GUEST EDITOR THEO PAPHITIS

Convenience has emerged as an important channel for the grocers but, asks guest editor **Theo Paphitis**, how do the economics stack up? **Luke Tugby** reports

NEWS ANALYSIS

What is the cost of convenience to the grocers?

The big grocers have increasingly turned to convenience as shopper habits shift

Tesco's Express and Metro formats and the Sainsbury's Local fascia have come to dominate high streets, reflecting the shift of time-poor shoppers towards more 'food-for-now' options in smaller baskets.

Figures from industry body IGD suggest that the convenience market was worth £37.7bn in the year to April 2015 – and sales are predicted to climb to £44.1bn by April 2020.

But while the size of the sales pie is clear, the costs of operating c-stores can be hard to gauge.

Dan Murphy, partner at management consultancy Kurt Salmon, pinpoints four key costs that grocers have to consider.

He highlights the higher costs of rent and business rates for high street locations and the creation of separate management teams as the two main areas of expenditure.

Murphy says the cost of deliveries to c-stores is also inflated, since there are local laws that prevent lorries accessing high streets during the day.

"All of these things add up to a significant differential," Murphy says. "If you factor all these costs in, running convenience stores would be 12% to 15% more expensive per square foot than a supermarket.

"But the supermarkets don't reflect those additional costs if they talk to you about their convenience businesses – and that's because they don't really know them."

Offsetting costs

While recognising the additional costs of running c-stores, TCC global insights director Bryan Roberts suggests these charges are offset by an increase of "between 3% to 8%" on store prices.

"The view I get from speaking to the multiples is that their convenience operations are as profitable as their bigger stores," Roberts says.

"Convenience has supported overall profitability. Without c-stores, certainly for Tesco and Sainsbury's, profitability would have been lower."

Roberts reckons Morrisons' failed venture into convenience stemmed from poor site selection and a lack of scale compared with its infrastructure overheads.

"There's a lot of analysis that goes into convenience locations. Just being on the wrong side of the street can have quite an impact on performance," he suggests.

Sales densities

Sainsbury's seems to have mastered finding the right locations for its smaller stores and is reaping the rewards.

According to its 2014/15 report, Sainsbury's convenience business generated more than £2.1bn in sales, representing growth of 16% on the prior financial year.

Up to March 31, 2015, the grocer had 707 Sainsbury's Local c-stores at an average size of 2,300 sq ft.

According to calculations by Retail Week Prospect analyst Philip Wiggenraad, those stores recorded sales densities of £1,380/sq ft during the year, compared with £960/sq ft in its larger supermarkets.

Wiggenraad said: "It is usually easier to generate higher sales densities in more compact stores.

"You have greater footfall relative to store size, smaller stores and higher prices all combining to offset the increased costs of running these stores."

Mounting pressure

But while Sainsbury's and Tesco have profited from the c-store cash cow – the latter reporting a 3.5% rise in convenience like-for-likes over Christmas – Shore Capital analyst Clive Black suggests that boom could be about to slow.

"Convenience stores require relatively low capital due to their leasehold nature. However, from an operational expenditure perspective, they are a real challenge," he warns.

"Where convenience has benefited is footfall over the last five years versus superstores. With falling fuel prices and the re-engineering of superstores, we see some of the secular [long-term] growth that has boosted convenience easing.

"We believe that online and discount will outperform convenience in the latter part of this decade."

While expenditure on c-store expansion has proved worthwhile to date, the emergence of reinvigorated big-box stores and the continued growth of online could be poised to put more pressures on the sector – and force grocery bosses to re-evaluate the costs of convenience.