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Retailers struggle to account for sales channels

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Retailers face the challenge of deciding which costs to attribute to stores and which to online sales
One customer browses in a shop, goes home and makes a purchase online. Another buys through a retailer's website and then collects the goods in a store. Where in a retailer's accounts do their purchases belong?

The answer is not straightforward – not yet, anyway, and retailers are grappling with how to express to investors what is going on in their businesses.

The alternative ways of shopping explain why, as Julie Carlyle, head of retail at Ernst & Young, says "retailers are struggling [with] how to put this in their accounting".

The result is that store groups are coming under pressure from investors and analysts to be clearer about the contribution online sales make to underlying sales performances.

There are two critical issues here: one is whether online revenues are used to flatter like-for-like sales; and the other is how a retailer will clearly explain the costs and margins associated with online sales. And the question of how to deal with online sales at retailers with a high street presence is only going to become more acute.

Already, according to retail research group Verdict, UK online sales are set to account for £1 in every £8 spent this year.

Internet sales are also powering ahead in the US where, according to Bain, online will account for just under 12 per cent of total sales by 2015.

"As online is growing, the way it is reported in sales and profit figures is only going to become more of an issue," says Christine Cross, chief retail and consumer adviser to PwC, the auditor and consultant. Until now, standard practice has been to include online sales in retailers' sales from stores open at least a year. Internet sales growth can readily be used to bolster weak underlying in-store sales.

"Most people include online in UK like for likes, and they usually give a figure for the online growth," says Nick Bubb, an independent analyst. "But most people then leave it up to you to work out."
One retailer says having a big internet business can make an enormous difference to like-for-like sales: "What it means is that people with big online businesses end up with like for likes that are not comparable to those without big online businesses."

One retail finance director says investors and analysts want to compare the performance of stores versus online sales: "The market will be very, very interested. And once some people start to do things, others naturally are forced into following, because otherwise they are thought of as having something to hide."

Two weeks ago, for the first time, department store chain Debenhams showed that UK online sales accounted for about 4 percentage points of its like-for-like sales growth, compensating for a like-for-like decline in UK stores. John Lewis made similar disclosures recently.

One retailer that is moving to more transparent reporting says: "If we didn't break it down, we would only get asked the question 'what are the components that are driving like-for-like sales growth'. We decided it was clearer to show it so there was no ambiguity."

At Next, meanwhile, like-for-like sales are no longer disclosed, because Next Directory, which generated sales of £1.2bn in the year to January 2013, is such a big part of the business. Instead, to inform investors on the underlying performance of its estate, Next provides a breakdown of its store profitability.

But online sales are only part of the picture. As demand through the internet continues to grow, so do the costs – including the expense of distribution and delivery. Even paying for a company name to appear in search engines can raise the cost of business online.

Amazon's and Ocado's respective struggles to achieve sustainable profit growth increases pressure on chains that have a high street presence as well to explain how much money they make from their various ways of getting goods to customers.

So retailers face the challenge of deciding which costs to attribute to stores, and which to online sales. Here there is a battle between the difficulties that shareholders have long seen in observing the profitability of online groups and acceptance that the internet's ability to increase sales without increasing the retail estate should improve group margins.

Michael Sharp, chief executive of Debenhams says the department store's internet sales, for the first time, have a higher margin at the level of underlying earnings than those from stores – even after taking account of the costs of running the online business.

But some regard these "in store" versus "online" debates as merely a transitional discussion.
Helen Dickinson, director-general of the British Retail Consortium is clear. "In the future, what we will need to be doing is measuring the value of customers," she says.

Ernst & Young's Ms Carlyle says: "Forward-looking investors are already becoming 'channel agnostic': they care less about how retailers win sales, and more about the top line and the margin."

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