

# Regular research papers and articles providing sector specific insights and issues analysis – Retail sector.

November edition 2010 – Retail

## Industry Intelligence Unit

Grant Thornton's Industry Intelligence Unit (IIU) blends the latest information and analysis of specific industries from publicly available sources (including the Australian Bureau of Statistics and the national press) with pragmatic, commercial and practical initiatives to improve stakeholder value.

### Welcome to our latest edition of the Retail IIU.

As the global economy elevates itself out of one of the toughest downturns in living memory, Australian retailers who have weathered the storm may be feeling confident about the robustness of their business models. However, the retail industry is a dynamic and fast-paced sector, with management constantly being required to re-visit their value offerings and consumer preferences.

On reflection, the downturn has clearly had a significant impact on the retail industry structure by, among other things, forcing many smaller shops to the wall, accelerating consolidation and causing a shift of consumers towards

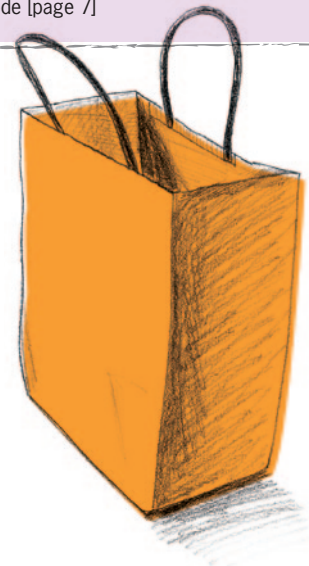
discount retailers and away from niche outlets and brands. Arguably the most profound shifts have resulted from the emergence of the internet, and the ability of some retailers to establish entirely new electronic sales channels with vastly different cost structures.

In light of changes in the retail market post downturn, this IIU reviews the lead up to Christmas and discusses the impact of new technologies on the retail sector, which has gone beyond the need for retailers to establish a viable online presence.

At the outset we provide a summary of the latest retail statistics across Australia.

Our latest edition of the Retail IIU provides a statistical update on retail performance across Australia and includes the following articles pertaining to current issues.

- "Will it be a Merry Christmas for Retailers?" – what are the experts predicting for Christmas 2010 and what is our opinion by Adam Field and Gayle Dickerson [page 4]
- "Is purchasing power in the hand of the iPhone" – a brief overview of the increasing influence of new technology on customers buying decisions by Adam Field and Gayle Dickerson [page 5]
- "The Price is Right vs. Sale of the century?" – What pricing strategy should retailers pursue to attract customers? By Gareth Jude [page 7]



# Retail industry snapshot

Seasonally adjusted turnover increased by 0.3% in September 2010 which followed a rise of 0.3% for the previous month.

Clothing, footwear and personal accessory retailing achieved the highest growth throughout September 2010 (2.5%). Household goods and food retailing both experienced minimal growth of 0.2% and 0.1% respectively. Cafes, restaurants and takeaway food services fell by 0.4% closely followed by department stores which suffered a 0.2% decrease in sales.

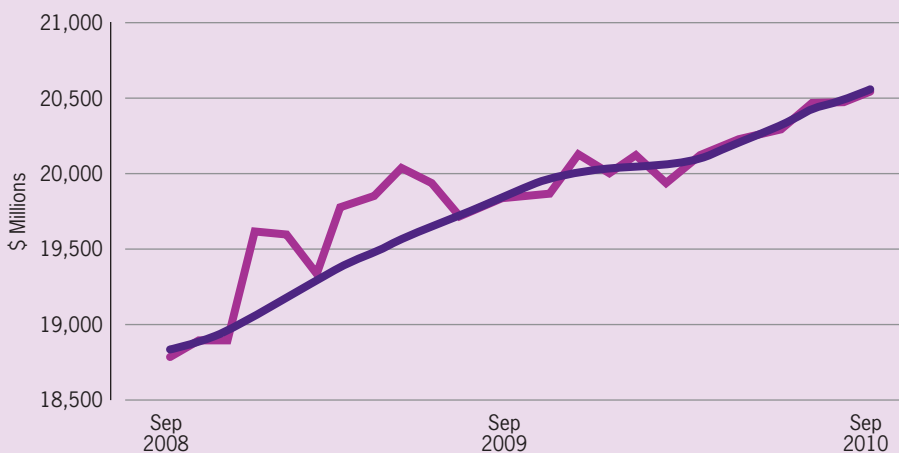
## Around the states

Retail trends in September 2010 varied across the states and territories however all reported fairly flat results. The movement for each state and territory is shown in the graph right.

We note that Perth has extended the retail trading hours with effect from November 2010 following reforms in WA shopping laws. We will monitor this in the December 2010 quarter to see if it results in an uplift in sales.

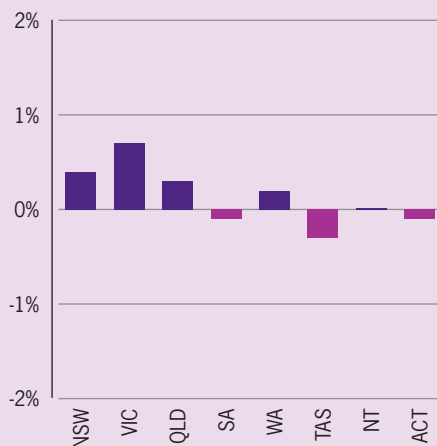
**Retail turnover in Australia, September 2008 to September 2010**

Source: ABS Retail Trade 8501.0 September



(a) Estimate for July to October 2008 are derived from the one-in, two-out sampling method.

**Change from proceeding month (% seasonally adjusted)**



# Movement in interest rates / Australian dollar

Interest rates and fluctuations in the Australian dollar are two key pressures on the retail sector. As the graph below illustrates, sales turnover has grown against a backdrop of declining interest rates and of course, was bolstered by the Federal Government stimulus handouts in 2008/2009. Interest rates are creeping back up and the banks' recent increase in rates beyond the RBA increase will impact on the extent of disposable income available. Having said that, financial markets have moderated their expectations around the speed of further official increases in 2010 and 2011 in light of the weakness of the rest of developed world's economic recovery.

Westfield Group managing director Steven Lowy said last week, that the strong Australian dollar, which has now reached parity with the US dollar, has boosted retailer margins and that despite slower turnover this year, the sector retains a strong base:

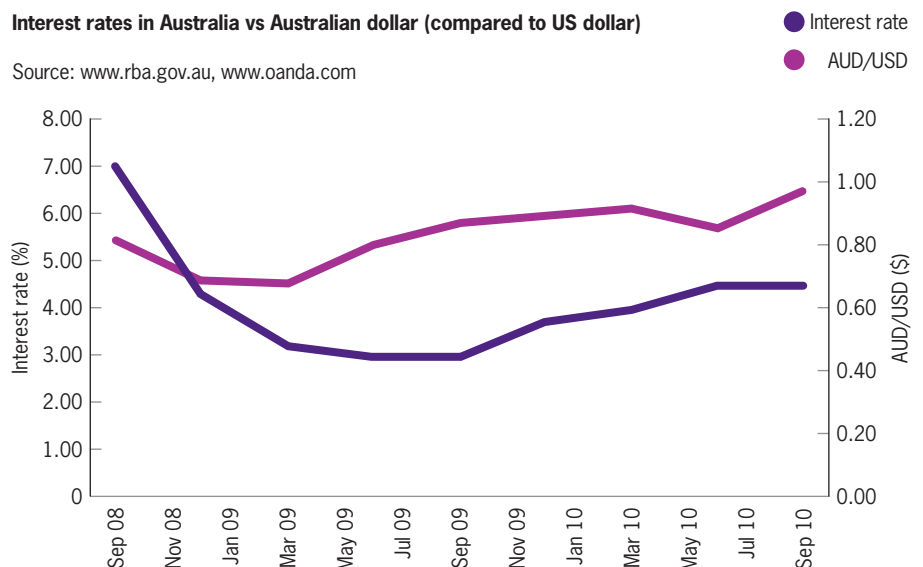
"Of course, you have a very strong dollar that assists in the margins of those businesses, and the ability to purchase goods from lower cost economies, such as Asian countries, have really boosted the ability for the efficiency of retailers."

On the other hand, some retailers, such as Harvey Norman and JB Hi-Fi are concerned that the high value of the Australian dollar is exacerbating price deflation on gadgets such as LCD televisions, but they have no choice but to adapt to falling prices. In addition major retailers continue to have concerns that more consumers will shop on overseas



Interest rates in Australia vs Australian dollar (compared to US dollar)

Source: [www.rba.gov.au](http://www.rba.gov.au), [www.oanda.com](http://www.oanda.com)



websites as the dollar continues to increase and because of the weak currency and cheap imports there will be an increase in smaller wholesalers/importers. The threat is such that one major retail

association recently called for the Federal Government to reduce the duty free personal exemption from \$1,000 to \$400 to reduce the leakage of Australian sales to overseas online retailers.

# Will it be a merry Christmas for retailers?

Before we discuss predictions for this Christmas, let us first reflect on Christmas 2009. Australian retailers reported soft sales in the lead up to Christmas 2009, however most retailers fared better in the New Year due to a renewed sense of confidence. But where are we now?

Overall, business conditions in Australia are stable and, when compared to most of Europe, the US and Japan, Australia is significantly better placed. Overall retail sales have fluctuated but compared to 2008-2009 are marginally improved. This has supported renewed interest from overseas retailers, such as Gap and Zara, in entering the Australian market, coupled with the flagship new Westfield centre in Sydney.

Expectations from retailers are high in Sydney for a strong Christmas 2010, further to the opening of 130 stores in the new Westfield shopping centre on Pitt Street on 28 October 2010. Grant Thornton's retail clients who are among the first "batch" of stores to open there, have reported a strong initial few weeks of trading, above their expectations. Industry insiders have commented that Gap's first Australian store had \$100,000+ daily sales for its first week of trading, so clearly there is still demand for well respected global brands and a sexy new mall offering.

There is clearly more confidence amongst Australian retailers in the lead up to Christmas. The recent Dunn & Bradstreet business expectation survey shows retailers are expectant that the



Christmas trading period will stimulate and strengthen trading conditions, with a 16 point surge in its sales expectations index to 34 points above the zero level that separates optimists from pessimists.

However, there are three key pressures which will particularly impact retailers in Christmas 2010:

- Frugal customers who are making "smarter" decisions regarding spending – reinforced by recent interest rate rises
- Focus on online shopping for Australian retailers. The strong Aussie dollar will make online shopping in the US even more attractive
- Impact of new technologies including smartphones giving more choice to the consumer, instantly at the touch of a button

We discuss overleaf technology advances in retailing. This Christmas is more than ever set to be the "Year of the Online Shopper" especially as, according to Paul Greenberg of DealsDirect.com.au, consumers of all generations now have

a lot more confidence in making their purchases online. This year it is expected that nearly half of all Australians will buy at least one Christmas present online.

Australian Retailers' Association executive director Russell Zimmerman, is extremely concerned about the number of Australians spending money online at stores based overseas, an issue exacerbated by the strong Australian dollar. Zimmerman says Australians are set to buy \$12 billion worth of products online this year, and he claims about 45% of that will be spent offshore.

However, some retailers are positive regarding Christmas 2010. Strong performer, JB Hi Fi, reported 12% stronger growth in the September quarter compared to last year and expects the Group to deliver another record earnings result in 2010/2011.

Retailers need strong Christmas trade to confidently step in to the New Year. Pricing strategy in particular will be relevant for Boxing Day sales (see retail expert Gareth Jude's article on page 7 for further discussion).

# Is purchasing power in the hand of the iPhone?



The vast majority of retailers now have some kind of online offering and most stores are embracing social networking sites.

It is fair to say that Australian retailers have been slower to respond to this trend compared to the US, Europe and Asia. David Jones only launched its online store recently in November 2010. This is just in time, as this Christmas is forecast to be the first where consumers in the 30 to 55 years age bracket (David Jones' core market) really embrace internet

shopping. This age group, with massive spending potential, have previously been reluctant to purchase online. Over time though, they have gradually become familiar with the internet as retailers have significantly improved the usability of their sites and there is more comfort regarding the security of paying online.

However, technology has advanced

far beyond retailers just having an online shopping facility via their websites. Advances in mobile phone technology are the next step, set to significantly impact the purchasing decisions of consumers.

We can now download applications (apps) onto our iPhones (for a few dollars) which allow us to stand in a shop and remotely compare pricing and buy online. A new app called RedLaser (launched in Australia in November 2010), allows users to scan the bar code of an item and will almost instantly provide a price comparison across a range of suppliers. This has major consequences for traditional retailers, who will be effectively funding "shop space" for cheaper online suppliers. A number of our clients report that they know their prospective customers get to feel, touch and see the goods in the store, yet purchase the item from an alternative supplier at a cheaper price. Reports from our clients indicate that this is a very real phenomenon and regularly customers don't even leave their store before placing an order with a US or UK online retailer.

This practice is sometimes referred to as "digital shoplifting" and has become something of a plague in Japan, where customers are utilising mobile phone camera technology to take photos of magazine pictures rather than buying a copy. Retailers such as Amazon see significant potential for their business with this new technology. This is likely to place further pressure on booksellers across Australia, who are already under

significant strain due to their high rents, large floor spaces and pressure from internet retailers through downloading of music and books as well as cheaper pricing structures. The choice for consumers will come down to price vs. convenience – do they want to buy the item now for more, or wait for delivery?

Some retailers may consider this is a gimmick or phase, a process far too complicated for their customers – but is it? Smartphones were the product of 2009/2010, with sales still soaring. Apple has forecast that iPhone sales are forecast to hit 100 million by 2011. It is certainly not “just for kids”. In Australia, it is estimated that over 40% of smartphone users are over the age of 40<sup>1</sup> and their usage rates are growing. The success of the iPad market since its launch in April 2010 further reinforces the future potential for the impact of mobile technology on the retail sector. Online auction giant, Ebay, estimates that 25% of Australians now use their mobile phone to shop online, and their own mobile sales have doubled in 2010. Australian retailers must take

these technology changes seriously and consider how their business model needs to be adapted to stay ahead of the crowd.

Likewise, Australian retailers will also need to consider the likely increase in pressure to succumb to discounting websites that offer discount vouchers in stores. Whilst this can be a useful marketing tool to attract shoppers, if Australia follows the UK trend (websites such as MyVoucherCodes.co.uk, offer 15% to 30% discounts for nearly all high street retailers), customers may ultimately never pay full price – why would they?!

The above examples illustrate just some of the new retail trends emerging. It is essential that retailers re-examine their business model and strategies to remain relevant to their customers. With the worst of the downturn now over, retailers cannot afford to relax, but must constantly evaluate their business.

For further information, refer to our February 2010 Retail IIU where we provided some strategies for growth, particularly focussed on e-tailing and social networking.



# The Price is Right vs. Sale of the Century

The below article was compiled with the assistance of our resident retail expert, Gareth Jude, an industry veteran who has held senior management positions (including CEO) with a number of high-profile retailers.

In the 1980's "The Price is Right" and "Sale of the Century" ruled the airwaves. "Sale of the Century" was an Australian (Reg Grundy) format originally hosted by Tony Barber in which contestants each started with \$20 then won extra money by answering general knowledge questions correctly. At the end of each round the leading contestant was invited to spend some of their winnings in the gift shop. It was Tony Barber's job to get the contestant to forfeit their leading position in the contest by spending some of their winnings on incredible bargains like lounge suites for \$10 or motor boats for \$20. Extra "real" cash was often thrown in to seal the deal.

The "Price is Right" was an older American game show format that originally appeared in Australia in the 1950's. By the 1980's it was called "The New Price is Right" and hosted by Ian Turpie. "The Price is Right" was made up of various pricing games centered around guessing the "right" price for a product.

In the 1980's "Sale of the Century" won the ratings war, was exported around the world and survived on air for 20 years. The "Price is Right" is still on air overseas and was last sighted in Australia in 2005 almost 50 years after its

initial appearance.

As a specialty retailer which format would you back? "Sale of the Century" or "The Price is Right"? I have walked around a number of shopping centres recently and it would seem that in Australia it would be a resounding vote for "Sale of the Century." Nine out of ten retailers seem to be on sale and the bargains seem to be getting bigger. "50% off," is replaced by "70% off," followed by, "Final Clearance". In Myer recently I saw a "50% off already reduced items"

sale. This meant that a suit originally ticketed at \$600 was selling for \$150. Tony Barber would be proud!

Are Australian retailers backing the right format? Are "Sale of the Century" style prices the answer to current business conditions or should they be more focused on getting the prices right?

The first question is how bad are business conditions in the retail sector in Australia? The answer is that generally they are not too bad. We have not suffered the long recessions and double digit unemployment experienced in Europe and the USA. Overall retail sales move up and down but continue to hold up just above last year. Overseas retailers would kill for the business conditions we enjoy in this country and that's probably why a number of them like Gap and Zara have decided to open stores in this market.





I have been to Europe recently and was interested to see how retailers were coping with a much worse business environment than we have in this country. Spain has one of the weakest economies in Europe and has had a prolonged recession and double-digit unemployment to go with it. I was expecting to see price carnage in the malls. Take what Myer has done and double it would be the Tony Barber approach to the problem. To my great surprise only about one in ten stores were discounting and I saw nothing like the severity of discounting that we see in this country. How and why are the retailers in Spain taking this approach?

I believe that the Spanish understand that retailing in tough times is about offering best value, which is not necessarily the same as offering the lowest price. Value is a subjective concept. We experience value when the benefits we get from buying a product outweigh the price we pay. My sons think \$80 represents good value for a pair of canvas sneakers with a Converse logo on them. I would prefer they went to the local cheap imports shop and bought the same thing, without the logo, for \$10. On the other hand, I think that my \$250 running shoes represent good value because I wear them on the end of two legs that haven't

got many miles left in them and need all the help they can get. My sons think I'm crazy and buy a different model of the same brand for \$100. The important points are that for both my sons and I, price is only one element of the value equation and that value means different things to different people.

Customers don't look at price alone when they make a purchase. They do a mental equation that balances all the benefits on offer to them versus the price you want them to pay. The benefits they are looking for could be in product, brands, assortments, services, displays or in-store ambience. All will be balanced against price.

The other value equation to consider is that of the retailer themselves. That is, can the range/services/in-store ambience offered to the customer be delivered at the ticketed prices profitably? This is where I believe "Sale of the Century" retail thinking can sometimes go wrong. Unless you have the lowest costs it is unlikely that you will beat the competition with lowest price. It's actually more likely that you will simply reduce profits or even go broke.

The history of Australian retailing is full of examples of retailers who have gone broke despite having the best price. Clive Peeters is the latest high profile

example. Successful discounters like Big W, JB Hi-Fi and Aldi buy better, carry narrower ranges, turn stock quicker and pay less rent per square metre. Smaller retailers will never turn the value equation in their favour through price alone against such super-efficient operators. The price has got to be right.

Another major problem with relying on price to create value is that it is highly addictive for both customers and retailers. Remember when David Jones didn't have sales, but only one annual clearance?

The bad news for specialty retailers is that offering value without resorting to price discounting is hard work. It is much easier to drop the price than bring in new ranges, negotiate exclusive deals, re-merchandise or create new services. If your target market wants lowest price and you can operate at the lowest cost then by all means have a lowest price strategy. The rest of us need to work hard on offering extra benefits. The more unique the range, the more unique the services and the more unique the in-store ambience, the less price will be an issue.

After more than 50 years "The Price is Right" is still showing in some parts of the world. For specialty retailers "The Price is Right" beats "Sale of the Century" any day.

# GT National Retail Team

Grant Thornton is a national full service accounting and business advisory practice that specialises in working with retailers of all makes and types, big and small. We closely work with our retail clients, so we understand this complex and diverse market well. If you would like to discuss any aspect of the above, please do not hesitate to contact one of our industry experts detailed right.

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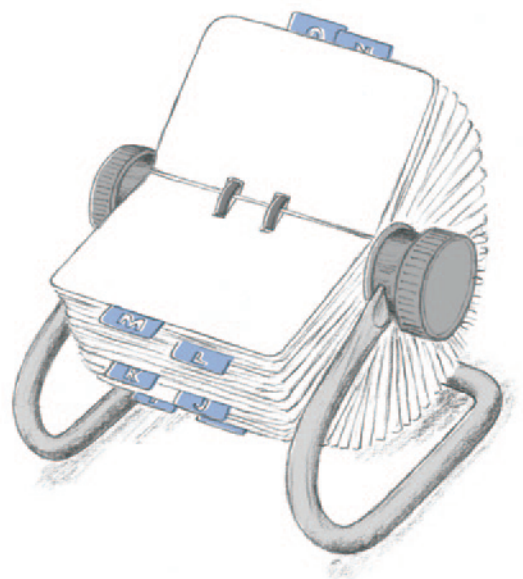
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# Industry Intelligence Unit

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- Retail
- Aged Care
- Automotive
- Hospitality
- Financial Services.

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