

3 Continued margin and cost pressure

The profitability of grocers was hit hard in 2022, and the pressure on margins, cash flows, and the cost of capital is likely to stay high in 2023.

Margins decreased for both grocery retailers and food processors (consumer-packaged-goods companies) between 2019 and 2022. The EBITDA margins of grocery retailers decreased by 1.0 percentage point, while the EBITDA margins of food processors decreased by 0.8 points (Exhibit 8).

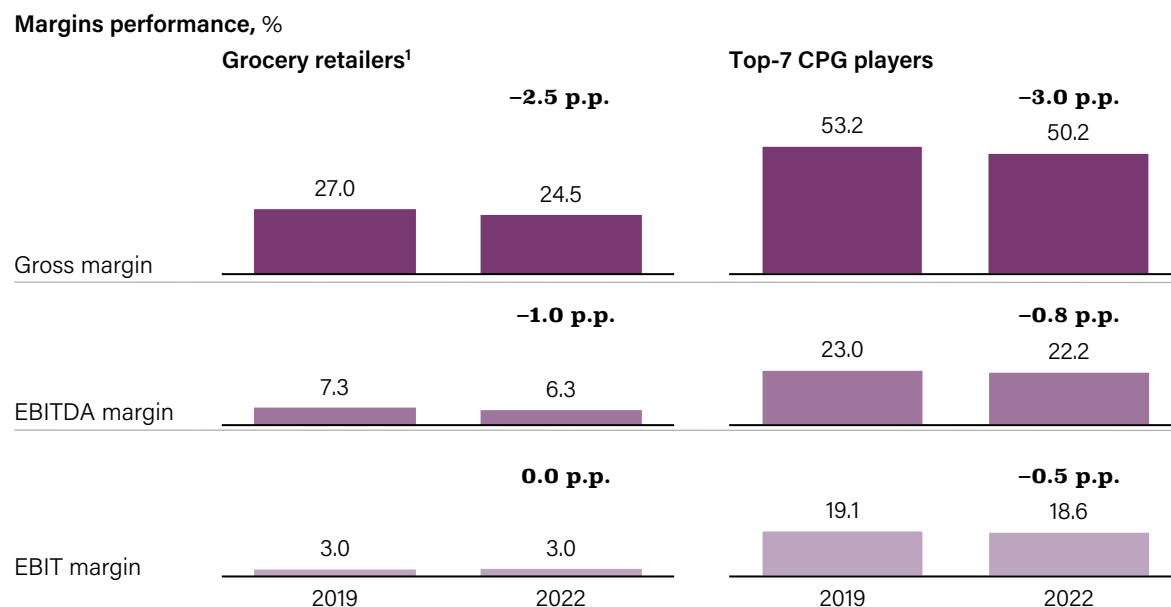
We expect cost and margin pressure for grocery retailers to remain high at least in the first half of 2023 because salaries are likely to grow and many cost increases have not yet reached grocery retailers. According to our CEO survey, dealing with cost and margin pressure is a top 2023 priority for 88 percent of grocery leaders. While energy and many food producer prices peaked in the

third quarter of 2022, it will take time for these increases to affect food processor prices and ultimately reach consumer prices set by grocery retailers. In addition, if governments were to introduce new regulation to limit retail prices, this would put further pressure on the margins of grocery retailers.

At the same time, the level of required investments for grocery retailers is increasing, putting additional pressure on the industry. Between now and 2030, the industry needs cumulative additional investments of €70 billion to €125 billion to drive sustainability, digitalization, IT improvements, and automation—an increase of 25 to 50 percent relative to current levels.⁷ Margin pressure and the increasing cost of capital will make it harder for grocery retailers to finance these investments. The weighted average cost of capital has increased from 2.6 percent in 2021 to 6.7 percent in 2022 because of higher interest rates. This makes it more expensive for grocers to borrow money or raise new capital.⁸

Exhibit 8

Both retailers' and CPG companies' margins face substantial pressure.



¹ Companies in the sample: 12 European grocery retailers (€278 billion total revenue in 2022), – Ahold Delhaize, Axfood, Carrefour, DIA, ELO SA, Eurocash, Groupe Casino, ICA, Jerónimo Martins, Kesko, Migros, and Sonae MC; top-7 consumer packaged goods companies (\$385 billion total revenue in 2022), including The Coca-Cola Company, Nestlé S.A., and PepsiCo, Inc.

Source: McKinsey CPA; company reports

⁷ Transforming the EU retail & wholesale sector, a joint report from McKinsey and EuroCommerce, October 2022.

⁸ "Cost of equity and capital (Europe)," Damodaran Online, January 5, 2023; "Cost of equity and capital (Europe)," Damodaran Online, January 5, 2022.