Last updated: December 1, 2025

Rating Methodology by Sector

Retail

This rating methodology is primarily applicable to multi-store retail chain operators such as supermarkets, convenience stores, home improvement centers, and electronics retail stores, excluding mail-order businesses. In addition, there are some cases where this rating methodology may not apply partly to department stores, which essentially function as "space rent" businesses rather than conducting their own sales under tenants' single-store operating method.

1. Business base

Retail is basically a domestic industry, making it largely influenced by domestic consumer trends. However, when examining individual companies, there are companies that achieve growth in performance regardless of macro consumption and industry trends. Therefore, while macro consumption and industry trends are considered in the rating assessment, JCR considers characteristics of each company's business model, competitive advantages, risk characteristics, and other factors.

(1) Characteristics of the industry

(i) Market overview

Many companies in Japan's retail industry primarily operate in domestic market. Some have expanded into overseas markets, but few have reached a point where their overseas operations significantly contribute to overall performance. Consequently, retail companies are highly susceptible to domestic trends of business, employment, income, demographics, etc. Although some companies benefit from inbound demand, but fluctuations in exchange rates can reduce this demand, impacting their performance in some cases.

With overall consumption expected to shrink over the long-term associated with the decline in the total domestic population, retail industry as a whole is positioned as a mature industry. However, as the aging population and declining birthrate progresses, consumption structures and consumer behaviors are to be significantly changing from the past, while traditional consumer markets are shrinking, there are some new markets that are expanding such as markets targeting the elderly.

Looking at the history of retail, the central players in the market have shifted from department stores to general merchandise stores, and then to convenience stores, showing the rise and fall of different business categories. Furthermore, specialty clothing stores, electronics retail stores, and drugstores have also increased their presence. Additionally, demand for e-commerce (EC) is growing, and there are multi-store retail chain operators who are focusing on their EC businesses.

As described in the above, within the retail industry itself, growth stages vary by business category. Consequently, JCR incorporates not only macro consumption trends but also market trends by business category in the individual evaluations.

(ii) Competitive situation

In the retail industry, excluding convenience stores, degree of market oligopoly by top companies is not particularly high, resulting in a situation where excessive number of stores operate and compete, often termed “over store.” However, anticipating market contraction due to population decline, particularly in regional areas, restructuring such as management integration, led by major companies, is progressing.

Under such circumstances, local chain operators maintaining high market share in specific regions also exist. When such local chain operators in a specific region expand their areas into neighboring areas, there are cases where competition with leading local chain operators in those regions intensifies.

Furthermore, rise of specialty store business categories, such as specialty clothing stores, electronics retail stores, and drugstores, has led department stores and general merchandise stores to lose their market shares in part of their categories to these specialty stores. Competition is intensifying not only within the same business category but also across different business categories.

JCR confirms changes in the competitive situation of each company and focuses on their effect on the business base in the medium- and long-term.

(iii) Cost structure

Retail is a labor-intensive industry, where labor costs in general constitute the largest expense item within SG&A expenses. Retailers operating chain stores, in particular, require massive manpower for tasks like cashier operations, merchandise display, and in-store processing. However, amid a declining population, labor shortages are worsening, leading to increased labor cost burdens. Against this backdrop, retailers are advancing initiatives like introducing self-checkout and semi-self-checkout systems and establishing process centers to reduce in-store operations. Promoting labor-saving measures is important, and JCR focuses on trends in the labor cost ratio.

Furthermore, as a process industry with numerous stores, proportion of fixed costs related to facilities, such as depreciation expenses and rent, is relatively high. JCR confirms whether rising fixed costs like labor costs and rent will push up the break-even point and squeeze profits, as retailers promote store expansion.

(2) Key factors in market position and competitiveness

(i) Market position

Within the retail industry, some business categories or companies even with large sales scale are seeing their earnings strengths declining due to changes in the external environment. Current sales scale or ranking does not necessarily lead to their competitive strength.

Some companies hold low national market share but hold high market shares in specific regions. For food supermarkets, product assortments reflecting regional characteristics are important for gaining consumer support. Even with low sales volume or national market share, strong competitiveness within specific regions can be highly valued in some cases.

(ii) Competitiveness of existing stores

For companies operating chain stores, strength of their business base and basis for earnings strength are derived from competitiveness of existing stores. JCR therefore evaluates whether a retail chain operator has a comparative advantage or lags behind by comparing and analyzing the year-on-year changes in sales of existing stores against the industry average and those of competitors. Furthermore, by breaking this down into factors such as the number of customers, sales per customer, average sales per item, and the number of products sold, JCR confirms what factors are driving changes in the sales, whether the company is losing its ability to attract customers due to intensifying competition, whether the changes are due to price competition, or whether they are the result of changes in the company's product strategy.

(iii) Merchandising skills

In retail, differences in earnings strength arise from the effectiveness of product appeal, pricing strategies, and sales promotional methods. After understanding characteristics of merchandising policies such as competitive strength by product category, differentiation through price appeal or customer services, and sales promotions like EDLP (Everyday Low Price) strategies, flyer-based special sales, and point giving, JCR will focus on whether these are appropriate strategies given consumer trends and each company's specific situation.

Furthermore, reducing cost of goods purchased is important factor for enhancing price competitiveness and gross profit margin. In recent years, many retail chain operators have leveraged economies of scale with the expansion of retail operations to develop private brand products, selling items at lower prices and higher gross profit margins than national brands. JCR confirms the private brand product development strategy, sales performance, and contribution to gross profit margin improvement.

(iv) Store strategy

For retailers operating chain stores, store openings and renovations of existing stores are important strategies. Chain store theory suggests that store openings through dominant method, which is concentrating stores in specific area, offers advantages in logistics efficiency and increasing customer awareness. Furthermore, renovating aging stores is necessary to improve competitiveness of existing stores. Through store formats, store networks, logistics systems, future expansion plans, and existing store renovation strategies of individual companies, JCR examines the impacts on business base and earnings strength by region.

On the other hand, chain retailers often have unprofitable stores due to worsening profitability from changes in the trade area environment or delays in achieving profitability after the new store openings. For unprofitable stores, which carry impairment risks in the future alongside deteriorating performance, JCR confirms the company's store closure criteria and individual stores’ response policies to assess their medium-to-long-term impacts on earnings strength.

(v) Group capacity

Some relatively large retailers have multiple business categories or affiliated companies such as those for credit card business within their group. In such cases, JCR places emphasis on whether synergies between business categories within the group are functioning, or whether synergistic effects exist with related businesses. Furthermore, with limited growth prospects in the domestic market in recent years, an increasing number of retailers are strengthening their overseas expansion. JCR evaluates overseas business promotion plans and their impact on profit and financials to confirm whether the group as a whole can strengthen its business base over the medium to long term.

2. Financial base

(1) Earnings strength

While retailers can easily increase sales by opening new stores, foundation of their earnings strengths ultimately lies with existing stores. To measure earnings strength of those existing stores, JCR places emphasis on year-on-year changes in sales of existing stores as an important indicator. Except for some manufacturing retailers, retailers that primarily purchase goods from wholesalers and sell them to their customers generally do not exhibit high profitability such as operating margin. However, many maintain relatively stable profit levels compared to other industries. For companies in their growth phase, many experience a decline in operating margin as sales scale increases, even if they maintained high profitability when sales scale was small. Therefore, JCR will pay attention not only to the most recent level of operating margin but also to its long-term trend.

When evaluating the core business' earnings strength, JCR confirms trend in operating income. Additionally, JCR places emphasis on efficient profit generation from invested assets.

Key financial indicators:

- Year-on-year changes in sales of existing stores
- Operating margin
- Operating income
- Return on assets (ROA)

(2) Cash flow generation capability

In retail, cash flow patterns vary depending on the business categories. In businesses like food supermarkets that daily receive cash flow, turnover difference funds, which are funds generated due to longer payable conversion period than accounts receivable conversion period, increase cash flow generation capability. In contrast, businesses with a long inventory turnover period, such as home improvement centers, require working capital, resulting in a reduced ability to generate cash flow. There are also business categories where EBITDA and cash flow from operating activities are relatively larger than operating income as seen in cases of general merchandise stores operating large shopping centers, which incur a large amount of depreciation expenses. JCR assesses debt repayment capacity after understanding these differences in patterns of cash flows generated by business type.

It is desirable that retailers operating chain stores reinvest the profits generated from existing stores in new stores. In reality, however, investment in new stores is often made through external financing. In this case, JCR confirms whether the invested capital is properly generating cash flows and is being recovered within a certain period of time.

Retailers often use leasing in opening new stores. For operating leases, if the lease assets are highly essential assets in operating business and have an impact on the balance sheet, JCR also considers adjusted financial statements reflecting this. Additionally, if the group operates financial businesses such as credit card companies or banks, interest-bearing debt related to these operations may also be adjusted in some cases.

Key financial indicators:

- Cash flow from operating activities
- EBITDA
- Ratio of interest-bearing debt to EBITDA
- Ratio of interest-bearing debt to cash flow from operating activities

(3) Safety

Stores that remain unprofitable for a certain period will be subject to impairment accounting assessments and subsequently record impairment losses. In the retail industry, impairment accounting assessments are basically conducted for each store, meaning new stores subject to impairment losses arise nearly every fiscal year. Particularly when the company's performance deteriorates, the number of stores triggering impairment accounting increases in a spiral pattern, significantly impacting the financials.

In the retail industry, promptly closing unprofitable stores is an important option for restoring performance. Furthermore, on a retail company's balance sheet, items like inventory and security deposits other than tangible fixed assets account for a relatively high proportion. Sufficient equity capital is necessary to withstand losses associated with evaluation as unprofitable stores, store closures, and inventory disposal, and JCR places importance in the adequacy of equity capital.

Furthermore, expanding retail operations requires continuous capital investments, including new store openings and renovations of existing stores. JCR confirms whether the company is being able to maintain the financial condition essential for smooth financing.

Key financial indicators:

- Impairment loss
- Shareholders’ equity
- Equity ratio
- Debt equity ratio

Because of the possibility of human or mechanical error as well as other factors in the information herein, JCR makes no representation or warranty, express or implied, as to accuracy, results, adequacy, timeliness, completeness or merchantability, or fitness for any particular purpose, with respect to any such information, and is not responsible for any errors or omissions, or for results obtained from the use of such information. Under no circumstances will JCR be liable for any special, indirect, incidental or consequential damages of any kind caused by the use of any such information, including but not limited to, lost opportunity or lost money, whether in contract, tort, strict liability or otherwise, and whether such damages are foreseeable or unforeseeable. Information herein is statements of opinion, and not statements of fact as to credit risk decisions or recommendations regarding decisions to purchase, sell or hold any securities such as individual bonds or commercial paper. JCR retains all rights pertaining to this document. Any reproduction, adaptation, alteration, etc. of this document, is prohibited, whether or not wholly or partly, without prior consent of JCR.

Japan Credit Rating Agency, Ltd.
Jiji Press Building, 5-15-8 Ginza,
Chuo-ku, Tokyo 104-0061, Japan
Tel. +81 3 3544 7013, Fax. +81 3 3544 7026