Grant Thornton

An instinct for growth™

August edition 2013

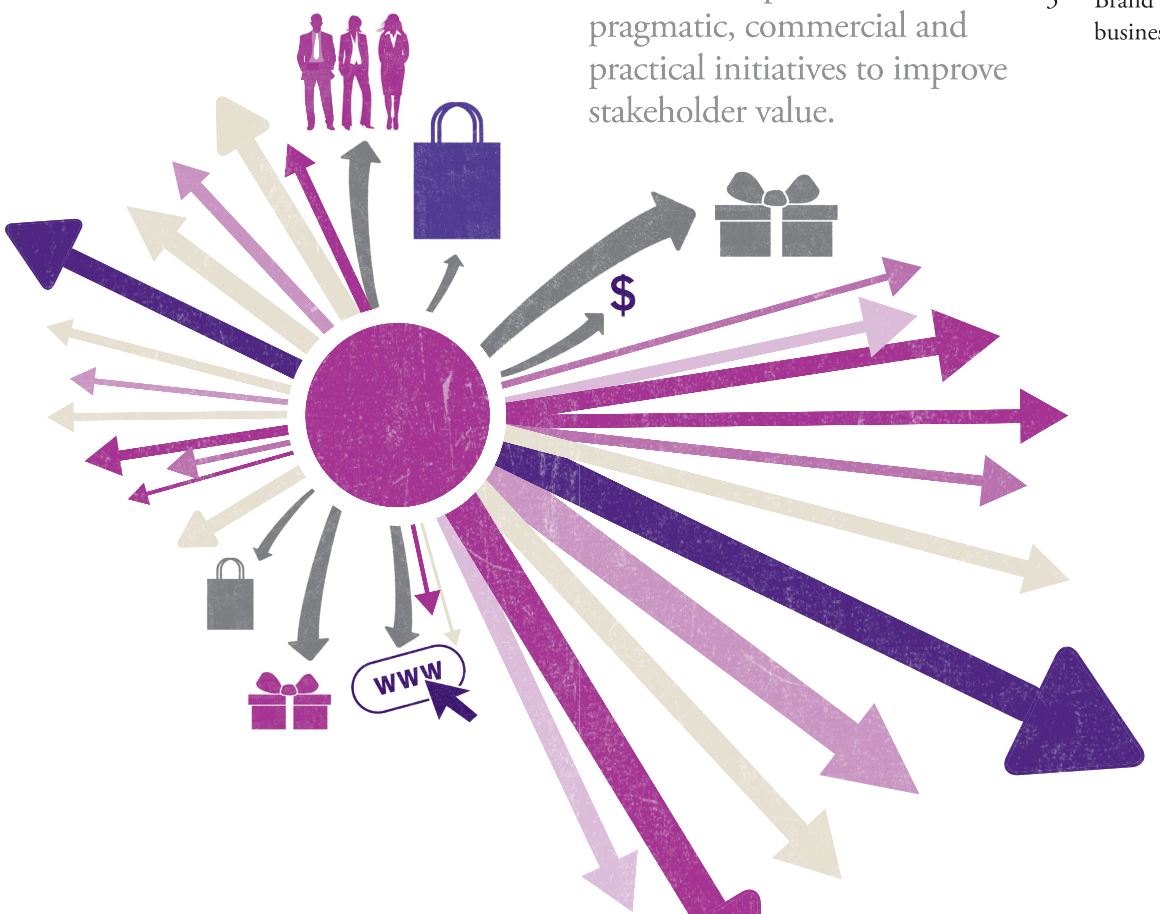
Industry Intelligence Unit - Retail sector

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

Our latest edition covers a number of hot topics for retailers:

1. Social media – winning strategies and tips for success
2. Working capital management – three key approaches to freeing up cash
3. Brand strategies - transforming businesses from the inside out



Before moving onto our usual summary of the quarterly statistics, we wanted to highlight that this month we attended a Committee for Economic Development of Australia (CEDA) breakfast focussed on the Digital economy fuelling Australia's export growth where Ebay Inc. launched their latest research: "Commerce 3.0: enabling Australian Export Opportunities".

Below are the highlights. We recommend that any retailer looking to export should read this insightful research paper:

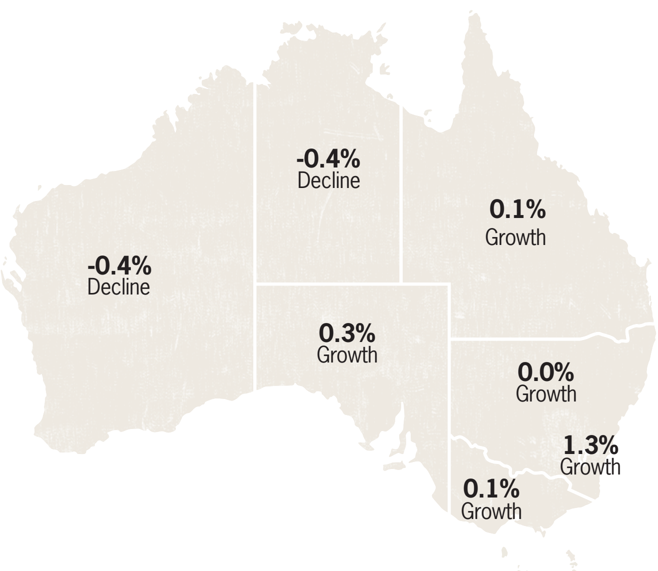
- The share of exports through eBay.com.au grew from 60% to 79% from 2006 to 2012.
- With cross-border sales of Australian goods expected to reach $AU5 billion in 2013, many Australian businesses are recognising the huge revenue opportunity in multi-channel international trade.
- eBay has access to 100 million active consumers worldwide.
- There is some indication that cross border demand for Australian goods could treble in the next five years - now is the time for Australian businesses to look hard at e-commerce for exporting.
- Last week, PayPal unveiled the new Modern Spice Routes, revealing that cross border demand for Australian goods is forecast to grow to $AU16 billion by 2018. Key markets include the US and China: 41.8 million American shoppers will spend $AU4.2 billion on Australian products by 2018, up from 34 million and $AU2.1 billion this year. By 2018, there will be nearly 36 million Chinese cross-border shoppers spending an incredible $AU10.7 billion with Australian retailers.

Key retail industry statistics

- The June 2013 results are in, and rather than an expected 0.4% increase in retail spending, the result was a bit of a fizzer with retail spending remaining flat at $AU21.8 billion
- Confidence in the economy remains flat, which has contributed to the RBA's decision to cut the cash rate by a further 0.25% to 2.5%, the lowest interest rate for 50 years!
- Meanwhile, the drop in the AUD exchange rate to $US0.89, will be positive news for most exporters. But this is placing pressure on importers who are already operating on a tight margin
- On the finance front, a July 2013 survey by UBS on the Australian banking sector found that credit writing standards to retail businesses within the SME space have remained unchanged from the tightening in the second half of 2012

Most economic forecasts (and our own expectations) are that consumers will return to driving growth in the economy in 2014/2015. But that may not be soon enough for some retailers.

% of retail sales growth



Source: ABS June 2013 retail turnover (seasonally adjusted) growth by state

The detail by industry group

Food Retailing
0.1%

Household Goods
0.3%

Clothing, footwear, accessories
-0.2%

Department Stores
0.0%

Café, Restaurant, Takeaway
0.9%

Other retailing
-1.1%

The role of social media and mobile devices in selling

An early opportunity to build brand loyalty and retail intelligence

In June 2013, Grant Thornton hosted two Retail Insights briefings on the role of social media and mobile devices in selling in Sydney and Melbourne. Our expert guest speakers were Jasper Vallance (Director of Jasper Online Consulting), Jack Dolphin (Intellectual Property & Technology Specialist, Mills Oakley Lawyers) and Maria Vu (Grant Thornton, Operational Advisory).

The sessions examined the current environment for Australian retailers and focused particularly on raising awareness and better defining the role that social media and mobile devices play in the customer's buying process.

Some key trends to note for households with the internet:

- Almost 50% of consumers' time spent looking at or using media is now spent online via computer, tablet or mobile device (approximately 30 hours per week)
- 90% of consumers trust peer recommendations, only 14% trust advertisements
- 97% of consumers will research online when researching products or services; and
- Social media is "word of mouth on steroids"

The key take away from the session was that your presence on social media and mobile devices should not be ignored. Rather, it should be seen as an opportunity for early mover advantage and a way of getting closer to your customers to build loyalty and collect useful information about them to better tailor your offering.

In our experience, many traditional bricks and mortar retailers are still struggling or do not give enough attention to keeping up with technology advancements and their successfully integrating these into their day to day business and connecting with customers.

Our observations reveal a fragmented operational environment and the following challenges:

- Social media, e-commerce and mobile activities often lack clear objectives or links to the rest of the business' strategy
- Business processes and organisational structure are often a secondary consideration when incorporating new channels such as social media and e-commerce. For example, siloed social media teams, separated from marketing or customer service, and disconnected from traditional risk managers
- Social media is not top of mind when considering brand reputational risk. Many companies do not have social media disaster management plans in place; and
- Non-integrated technology systems cause back-end operational issues and deliver sub-optimal customer experiences at the front-end

We believe that there are three immediate key priorities for Australian Retailers in respect of how they manage Social Media and interaction via Mobile Devices:

- Realign and optimise business operations so that things are coordinated between the physical and virtual worlds
- Appoint someone internally to actively manage reputation/brand risk within social media in particular; and
- Identify and capture new opportunities to get closer to the customer, particularly when they are in-store

A powerful differentiator for traditional retailers will be their ability to offer customers a seamless end-to-end customer experience, blending bricks & mortar with social media, e-commerce and mobile. If this is coordinated well then it makes you easy to buy from.

If you'd like more information please contact a member of the Grant Thornton retail team.

Three steps to improve working capital through inventory efficiencies

Do you need to improve your working capital? Carrying out a detailed inventory review can generate surprising working capital benefits.

Here's how to do it!

CFOs and Financial Controllers will be well aware of the improvements that can be made to working capital by refocusing their efforts around cash, debtors and creditors. However, a sustainable reduction in inventory can also unlock significant working capital – while delivering associated business benefits, including lower transport and warehouse costs, in the process.

The biggest benefits will be felt by businesses that:

- overstock the wrong products and don't always have the right products to meet customer demand
- have a surplus of obsolete or marked-down stock on hand
- experience stock-outs and back orders on popular products
- stock a large number of products to meet the needs of few customers
- have a number of customers that place small or irregular orders

For retailers where inventory is a significant contributor to working capital, a structured and detailed approach to reviewing inventory is vital to avoid compromising levels of customer service.

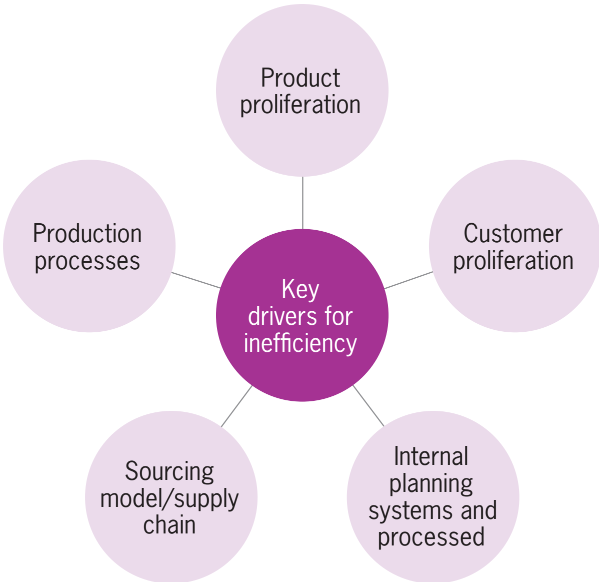
Three steps to improving your inventory efficiency

1. Inventory analysis at Stock Keeping Unit (SKU) level

An in-depth analysis of current raw material, work in progress and finished goods inventory at SKU level is an essential first step to drive inventory efficiencies. This analysis helps businesses understand the value and level of inventory, as well as the coverage costs for each SKU against historical and future demand.
It is critical that this analysis is carried out at SKU level – not at the more aggregate category level. A category level analysis can be flawed as individual SKU under or overstocking issues can remain hidden among category averages.

2. Identifying key drivers for inefficiency

The inventory analysis at SKU level is the base reference from which to pinpoint the causes of inefficiencies and to start identifying solutions. To build on this the key drivers for individual under or overstocking issues need to be identified:



Key driver: Product proliferation

Product proliferation is a common factor behind large imbalances in inventory coverage. As such the inventory value and coverage for each SKU should be overlaid against its gross margin contribution. This provides the basis to justify product rationalisation.

Dealing with product proliferation issues:

- Identify those SKUs that contribute the lowest gross margin contribution in value per annum
- Compare gross margin contribution against average inventory value, cover and cost
- Establish all SKUs and customers with a high inventory cover relative to demand and contribution; and
- Establish robust metrics and processes to deal with new product introduction, product promotions and de-listings

The greater the number of SKUs, the more complex and costlier it is to sell, plan, track, manufacture, ship and deliver those units.

Key driver: Customer proliferation
Having too many customers with unique products (unless appropriate margins are achieved for this level of customisation) can result in excessive inventory costs, so it is important to evaluate the net impact of each customer on both the business and the inventory.

Dealing with customer proliferation issues:
- Analyse customer sales history to understand the order frequency, the number and range of SKUs purchased and the average order size; and
- Identify those customers with the lowest gross margin contribution and highest conversion and distribution cost

Key driver: Internal planning systems and processes
Robust demand, supply and inventory planning processes are key. However, we often find that the planning function is underinvested and not aligned to the needs of the business. Often, realignming people's skills, systems and processes to the business model is necessary.

More effective demand and inventory planning enables more effective communication with suppliers. This aids the negotiation and implementation of consigned or vendor managed inventory as part of the inventory reduction solution.

Key driver: Sourcing model/supply chain
The sourcing model and supply chain have a significant impact on inventory, which is not always positive. For example, supply-chain efficiencies often drive companies to overseas suppliers with longer lead times.

Dealing with sourcing model/supplier issues:
- Identify the inventory items that are overstocked because of supplier location, lead time, minimum order size or replenishment frequency
- For suppliers with long lead times, robust inventory planning will be needed, particularly for SKUs with low/high volatility or seasonal demand; and
- Align sourcing and inventory planning to reduce coverage costs. Work with customers to provide accurate demand forecasts

Key driver: Production processes
Vertically integrated manufacturing companies face a major challenge in supply chain management: driving economies of scale in production while maximising inventory efficiency. For some businesses this may be straightforward. However, complications arise in cases of high product proliferation and low order volumes.

To balance these conflicting requirements:
- Improve the planning process
- Improve the efficiency and responsiveness of production
- Differentiate service level by product and sales channel; and
- Determine target inventory levels as a result of the desired service level

3. Pulling it all together

Once the SKU inventory analysis is complete and the key drivers for inefficiencies have been identified, CFOs and Financial Controllers should prioritise solutions that will maximise inventory efficiencies to reduce working capital.

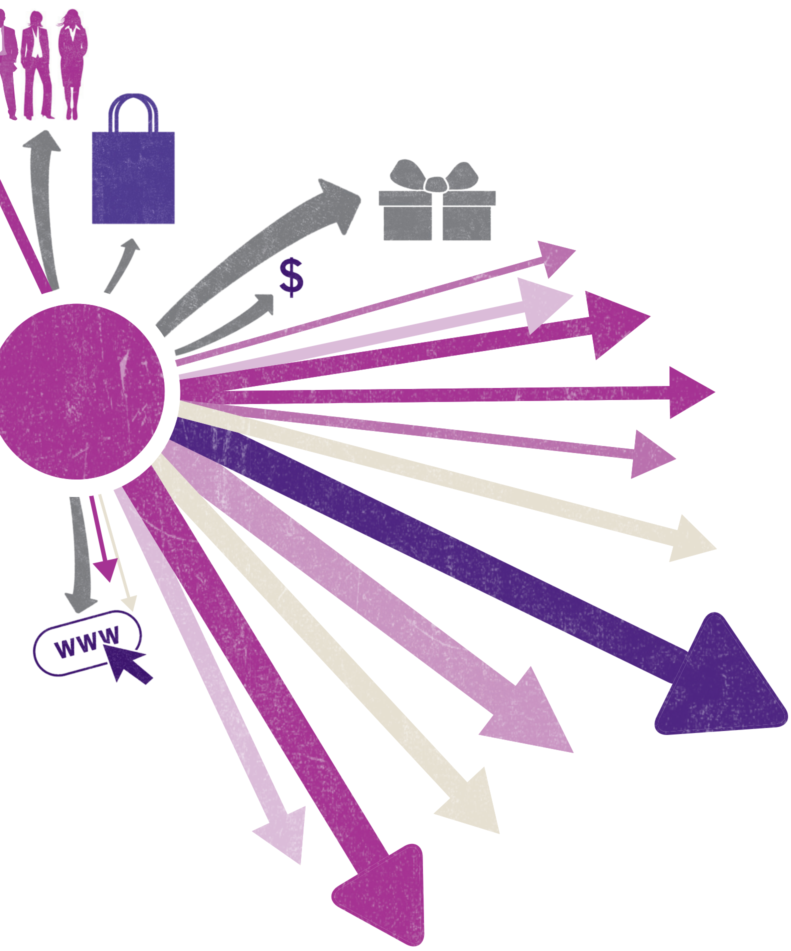
It is common for retailers to encounter significant push-back at this stage. For example, sales teams may not want to let go of products for fear of losing customers. Sourcing professionals who have painstakingly built up an overseas sourcing model may feel threatened.

Therefore, independent advisers are often better placed to demonstrate the true impact that inventory inefficiencies have on the business, and to support management teams in the implementation of the necessary changes.

If you'd like more information please contact a member of the Grant Thornton retail team.

Why Australian brands are losing their way

Catherine Taouk and Ivan Fuchs of THiNK Consulting specialise in assisting the fashion industry with innovative solutions to challenges that need to be met and transformation that needs to take place. For this Retail IIU, Catherine and Ivan provide some insight on the importance of branding and transforming the business from the inside out. The opinions expressed in this article are those of Catherine and Ivan.



Today there are an increasing number of iconic Australian brands in the fashion sector that have lost or are on the path to losing their way.

This decline of brand equity and loyalty is due to a combination of out-dated business models, tired branding strategies, lack of product and service innovation, soaring rental costs, rapidly changing technology, high staffing costs and exciting new international brands entering our competitive domestic fashion space.

One of these brands is SUPRÉ, which traded its way out of voluntary administration in the early 2000's. A distinguished brand, SUPRÉ quickly rose to the forefront of the youth fashion and lifestyle market. Historically, their model was constantly evolving, adapting and had the characteristics of a true brand innovator. This quick-to-market brand had a real connection with the market it competed in, and enjoyed unrivalled brand loyalty amongst its consumer base.

Today, stripping all those attributes back, we find a company that sells a product for a price; it has certainly lost its lust and desire. However SUPRÉ is not alone.

Sadly, Lisa Ho, an iconic Australian brand, was put into administration recently after enjoying 30 years as a high-end brand in women's fashion.

Billabong, which started from humble beginnings in 1973 by Gordon Merchant has certainly been bracing itself as a brand in turbulent waters with a number of potential takeovers and refinancing deals. Recently, the refinancing deals and the appointment of a new CEO have been positively received by investors and the market as a whole.However this doesn't take away from the fact that Billabong is underperforming in Australia, which opens up questions relating to business strategy, buying processes and , is the entrance of ultimately the brand.

One of the key, identifiable pressures making waves in this sector international brands like Zara and TopShop. They are run like well-oiled machines and benefit from world class supply chains and inventory systems. Their product is undeniably 'cool', innovative and cutting edge, fast-to-market and exciting for Australian shoppers.

Why Australian brands are losing their way

In a world where consumer loyalty is driven by choice and convenience, global e-tail brands like ASOS, Net-a-Porter, Shopbop and Urban Outfitters (Australia being their second largest online market outside of the US), are sweeping our hard earned Aussie dollars offshore. They have launched aggressive marketing campaigns that include successful lures such as free international shipping to entice the local market into finally being able to shop the High Street without having to manoeuvre international security measures.

These brands share in their business foresight, as the e-tail market is set to soar in the next few years it is valued to be worth $27 billion in Australia by 2016.

The question is, knowing these issues, what does a brand do to turn itself around?

In broad terms, here is a step-by-step approach to start the transformation process:

- Rebuild the brand to what it was previously remembered for, the stories it told and the relationship it built with its customers
- Reinvigorate the "business as usual" model
- Update the business model to be in-line with local and global competition
- Stay abreast of new and innovative technology – master end to end processes
- Develop a strategic cost cutting strategy
- Invigorate the sales strategy – create a sense of trust with consumers, bring back the fun and entertainment to the brand
- Analysing the people in the business from the top down – are they the right team to carry the business forward?
- Create an exit strategy
- Refine the business plan
- Set clear and focussed business goals
- Set sharp KPI's to keep all team members accountable for the success of the business, and responsible for shortfalls; and
- Systemize the buying process

With many more Australian brands under pressure, it is time that we stood up to our global counterparts and brought back our own Aussie buzz to the marketplace.

It's THiNK Consulting's mission to create a movement of change in the fashion sector to nurture it back to how it used to be. There was hype, there was fun and there was an excitability and entertainment value in Australian brands.

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Industry intelligence unit

About Grant Thornton Australia

Grant Thornton is one of the world's leading organisations of independent assurance, tax and advisory firms. These firms help dynamic organisations unlock their potential for growth by providing meaningful, forward looking advice. Proactive teams, led by approachable partners in these firms, use insights, experience and instinct to understand complex issues for privately owned, publicly listed and public sector clients and help them to find solutions.

Grant Thornton Australia has more than 1,300 people working in offices in Adelaide, Brisbane, Melbourne, Perth and Sydney. We combine service breadth, depth of expertise and industry insight with an approachable "client first" mindset and a broad commercial perspective.

More than 35,000 Grant Thornton people, across over 100 countries, are focused on making a difference to clients, colleagues and the communities in which we live and work. Through this membership, we access global resources and methodologies that enable us to deliver consistently high quality outcomes for owners and key executives in our clients.

What is the Industry Intelligence Unit?

The IIU is unique in its objective of providing stakeholders with information, understanding and analysis of the issues faced within specific industries and subindustries. The IIU also seeks to provide pragmatic, commercial, practical measures and initiatives to improve stakeholder value.

Industry focus

The IIU utilises the industry experience and expertise of Grant Thornton partners and staff across Australia. The IIU is predominantly focused on the following industries and their related sub industries:

Automotive Dealerships ENERGY & RESOURCES
Financial Services
Food & Beverage
Hospitality & Tourism
HEALTH & AGED CARE
LIFE SCIENCES
Manufacturing
PROFESSIONAL SERVICES
Not for Profit
Major Projects & Infrastructure
PUBLIC SECTOR
Technology & Media
REAL ESTATE & CONSTRUCTION
Retail

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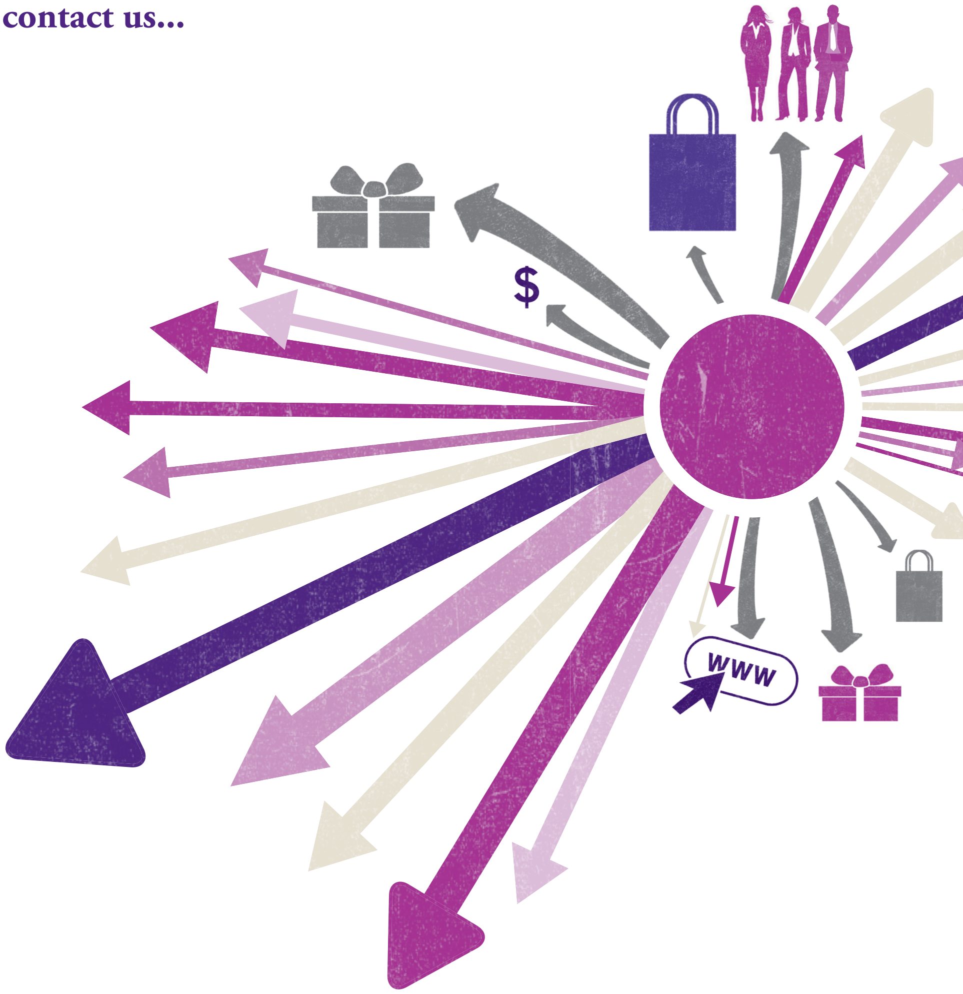

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