What, No Comps?

The Home Depot shuts the door on a major metric

By Abhay Padgaonkar and Robert Welch

"There is nothing as deceptive as an obvious fact."
—Sir Arthur Conan Doyle

In a surprise move in May 2006, home-improvement giant The Home Depot stopped issuing comparable-store sales (or comps) numbers, becoming the first major retailer to withhold sales data for stores open at least one year, a closely watched measuring stick in the retail industry. While many analysts and investors quickly criticized Home Depot's move as a "bad decision," the discontent against comps has been building for a while.

Revered by analysts, investors and retailers for decades as a standard measure for assessing a retailer's performance, comps have been facing steady criticism. While The Home Depot may seem like an anomaly, both Wal-Mart Stores' CEO H. Lee Scott and Sears Holdings Corp. chairman Edward S. Lampert have also railed against comps. Wal-Mart complained because its strategy to supersaturate a market results in misleading same-store comps. Sears was unhappy because comps are not necessarily correlated to cash flow—a more important business measure. Home Depot's CFO Carol Tomé explained that "same-store sales will become less relevant as Home Depot opens fewer stores and expands more aggressively into the wholesale-supply business." Meanwhile, Fort Worth, Texas-based The Bombay Co. recently put an end to its practice of reporting comps on a monthly basis.

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What Comps Don't Tell You

Whatever the reason, it is clear that comps have come under fire. Their ability to accurately and legitimately measure a retailer's health from one month to the next is being questioned. Major problems arise not from what comps measure, but from what they can't measure—namely, overall sales of a retail corporation, customer loyalty at multiple locations, earnings and a retailer's margins.

Table 1
Traditional Comps
ACME Retail, Inc.
Quarterly Same-Store Sales Report

Store name	Sales 3rd quarter 2005	Sales 3rd quarter 2006	Change over prior period
Braker Lane	$10,423,342	$10,948,340	5.04%
Downtown	15,342,123	16,394,938	6.86
Highland Village	18,098,896	17,998,982	-0.55
TOTAL	**43,864,361**	**45,342,260**	**3.37**

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> **Peter Drucker, management authority and author**

Besides these cited shortcomings, comps also bear another less-obvious weakness: They don't discern fraudulent calculations. As a result, comps cannot comply with the 2002 Sarbanes-Oxley Act guideline "to disclose to the public on a rapid and current basis such additional information concerning material changes in the financial condition or operations." In fact, the financial-reporting processes for comps are not precisely defined. Neither are they governed by SEC or GAAP and, therefore, are easy to manipulate—giving retailers the creative urge to calculate comps to their advantage. One international retailer is reported to have employed 50 different processes for assessing comps in 65 countries. All this in a day and age when corporate performance is being watched more closely than ever before and former Enron executives are being judged by the jury for "willful blindness."

Theory of Relativity

There is another fundamental problem with the way comps are reported.

The two main factors that impact same-store comps are prices and the number of paying customers. The sales performance of a given store or group of stores is not absolute, but only relative to the population of the trading area—the geographic boundaries around the store that contain the majority of the customers. The overall performance of the retailer is simply an aggregation of each comparable-store's performance.

Rising comps mean that more people purchased products at the stores, or the customers paid more for the same things they bought a year ago, or both. Either way, sales increased without the added expense of opening new stores. This indicates that marketing is doing its job and the brand is popular with consumers. The products' unique features, regional differences, advertising and promotions, and competition govern prices. The number of paying customers is mainly determined by the demographics for each store's trade area.

Yet, today, the same-store comps are reported solely over time by disregarding demographics altogether. When a store's performance is judged based on the time element alone—without regard to the underlying demographic changes—it can present a distorted picture. As Peter Drucker, renowned management authority and author, said, "The basic assumption for our time must be that populations are inherently unstable and subject to sudden sharp changes—and that they are the first environmental factor that a decision maker, whether businessman or politician, analyzes and thinks through."

For an investor or analyst, the traditional way of calculating comps provides insufficient information to make an informed decision. Without an understanding of the underlying demographic changes, there is no yardstick or benchmark to determine if the comps reported by the retailer are good or bad. It is impossible to tell how well a given store or a given retailer is performing unless it is benchmarked against changes in population. (See Table 1 on page 127).

False Assurances

From this limited assessment, how can you tell which store is really performing well and which one isn't? Also, it fails to show whether the retailer as a whole is keeping up with underlying demographic changes or not. It appears that the downtown store is performing the best based on a 6.86% increase over the prior period. But is this really true? A closer look at the underlying population changes during the same time period reveals the truth (See below).

The population increased by 11.7% in the trading area for the downtown store, but its sales increased by only 6.86%. In other words, its relative market penetration declined and hence its relative store performance was down. The other two stores, however, increased their market penetration and actually performed better relative to the population changes in their respective trading areas.

Table 2
Enhanced Comps Overlaid With Demographics
ACME Retail, Inc.
Quarterly Same-Store Sales Report

Store name	Change prior quarter	Population 3rd quarter 2005	Population 3rd quarter 2006	Population change	Market penetration	Relative store performance
Braker Lane	5.04%	123,343	124,809	1.2%	3.85	Up
Downtown	6.86	170,046	189,938	11.7	–4.84	Down
Highland Village	–0.55	224,562	210,333	–6.3	5.78	Up
Total	**3.37**	**517,951**	**525,080**	**1.4**	**1.99**	**Up**

It's easy to see how the addition of population data both added a new level of internal control to the comps and also gave retailers a more sophisticated insight for making profit-focused business decisions. This double duty from a single point of data is a significant advantage for analysts looking for the opportunity to simplify data research—including those who are tasked with overcoming the mounting challenges created by Sarbanes-Oxley's complex guidelines.

The Sarbanes-Oxley Act of 2002 was enacted to "protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws and other purposes." Because looks can be deceiving, this type of analysis raises an important question: If the retailers do not report or track performance relative to population changes for external or internal management reporting purposes, are they in compliance with the letter and spirit of the Sarbanes-Oxley Act of 2002?

Now that Home Depot has fired a shot across the bow, with other retailers likely contemplating their options, it is time to fundamentally reconsider the comps reporting.

In recognition of the fact that analysts and investors look to comps for financial performance and transparency, the Public Company Accounting Oversight Board (PCAOB)—the private sector, nonprofit corporation created by the Sarbanes-Oxley Act of 2002 to oversee the auditors of public companies to protect the interests of investors and further the public interest in the preparation of informative, fair and independent audit reports—should create a standard for same-store comps.

The new PCAOB rules for comps should standardize an auditable methodology to avoid temptation toward creative accounting.

True Picture

Reporting comps by disregarding underlying demographics can be very misleading. The enhanced methodology should incorporate quarterly population estimates so that investors and analysts can see a truer picture of a retailer's health and performance.

Mandated for external financial reporting purposes or not, correlating same-store performance to population estimates may have been a nice to have and a desirable management practice in the past, but retail executives should make it a must-have business intelligence measure for internal decision-making. ■