

# MyConsultant

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Cassandra Ballard

## Consultant

Cassandra joined JANA in 2003 as an Investment Analyst and has been a member of both the Property Research Team and a number of client consulting teams since that time. For a number of years, Cassandra also held a position on JANA's Global Equities Research Team. Cassandra's client consulting experience involves working with a broad range of clients across the charitable trusts and foundations, industry super and Government sectors. Over the period of her employment at JANA, Cassandra has been involved in the formulation and review of investment strategy including asset allocation and manager selection along with governance processes and interaction with clients' service providers.

During her studies, Cassandra held a casual employment position at JANA. Her responsibilities during this time included portfolio input and report writing. Cassandra studied at the University of Melbourne from 1998 to 2002, graduating with a Bachelor of Engineering, Mechanical (Honours) and a Bachelor of Commerce with a major in Finance.



## Retail: Crowd vs. Cloud

Worldwide growth in internet access in the space of less than 20 years has been staggering, to the point where there is little doubt that the internet has irrevocably changed the way people communicate, work and play.

Accordingly, it is hardly surprising given the penetration, convenience and the near-instant communication provided via the internet today that businesses have sought access to consumers via this channel. The popularity of accessing consumers 'online' will continue to gain traction going forward as more businesses embrace the commercial opportunities the internet provides. So far the share of online sales as a percentage of total retail sales remains low, albeit growing rapidly, and with varying degrees of penetration across different segments of the retail sector.

Media attention and speculation regarding the impact of online retailing in Australia became a hot topic approximately three years ago; however the true impact was hard to quantify with estimates varying substantially from survey to survey. In order to provide clarity on the impact on the Australian market, seven major shopping centre managers commissioned property consultancy Urbis to undertake a comprehensive independent research study with the aim of providing an informed and rational assessment on the subject, including the risks and opportunities. The Urbis Report<sup>1</sup> produced in July 2011, whilst being based on 2010 data, remains a key piece of research on the topic of Online Retailing and provides meaningful insight into consumer spending patterns and longer term expectations.

Another key data source is the NAB Online Retail Sales Index (NORSI) which tracks the monthly movement in online retailing and supplements the initial research undertaken by Urbis. The NORSI commenced in January 2010.

### Drivers of Online Sales in Australia

Research undertaken by both PwC/Frost & Sullivan and Urbis identified a number of factors driving online sales growth in Australia. In JANA's opinion, there are four main drivers:

1. Price differential<sup>2</sup> – Consumers are finding lower prices online (percentage represents average in store premium), particularly in the case of books (58%), computer software (44%), beauty products (36%) and music, DVDs and video games (27%).
2. Convenience – Consumers can shop whenever and wherever it suits them. Consumers can also conduct product research in an equally convenient manner rather than having to physically visit multiple stores or make numerous phone calls to obtain information and price comparisons. The increasing uptake of smart technology (smartphones and tablets), particularly over the past couple of years, has greatly changed the online shopping landscape such that mobile shopping has become commonplace among online shoppers.
3. Variety – There is a greater range of goods and services available online compared with in 'bricks and mortar' stores.
4. Technology – The Australian population is becoming more computer literate, broadband speeds are increasing and payment systems are becoming more secure, resulting in greater confidence in online purchasing. As discussed above, the significant uptake of smart technology via mobile devices is also driving growth in online sales.

1 Online Retailing in Australia: Implications & Challenges for the Retail Industry, Urbis, July 2011

2 Figures quoted from Online Retailing in Australia: Implications & Challenges for the Retail Industry, Urbis, July 2011

## Retail: Crowd vs. Cloud

Price differential remains a significant driver of online sales in Australia with 55%<sup>3</sup> of online shoppers stating this is their most important reason for shopping online. The low cost structures of online retailers, including absence of the high rental costs required for floor space for traditional retailers and fewer employees to service customers, remain an advantage for online retailers.

However, the growth in categories such as Groceries and Liquor highlight that convenience has also become a major driver. 20%<sup>4</sup> of online shoppers state convenience is their most important reason for shopping online, with a further 9%<sup>4</sup> indicating the ease with which desired products can be located is their main reason for shopping online. 15%<sup>4</sup> of online shoppers state the more comprehensive range available online and access to products not available in physical stores is their main reason for shopping online. Whilst not stated as a reason for shopping online in and of itself, technology is the key enabler of penetration of, and growth in, the online shopping sector.

### Current Penetration of Online Retailing in Australia

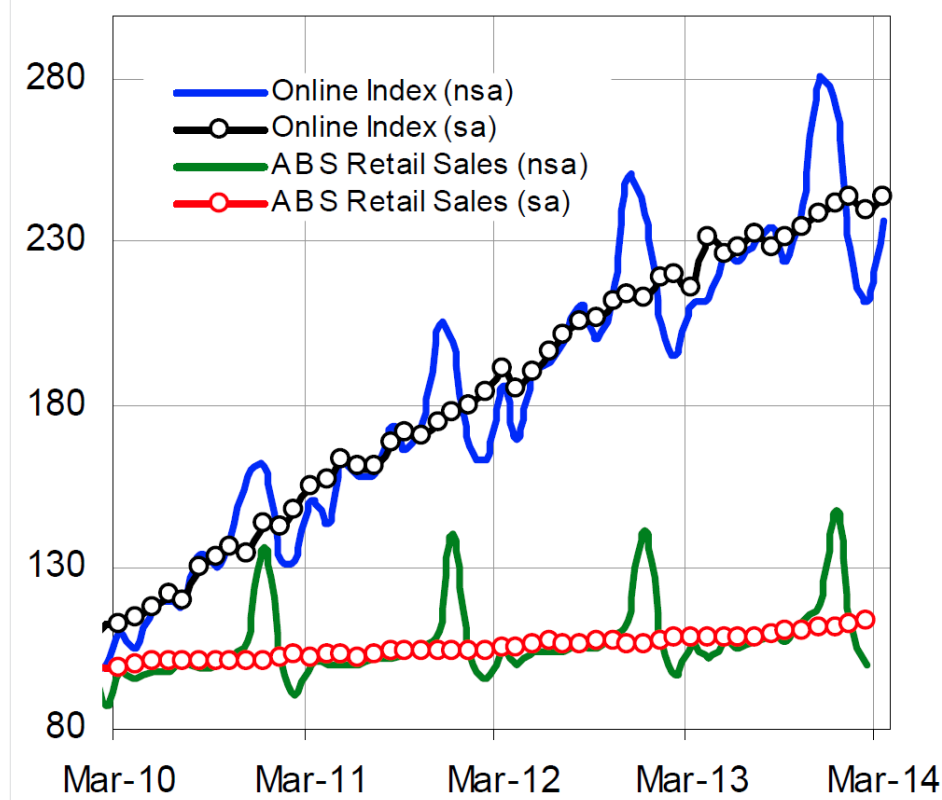
An overview of key findings from the Urbis Report, supplemented with current figures from the NORSI, is summarised below:

- Total domestic consumer spending in 2010 was estimated at around \$263B, with online retail sales accounting for approximately \$9.4B which translates to 3.6% of retail spending. By December 2013, the value of online retail spending had increased to \$14.7B, representing 6.5% of traditional bricks and mortar spending<sup>4</sup>.
- Strong growth in online sales over the period since 2010, as shown in the chart comparing the rate of growth of online and broader retail sales, has brought the level of penetration of online retailing in the Australian market into greater alignment with that of global markets. In 2010, Australian penetration of 3.6% compared with 7.6% in the UK. By 2013, these figures were 6.5% and 9.8% respectively. The stronger growth in Australia reflects the earlier stage of online retailing

in the domestic market versus the more mature online market of the UK and the lower penetration rate in Australia is reflective of a number of factors including strong physical store presence, less investment by domestic retailers in online platforms and a limited 'mail order' culture. As a result, Australian retailers are significantly behind their global counterparts in respect of the sophistication of their 'e-tailing' platforms. Both global and domestic retailers forecast online sales will eventually represent up to 20% of total sales.

- While the perception is that most online shopping occurs on foreign sites, both Urbis and NORSI research has found the reality is that the majority of online purchases in Australia are made through domestic sites. In 2010, the domestic capture of online consumption was in the range of 55-60% whilst NORSI places this figure even higher at 74% in January 2014. Retail categories that dominate the share of online spending include Department and Variety Stores (34%), Homewares and Appliances (17%) and Groceries and Liquor (15%), as shown in the chart on page 3.
- The level of capture of online spending by domestic retailers is interesting in the context of the debate around the taxation implication of international sales, with sales valued at less than \$1,000 currently exempt from GST. Whilst this contributes to price differentials, the vast majority of online competition for traditional retailers is coming from domestic sites.
- Interestingly, the average value of online transactions has fallen significantly between January 2010 and October 2013, from \$64 to \$41 respectively, according to the NORSI Special Report – October 2013. The average value of international sales has fallen by almost 50% from \$74 to \$38 per transaction over the same time period. The fall in average transaction size can be attributed to a number of factors including price deflation, changes to shipping arrangements (encouraging fewer items per transaction) and changes to sales by category (in particular, the strong growth in the relatively low cost Media category over time).

### Online sales vs. Retail sales (monthly)



Source: NAB Online Retail Sales Index, Monthly Update – March 2014

3 PwC/Frost & Sullivan, Online Shopping Surveys, 2011 & 2012

4 NORSI methodology excludes cafes, restaurants and takeaway food to create a like-for-like comparison.

### Expectations for Online Retailing in Australia

The key expectations for the impact of online retailing in Australia going forward detailed in the Urbis report included:

- Online sales are forecast to be 7.2% by 2015 and 11.8% by 2020, growing at an annual rate of 18% in 2010-2015, and 13% in 2015-

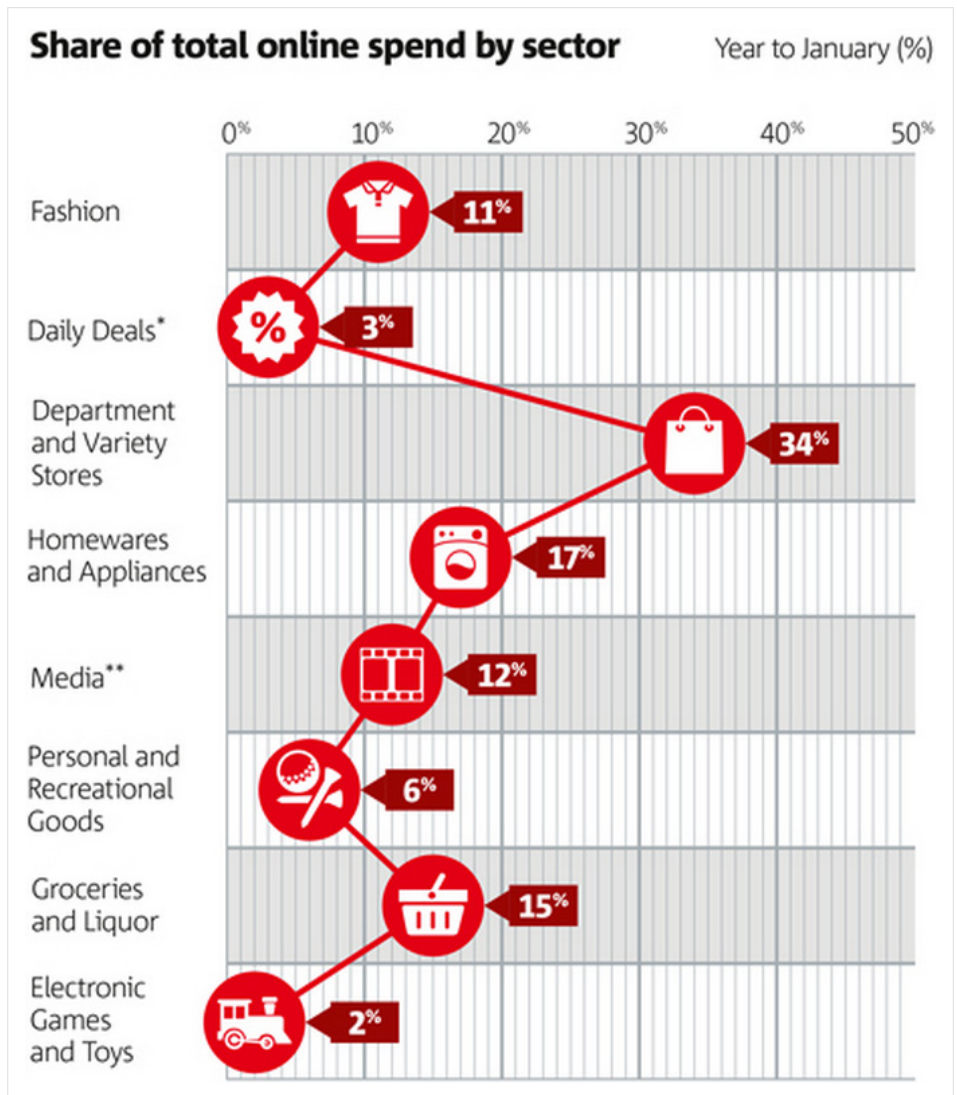
2020. The expectation is for 16% p.a. growth for the total period 2010-2020 to a level of approximately \$41B, or 12% of market share.

- Online sales are expected to benefit from strong population and wage growth, higher consumer prices (relative to offshore), narrower local product ranges, and consumer willingness to adopt new technologies.
- Total Australian annual retail sales are forecast to grow by 2.9% p.a. to \$350B by 2020.
- Shopping centre turnover is also forecast to grow by 2.4% p.a. over the next 10 years, increasing from \$153.5B p.a. to \$185.5B p.a. in 2020. This growth is expected to be driven by the strong fundamentals that exist in the Australian market, with population growth and real spend per capita (due to income growth) forecast to continue to increase.
- Urbis predicts that online purchases will ultimately capture a maximum of 15% of the total retail market in Australia. Domestic share of online purchases is expected to increase as retailers focus on online investment. Urbis also expects that roughly 44% of total online market share is likely to be delivered from or collected through a physical store, which will result in some 'claw back'. This means a net total of around 8%, rather than 15%, will be the expected maximum online market share impact.

JANA is of the view that growth in online retailing is not primarily responsible for the sluggish retail sales growth which has been experienced over the past few years. Retail sales growth has averaged 2-3% p.a. since 2010, compared with approximately 6% p.a. growth over the decade prior to 2010. JANA agrees with AMP Chief Economist Shane Oliver's summary of contributors to sluggish retail growth being more cautious consumer attitudes to debt and savings post the GFC, the dent to household wealth caused by the GFC, higher interest rates until recently, the strong AUD encouraging spending on overseas holidays and accelerating online penetration, increases in the cost of living (such as utilities and health costs) and job insecurity<sup>5</sup>. In short, increased online penetration is one of many factors which have impacted retail sales growth.

Pleasingly, over the last couple of months of 2013 and into 2014, we have seen an improvement in retail sales growth. The improvement is attributed to a number of factors including a fall in the household savings

<sup>5</sup> Overview, Recommended Retail Practice Report from AMP Capital Shopping Centres "The New Consumer Paradigm, Embracing the Evolving Retail Landscape", 2013.



Source: NAB Online Retail Sales Index, Indepth Report – January 2014

ratio over the December 2013 quarter, steady employment, improved consumer confidence relative to earlier in the decade (albeit falling in more recent months), increased household wealth (driven by house price and share market gains), lower interest rates and a fall in the AUD. Whilst short term growth may be impacted by recent job cuts, supportive drivers of a sustained improvement in retail growth include increased housing investment (which should drive demand for household goods) and the global recovery (which is expected to support employment growth in non-mining sectors).

### Impacts of Online Retailing in Australia

While the proportion of total retail spending occurring online remains quite low, online retail is a significant 'game changer' within the Australian retail sector, with growth expected to

remain strong. It has now become apparent that Australian retailers need to rethink and adopt strategies to 'catch up' in order to capture any rebound in consumer spending. This includes investing more heavily in merchandising and shopping experiences, alongside their online and mobile platforms, in order to compete with the influx of global brands targeting Australian consumers through both physical and virtual stores.

### Shopping Centres

Continued strong growth in online retailing may lead to lower levels of development of 'bricks and mortar' shopping centres as the share of online retailing grows. However, demand for retail space in dominant centres is expected to remain strong and landlords should be focused on ways to improve the 'experience' of attending shopping centres. This includes improved technology access, better food and

entertainment offerings, attracting global 'power' brands (e.g. Zara, Apple, H&M), ease of access and car parking (e.g. valet parking and high-tech information systems). There is an observable trend in major shopping centres to change the 'mix' of tenants, with the number of apparel/fashion retailers declining, including in some instances the size of the 'footprint' of department stores, and a growing focus on services, food and leisure oriented retailers.

Interest in the Australian market by global 'power' brands has led to the rise of major international chain stores in the Australian retail market, especially in apparel/fashion and technology, which was not apparent five years ago. As these brands seek a strong presence in the market via larger 'flagship' tenancies, these larger-than-typical specialty stores are now an important part of a strong retail offer, enabling certain centres to reinforce their dominance and potentially expand their catchment areas. For these brands, online offerings complement rather than purely compete with their physical stores and it is reasonable to expect a greater number of retailers will pursue a strategy which sees them downsize their physical footprint whilst seeking to upgrade the quality of physical stores and online offerings. A key component to the quality of physical stores will be the overall quality of the shopping centres in which they lease space.

## Retailers

Compared with traditional retailing, online retailing enables consumer spending patterns and preferences to be easily monitored and researched by those retailers with more advanced online platforms, enabling targeted and personalised advertising and promotions. In addition, retailers can reach vastly more consumers than ever before and offer a wider range of stock and sizes. Given the convenience and personalised nature of online shopping, traditional retailers will need to work harder to encourage shoppers into physical stores.

It appears that now more than ever before, it is of paramount importance for 'bricks and mortar' retailers to focus on the consumer and their needs and wants. Retailers must acknowledge and value the fact consumers have chosen to physically attend their stores

and focus on providing a first-rate, service oriented experience. This will need to include highly competent sales staff, a desirable store atmosphere and proactive service. Retailers must explore opportunities to add further value to the consumer experience, such as VIP events and promotions, product maintenance, community engagement and a focus on sustainability.

Customer experience is one of the most important factors in differentiating retail businesses and giving customers a powerful reason to engage with a particular brand. This is evidenced by the shift in power from brands to consumers which is occurring via greater consumer input into product ranges, the advent of 'group-buying' enabling consumers to secure more competitive pricing, and consumers seeking advice from, and providing advice to, other consumers (particularly via social media) rather than relying on retailers and brands for advice.

Retailers expected to succeed in the future are those which will be able to offer their customers more of a 'lifestyle' experience, referred to as a 'third space' (in addition to work and home). Reflective of the growing 'local community' mindset, consumers will seek a place where they can make social connections rather than simply transact. As highlighted by innovation psychologist Dr Amantha Imber<sup>6</sup>, *"Apple is a great example of this trend in action: going to the Apple store is never just about transactions, but rather it is about connecting, experiencing and learning."* Improving the consumer experience may include changes to store layouts to facilitate greater interaction of consumers, increased levels of personalisation and using data captured either online or in-store to offer a more customised product selection or make more informed suggestions.

Both shopping centres and retailers will need to be more dynamic and adaptive in their approach to capturing the consumer and over time, we expect to see more changes not only to the tenant mix within shopping centres but to

lease structures as well. As owners of shopping centres, maintaining growth in foot traffic and productivity is important to enable retailer profitability yet translating this to continued income and capital growth is the ultimate return driver.

Online retailing is here to stay and will continue to grow strongly, aided by the mass adoption of mobile technology. The level and breadth of choice will continue to increase and price transparency will remain high. The strong growth of online retailing via mobile devices and the growing use of social media by retailers over the last couple of years is suggestive of the evolution and increased sophistication still to come within online retailing. There is an expectation that over time, the various retail channels (online, mobile, physical store, catalogue, social networking) will become part of one seamlessly integrated retail offering for successful retailers.

## Conclusion

Whilst online retailing is only one of a number of factors which has contributed to sluggish retail sales growth in Australia over the past few years, it is important to recognise the significant impact it is likely to have on the existing retailing and shopping centre model going forward.

Where discretionary spending is concerned, the best centres to own will remain those that dominate their catchment centres and which are able to offer an attractive overall 'experience' to consumers in terms of the mix of desirable 'power' brands, leisure-oriented retailers and service, food and beverage offerings.

<sup>6</sup> 'Consumer Behaviour' white paper incorporated in Recommended Retail Practice Report from AMP Capital Shopping Centres, "The New Consumer Paradigm, Embracing the Evolving Retail Landscape", 2013.