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AUSTRALIA'S RETAIL CHALLENGE TEN ISSUES FACING AUSTRALIAN RETAIL IN 2011



- Australian retailers face challenges in 2011
- A number of external and internal issues are putting pressure on retailers
- Understanding these issues are essential for the continuing growth and success of Australian retailers and managing turnarounds and workouts in this sector

Taylor Woodings and Allen Capital have formed an alliance with Michael Holtzer, Executive Director of Turnabout Retail, to provide advisory services in the retail sector. We have identified the below issues affecting retail businesses in 2011.

OVERVIEW

Depending on how they respond to external and internal issues that affect their business operations, 2011 could be a difficult year for Australian retailers.

Detailed below are the key external and internal issues for Australian retailers that need to be managed in order to avoid difficulties in the year ahead and lead to a more globally competitive market.

Understanding these issues and with the right advice and guidance, retailers can navigate the current economic challenges.

EXTERNAL ISSUES AFFECTING AUSTRALIAN RETAILERS

Although many external issues affecting Australian retailers cannot be controlled, it is important for retail owners to understand the impact of these issues and adjust their operations to minimise any negative impact.

The key external issues adversely affecting Australian retailers include:

1. Online Shopping

The growth in popularity of online shopping has had considerable media coverage recently and is expected to grow by 5.1% per annum over the next five years in Australia (IBISWorld). The strong Australian dollar, low costs, technological advancements and the willingness of overseas businesses to reduce profit margins have contributed to the increase in online shopping at the expense of bricks-and-mortar shopping centres. These factors create a

major competitive risk for Australian retailers, as seen by the recent voluntary administration of REDgroup Retail, the parent company of Borders and Angus & Robertson.

Although there is recent commentary surrounding imposing of GST to online purchases, the reality is that this will unlikely inhibit the growth of online purchases.

2. Overseas Brands Entering the Market

A number of major international brands have entered the Australian market in recent years, including GAP, Costco, Banana Republic and Zara. As these brands are widely known, they pose a huge risk to Australian retailers and will significantly impact sales volumes.

However, these overseas companies are faced with their own challenges which, if understood, can allow Australian retailers to successfully compete with these overseas brands. Such challenges include, seasonal differences between northern and southern hemispheres, unrealistic volume expectations, reaction speed to market take-up due to the geographical location of manufacturers, and licence, franchise and management issues.

3. Interest Rate Increases

Interest rate movements affect all businesses in several different ways. When interest rates go up, consumers have less disposable cash available and tend to tighten their purse strings as mortgage payments increase. Depending on the levels of business debt, rising interest rates also increase retailers' interest costs, thereby placing further pressure on retailer owners. Additionally, rising interest rates increase the criterion for private equity and decreases the amount of cash available for investing.

Even though Australia's interest rate affects all businesses, the current interest rate is considerably below what it was in the early 90s (16.5%) and businesses were able to survive then.

4. Tightening Capital Markets and Bank Facilities

The retail industry continues to deal with a general lack of confidence amongst investors. Banks and private equity firms have become less tolerant to poor performing businesses and stocks over the past year.

Private equity firms have become risk averse in their investment decisions ensuring that businesses have a solid foundation, experienced management teams and a valid business plan before investing. Banks that previously accepted covenant breaches have tightened the loophole and will be withholding future draws and, in many cases, withdrawing support altogether.

5. High Costs of Doing Business in Australia

The high cost of doing business in Australia has placed enormous pressure on retailers including some of the highest rents in the world and high staff costs. For example, Westfield's Pitt Street Mall in Sydney CBD is ranked as the second most expensive retail

location in the world. Australia's minimum wage is somewhere between \$13 and \$20 depending on age - in the United States it is \$7.25. In addition, import duty costs are high and with Australian product volumes being considerably lower than other countries, freight costs are significantly higher.

Australian retailers must be smart and efficient in order to compete in the ever increasing global economy and seek independent advice.

INTERNAL ISSUES AFFECTING AUSTRALIAN RETAILERS

As with any industry, Australian retailers are faced with a number of internal challenges that lead to poor business performance and high turnover. These issues can be quickly and easily overcome if controlled and managed properly.

The key internal issues affecting Australian retailers are:

1. Resistance to Change

Historically, Australian retailers culturally resist change. For example, Australian retailers have been slow to move online, reluctant to move business headquarters to suburbia and unwilling to aggressively clear old stock. Additionally, smaller Australian retailers have not adopted strategic alliances, which Michael Porter's 5 Forces Framework identifies as important for business growth and limits new threats to the market.

Self-service models have also made their way into retail stores in an effort to reduce costs, however, this has taken away the valuable customer service experience and therefore resulted in decreased sales.

Furthermore, although the strong Australian dollar has provided cost-savings for business owners, retailers have been extremely slow in passing on these savings to customers, preferring to keep the margin for themselves making it easier for competitors to undercut on price.

Retailers need to understand their customers' key drivers and ensure they adapt internal models to suit their customers.

2. Too Much or Incorrect Inventory

Managing stock levels and ensuring stock is rotated is vital for any business, particularly retail businesses. Retailers have been reluctant to aggressively clear stock and, in the past, they only cleared stock during big annual sales in January and July. Outlet stores have grown over the past few years and, sales have become more frequent - especially in department stores.

In the late 1990s and early 2000s, the retail sector was growing exponentially, inventory and stock control plans were not created and mistakes were 'washed over' with increasing demand. In recent years, particularly due to the global financial crisis, conditions have been

challenging for Australian retailers and buying mistakes are more prominent. Retailers do not have appropriate plans to control the intake and sell-through of inventory - a key element in any retail business.

Through advances in technologies, retailers have access to a number of efficient inventory control methods that are not being utilised.

3. Young Management Teams

Australia is the land of opportunity and offers a great avenue for young, talented, intelligent and hard working people. The retail industry has allowed many young entrepreneurs to succeed, however, as the retail industry is very cyclical, the young talent running retail businesses today often lack experience in running a business during the tough times.

These companies need to surround themselves with advisors that can guide them through difficult times with the right expertise.

4. No Investment in the Future

Short term thinking is another internal factor affecting retailers. Many retailers simply cut down the wrong costs when times are tough, which ultimately places the business in a difficult position which is hard to recover from.

Retailers must invest in experienced people and appropriate technologies that will allow them to compete in the global marketplace.

5. Inexperience in Overseas Business

Retailers expanding their operations overseas must not lose sight of their core business. Sales volumes that can be achieved in other countries can quickly outstrip the volumes in Australia, which can adversely affect the prime business here in Australia and cause havoc in the head office.

It also is extremely important to understand the legal differences and business operations in other countries before investing. For example, clothing businesses have to deal with northern and southern hemisphere issues. Additionally, understanding local demographics and culture are essential, making it crucial to employ local talent.

TAYLOR WOODINGS' AND TURNABOUT RETAIL'S VIEW

As in any industry, Australian retailers are faced with a number of external and internal challenges that lead to poor business performance. We recommend Australian retailers understand these issues, and adopt change management practices internally as a way to successfully overcome them. The right guidance, expertise and experience are key to the future success of retail businesses.



RESTRUCTURING | CORPORATE RECOVERY | ADVISORY AND TRANSACTION SERVICES | FORENSIC ACCOUNTING

Taylor Woodings and our affiliate corporate advisory and private equity investment firm, Allen Capital, have extensive experience in retail restructuring and are well positioned to offer assistance to businesses facing current challenges. From formal and informal workouts to restructuring and turnarounds, Taylor Woodings and Allen Capital are able to assist retailers with their needs.

Taylor Woodings and Allen Capital have formed an alliance with Michael Holtzer, Executive Director of Turnabout Retail, to provide advisory services in the retail sector.

Michael Holtzer is a retail industry executive with considerable experience in crisis management and commercial negotiations in his roles as COO of Cat Media, COO of Oroton Group Sydney, which included retail brands such as Oroton, Polo Ralph Lauren, Aldo, Marcs and Morrissey, Vice President of Finance and Operation of Specialty Bakers (USA), and as Operations and Finance Director of Sheridan Europe.

The relationship between Turnabout Retail, Taylor Woodings and Allen Capital, ensures our advice is relevant and practical in these difficult times for retailers.

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