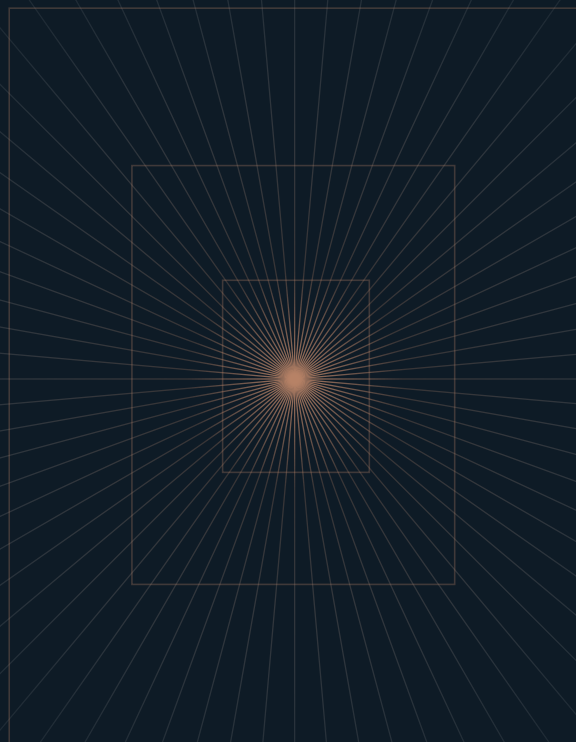


Retail profitability: where does the problem really arise?

How to diagnose the sources of unprofitability before a company starts a cost-reduction programme



STARTING POINT

A fall in profitability rarely has a single cause.

When a chain's results begin to deteriorate, the natural reaction is to look for savings. Cutting costs, renegotiating rents, reducing headcount, changing the level of marketing spend or closing unprofitable locations can all be justified elements of a recovery programme.

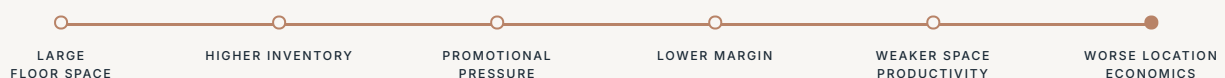
The problem arises when costs are merely the consequence of a deeper inconsistency in the model.

In retail, profitability is created through the interaction of many elements: sales, margin, the structure of the offer, the level of inventory, space productivity, location costs, the way the business is organised and the quality of management.

A change in one of them affects the others.

Excess floor space may require more stock. Excess inventory may increase promotional pressure. Promotions may reduce margin and weaken positioning. Lower space productivity, in turn, worsens lease economics.

That is why cutting costs alone may reduce the scale of the problem without removing its source.



So the first management question should not be:

~~"Where else can we cut costs?"~~

It should be:

"What is causing the current model not to generate the expected profitability?"

HEFT7 FRAMEWORK

Six areas of retail profitability.

Profitability should not be analysed as a single indicator.

HEFT7 sees it as the result of several interdependent elements of the business and operating model.

01 SALES AND PRODUCTIVITY

conversion · ATV · productivity

Is the problem caused by insufficient demand, weak conversion or poor use of the location's potential?

Sales level, dynamics, conversion, average transaction value, number of items per basket, and the productivity of the location and the team.

02 MARGIN AND COMMERCIAL POLICY

price · discount · mix

Does the company generate sales that actually create value?

Gross margin, pricing policy, level of discounts, frequency of promotions, sales mix and the impact of individual categories on the result.

03 OFFER AND INVENTORY

turnover · stock · availability

Is capital working in the products the customer needs?

Breadth and depth of the range, turnover, product availability, stocking level, slow-moving stock and the relationship between purchasing and actual demand.

04 FORMAT AND LOCATION

m² · format · potential

Do the cost and size of the location match its economic potential?

Store floor space, productivity per square metre, the location's potential, the store's role in the chain and the fit of the format to the scale of sales.

05 OPERATING COSTS

rent · payroll · opex

Which costs are truly excessive, and which result from the construction of the current model?

Rent and service charges, salaries, logistics and other operating costs of running the chain.

06 OPERATING MODEL AND MANAGEMENT

processes · KPIs · decisions

Can the organisation quickly see a problem, take a decision and carry it through?

Processes, accountability, reporting, data quality, KPIs, how decisions are made and the tools that support management.



HEFT7 PRINCIPLE

Do not optimise a single element without checking its impact on the others.

SYMPTOM AND CAUSE

The symptom shows where. The diagnosis explains why.

01

SALES ARE FALLING

FIRST INTERPRETATION:

The location has lost its potential.

POSSIBLE REAL CAUSES:

- a mismatched offer
- wrong pricing policy
- excessive promotions
- lower conversion
- wrong format
- product availability problems
- weakened brand positioning

02

INVENTORY IS RISING

FIRST INTERPRETATION:

The company is buying too much.

POSSIBLE REAL CAUSES:

- range too broad
- wrong purchasing structure
- purchasing not matched to sales
- slow-moving goods
- store format too large
- too slow a response to changes in demand

03

RENT COST IS TOO HIGH

FIRST INTERPRETATION:

The rent should be renegotiated.

POSSIBLE REAL CAUSES:

- too much floor space
- insufficient store productivity
- a format not matched to sales potential
- a model in which the cost of space does not correspond to the margin generated

The symptom says where the result is deteriorating.
The diagnosis answers what is causing it.

Only once the mechanism is recognised can we decide whether cost optimisation, operational improvement, redesign of a specific element or transformation of the model is needed.

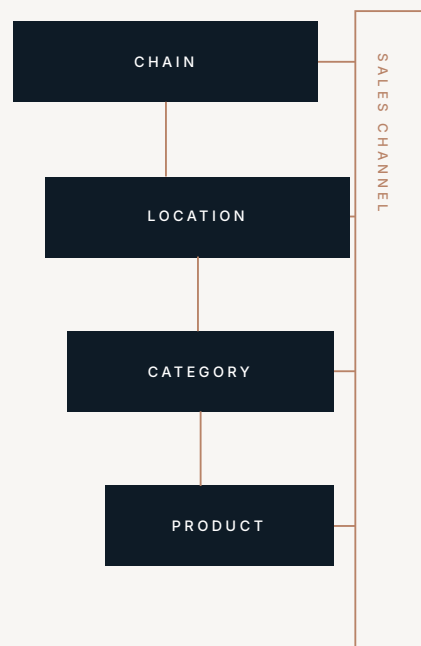
DATA ANALYSIS

The average for the whole chain may hide the problem.

Profitability analysis should be carried out at several levels.

It is not enough to know whether the whole chain makes a positive or negative result.

You have to see where that result is actually generated.



Two parallel dimensions of analysis: the structure of the chain and the offer, and the sales channel.

Which parts of the organisation truly create the result, and which merely generate turnover?

At every level you should analyse not only turnover, but also margin, costs, inventory and use of resources.

Only such a breakdown shows whether the result is spread evenly, or whether a few units finance the rest of the business.

01

WHERE IS SALES
GENERATED?

02

WHERE IS MARGIN GENERATED?

03

WHERE IS CAPITAL
TIED UP?

04

WHERE IS THE RESULT
CREATED OR LOST?

If the organisation cannot answer these questions quickly and unambiguously, the lack of transparency itself becomes part of the management problem.

DECISION MAP

When is cost reduction the right answer?

Before starting a savings programme, it is worth determining what type of problem the company is actually dealing with.

○ COST OPTIMISATION

○ OPERATIONAL IMPROVEMENT

○ REDESIGN

● TRANSFORMATION OF THE MODEL

01

THE MODEL WORKS. COSTS ARE TOO HIGH.

Sales, margin and the value proposition remain healthy, but the cost structure does not match the scale of the business.

DIRECTION:

COST
OPTIMISATION

02

THE MODEL WORKS. EXECUTION IS INSUFFICIENT.

Strategy and business economics remain sound, but processes, accountability or operating standards limit the result.

DIRECTION:

OPERATIONAL
IMPROVEMENT

03

THE MODEL WORKS ONLY IN PART.

Some locations, channels, categories or elements of the model create value, while others consume it.

DIRECTION:

REDESIGN OF
SELECTED
ELEMENTS

04

THE PROBLEM IS STRUCTURAL.

The offer, format, inventory, costs and way of operating no longer form an economically coherent whole.

DIRECTION:

TRANSFORMATION
OF THE MODEL

The greatest risk arises when the organisation is in situation three or four but treats the problem as a classic cost-reduction programme.

Spending can then be cut while at the same time weakening sales, quality of service, availability of the offer or the organisation's ability to rebuild its result.

Are we reducing cost, or reducing the business's ability to generate value?

QUESTIONS FOR THE BOARD

10 questions before launching a recovery programme.

- | | |
|--|--|
| 01 Which locations, channels and categories really create the company's result? | 06 Does the structure of the offer match the customer and the positioning the company wants to maintain? |
| 02 Does the fall in profitability stem primarily from sales, margin, costs or productivity? | 07 Do lease terms remain economically justified at the current level of sales and margin? |
| 03 What part of current inventory is justified by actual sales and its turnover time? | 08 Are purchasing decisions and stocking levels linked to demand, sales and working capital? |
| 04 Do the format and floor space of the stores match their current potential? | 09 Is accountability for the result of individual areas unambiguously assigned? |
| 05 Do promotions support sales, or do they merely compensate for a mismatched offer while reducing margin? | 10 GOVERNANCE
Do the people responsible for the programme have the data, resources and real decision-making rights needed to implement it? |

The last question is the one most often overlooked.

A good plan is not enough if the organisation has no mechanism for taking and enforcing decisions.

"A recovery plan is worth only as much as the real decision-making rights that allow it to be implemented."

HEFT7 PERSPECTIVE

Profitability is not rebuilt by optimising indicators in isolation.

It is rebuilt by understanding the system that creates those indicators.

A recovery programme should start with a diagnosis of the business economics and the interdependencies between sales, margin, inventory, the offer, format, location, costs and the way the business is managed.

Only then can it be decided whether the company needs:

01 COST OPTIMISATION

02 OPERATIONAL IMPROVEMENT

03 REDESIGN

04 TRANSFORMATION OF THE MODEL

If the answers to these questions are not unambiguous, what is needed is a diagnosis of the business economics.

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