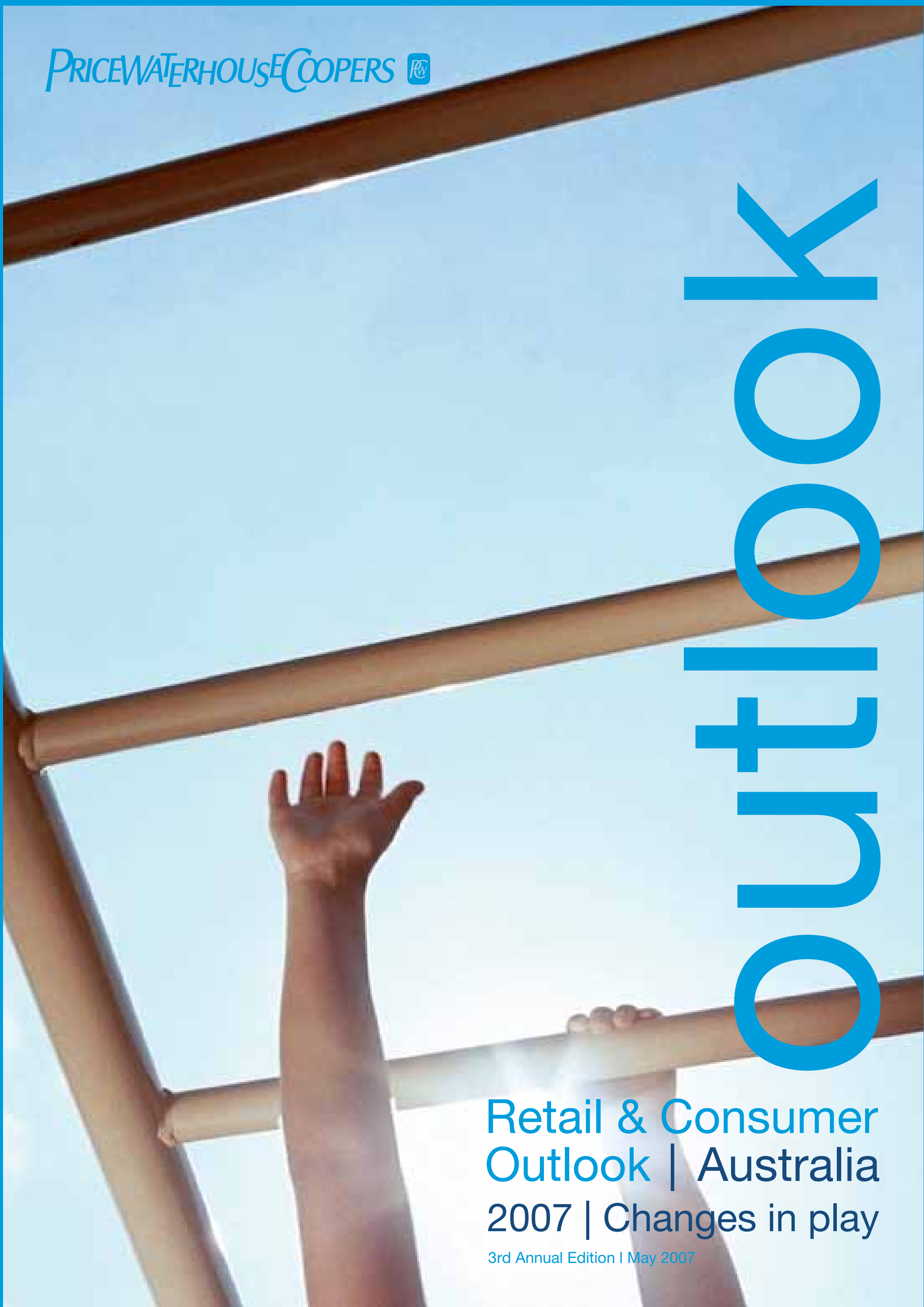
Extract

Retail & Consumer Outlook | Australia

2007 | Changes in play



This is an extract of Retail & Consumer Outlook 2007.

The complete version of Retail & Consumer Outlook is available by request.
Limited hard-copies will be sent to industry professionals.

Please visit www.pwc.com/au/rc-outlook

Foreword

I am pleased to introduce Retail & Consumer Outlook 2007.

This 3rd edition contains chapters from PricewaterhouseCoopers' thought leaders on key challenges faced by companies operating in Australia's retail and consumer goods sector. Issues such as the retail grocery supply chain, private label and franchising continue to impact our ever-changing landscape. New this year are chapters focusing on emerging challenges and influences such as private equity, the environment, innovation and retailing on the web.

Our theme is 'changes in play' and as always each chapter includes *The Way I See It* – an independent, first-hand commentary from those who are out there in the industry experiencing the issues first-hand.

I trust that you will find our views both informative and thought provoking. The *Outlook* sections and *Take action* recommendations are especially designed to provide you with insights and practical guidance.

Mike James
National Leader
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01

Who wants to be a green grocer?

Business leaders will remember 2006 as the year in which environmental affairs became a matter of strategy rather than compliance. The unparalleled public concern over issues such as water scarcity and climate change created significant new risks and opportunities for business, yet only a handful of Australian companies moved to capture them.

The consensus is that this shift in public sentiment on the environment is permanent. PwC's engagement with executives, at a personal level and through formal surveys,[1] confirms that business expects the issue to grow in significance. Moreover, governments have responded to changing public attitudes with new regulations and policies that promise to keep environmental issues at the forefront of consumer debate and increase the pressure for corporate action.

This development is international; however corporate Australia has been slower to respond than its overseas peers. In 2006, six of the world's 10 largest public companies by market capitalisation – BP, Citigroup, GE, HSBC, Shell and Wal-Mart – were explicitly pursuing competitive advantage through improved environmental performance. In Australia, by contrast, only one of the 20 largest ASX-listed companies has taken this approach and the retail and consumer goods sector is lagging.

It would be surprising if this gap did not narrow over the coming year. We expect to see more Australian businesses, particularly those in the retail and consumer sector, develop offerings that respond to the call for improved environmental performance. The business case will be straightforward and compelling – as Marks & Spencer puts it: "We're doing this because it's what you want us to do. It's also the right thing to do. We're calling it Plan A because we believe it's now the only way to do business. There is no Plan B."[2]

1 *Carbon Conscious*, PwC, December 2006, and *Business Insights Survey*, PwC, March 2007.
2 http://www2.marksandspencer.com/thecompany/plana

The outlook

- The public concern about dwindling water supplies and climate change will deepen, forcing governments at local, state and federal level to introduce more and stronger regulations on business.
- Senior management will have to not only engage with these issues but also demonstrate leadership, especially on water use and energy efficiency.
- Severe penalties – individual and corporate – will await those executives and companies who ignore their environmental obligations.
- A company's attitude to sustainability will directly affect the mood of investors, the integrity of its brands and the health of its share price.
- Big players will move on environmental issues and in doing so change the rules for the entire sector.
- Employees, consumers, suppliers and clients will all demand better corporate social responsibility performance from companies, who will respond by instigating environmental initiatives to enhance their positioning with these various audiences.
- Information about environmental performance will become a matter of public record and a competitive issue for businesses.
- Competitive pressure will drive rapid change and sharpen companies' focus on improving environmental performance.

The complete version of this chapter covers:

- The international experience
- The local context
- What does this mean for the retail and consumer sector?

The way I see it – Peter Slator, Chairman, Unilever Australasia.

Conclusion

There is no force more powerful than a knowledgeable and energised public backed by government mandate and regulations. The dual spectres of climate change and water shortages are now constants for businesses around the world. They are propelling the issue of businesses' environmental performance out of the background and into the spotlight, creating new risks and opportunities.

Business now has no choice but to adapt to this new paradigm, employees demand their employers be more environmentally responsible; governments continue to generate green policies and regulations; investors track a company's environmental performance with the same zeal as closely they watch its share price; and leaders seize the zeitgeist to create competitive advantage.

Once Australia's retail and consumer giants chart their own courses to meet these imperatives they will drag the entire industry along with them. The momentum is building and it will soon become irresistible.

Take action

- Senior management must heed the public's growing concern over the environment, engage with the issues and show leadership on matters such as water use and energy efficiency.
- Small-to-medium retail and consumer goods companies should prepare for the self-interested actions of larger companies that will re-engineer supply chains to suit their own approach to reducing environmental impact.
- Launch environmental initiatives to enhance your standing with employees, consumers, suppliers and clients who will all demand better corporate social responsibility performance.
- Prepare initiatives to transform the new transparency of environmental performance information into a competitive advantage.
- Get up to speed with new and proposed regulatory requirements that affect your business, your customers and suppliers, and prepare strategies to meet and take advantage of them.

The insight in this chapter has been provided by Sean Lucy, Director, PwC Legal.

Sean has a broad range of experience in environmental matters and regularly assists clients develop environmental strategies and governance frameworks as well as with transactions and litigation that contain significant environmental aspects. Sean also contributes to the ongoing public debate surrounding sustainability, renewable energy and climate change through his work on the Board of the Australian Business Council for Sustainable Energy.

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02

Retail therapy works

Domestic and global private equity firms are engaging in a level of 'retail therapy' never before seen in Australia. Numerous high-profile retailers have been acquired by private equity firms, often at unprecedented valuations. Examples such as the department store leader Myer and the interest in giants like Coles also show that size doesn't matter.

The boom is good news for those looking for capital to expand, restructure or exit their businesses, but will also have far-reaching consequences for the entire industry. Private equity-backed retailers will become more aggressive in the marketplace and offer management teams significant incentives to outperform their peers. Private equity managers will also leverage their expertise and contacts in Australia and overseas to make their companies more successful. Retailers that fail to respond to this new level of pressure will see a significant decline in value and may become potential acquisition targets.

Management teams need to consider carefully the impact of private equity on the retail industry. The choice is whether to maximise value in the short term through a full or partial sale of shares in the business or to prepare strategies to prosper in an even more competitive marketplace. Failing to act will destroy significant shareholder value, meaning that for most the status quo is not an option.

The outlook

- There have been (or are pending) a number of high-profile private equity-backed transactions in the retail sector. Size is no object and more are likely to come.
- US and European private equity firms are looking at investment opportunities in the relatively immature Australian market. Coupled with more aggressive lending practices from banks, this is leading to increased investment at all levels.
- Private equity firms will drive efficiency and competition in the marketplace.
- Private equity investors will continue to target companies with good brands, growth prospects, quality management, defensible market positions and strong cash flows.
- Competition for funds between traditional fund managers and private equity will continue to intensify, with more private equity-backed transactions being blocked by fund managers.
- While valuations are high, companies will need to focus on their competitive position to maintain and grow this value in the medium term.

The complete version of this chapter covers:

- Rise in M&A activity
- Why retail?
- Mechanics of a typical private equity transaction
- Implications of private equity for shareholders and managers

The way I see it – Eric Morris, Chief Executive Officer, The PAS Group Pty Ltd.

Conclusion

Private equity's interest in retail businesses highlights the enormous potential of the sector. However, it should also serve as a warning sign that the competitive landscape is changing fast. Owners and their management teams need to capitalise on the high valuations of retail businesses or actively improve their operations to ensure they remain competitive in a more aggressive and efficient marketplace. Those that do nothing will suffer the consequences.

Whether shareholders are seeking an exit or simply looking to maximise the value of their holdings, management needs to review a range of business issues. Focusing on areas such as corporate structure, capital structure, supply chain systems, cash flow, working capital, management and growth strategies will not only maximise value during a transaction but also help the business cope with more aggressive private equity-charged competitors. Carefully assessing the options and developing a clear strategy will provide significant value to current and future stakeholders.

Take action

- Update the strategic plan covering the next three to five years.
  - Review existing operations and improve efficiencies, particularly around working capital and logistics.
  - Consider growth and exit options, including seeking a strategic private equity investor to partner growth prospects.
  - Streamline the corporate structure and formalise procedures including franchise arrangements.
- Know your value and communicate it to shareholders.
- Employ sufficient debt funding to optimise your capital structure and maximise shareholder value.
- Closely align KPIs with your strategic plan and management incentive programs to ensure superior performance.
- Identify key managers and give them incentives to remain with the business.

The insight in this chapter has been provided by Greg Keys, Partner, Corporate Finance and Lorcan Barden, Associate Director, Corporate Finance.

Greg leads PwC's Corporate Finance team in Australia. Greg's extensive lead advisory experience acting for both public and private companies covers business divestments, IPOs and capital raising and mergers and acquisitions.

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Lorcan provides lead financial advisory services to both public and private companies. Lorcan's primary focus is in the retail sector, where he has undertaken a range of assignments including acquisitions, divestments, private equity transactions and strategic options reviews.

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03

Strengthening the chain

While many expected 2006 to be a year of great change in Australia's grocery retail supply chain, the potential break-up of one of our major retailers combined with other forces to temper the transformation.

In some respects, the past 12 months have been dynamic, with opportunities – and threats – becoming more evident. The year provided moments of truth as the reality of some major supply chain initiatives launched by the big retailers started to bite. Primary freight arrived as a strategy and is now embedded as a standard way of doing business with major retailers. Evidence suggests some retailers are moving away from collaborative planning, forecasting and replenishment (CPFR) as a supply chain enabler. Private equity emerged at the highest level of Australian grocery retail, raising questions as to whether one major retailer will follow through on supply chain initiatives already launched. And although retailers' distribution networks are starting to unfold, they are different than initially proposed.

To analyse these issues and describe the grocery retail supply chain of the future, we will examine eight issues that may have deep implications for investments by retailers, suppliers and service providers to the grocery retail sector.

The outlook

- Distribution networks servicing independent retailers will not only survive but grow stronger.
- The execution challenges and commercial reality of scan-based trading will reduce its appeal to companies in the Australian grocery retail supply chain.
- Regional, off-shore based supply hubs will become standard practice for multinational consumer packaged goods companies within the next three to five years.
- The rate of CPFR adoption will slow and for some retailers cease, creating downstream issues with retailers' new generation distribution channels.
- Except for fresh produce and selected shelf-stable lines, the uptake of shelf ready packaging in the Australian retail grocery industry will be limited in the short-to-medium term.
- Local grocery retailers will maintain their 'wait and see' position on radio frequency identification (RFID) technology in the short term but it will eventually become an important technology.
- Progressive retailers and manufacturers will drive the pursuit for carbon consciousness in the Australian grocery retail supply chain but carbon neutrality is a long-term journey with significant associated costs.

The complete version of this chapter covers:

- The survival of independent networks
- Should retailers own inventory?
- The case for regional supply chain hubs
- To merge or de-merge
- Will radio frequency identification be a major force?

The way I see it – Andrew Reitzer, Chief Executive Officer, Metcash.

Conclusion

All parties involved in the Australian retail grocery supply chain have to devise strategies to prepare their businesses for the changes that will shape the industry over the next five years: scan-based trading, regional supply hubs, RFID, shelf-ready packaging and collaborative planning, forecasting and replenishment, to name a few.

Some of the disappointments and false starts of the past year may fade quickly as the Coles issue is resolved and the industry adopts new technology and productivity measures. While independent retailers can feel confident that they have a bright future, they still have to plan how they will deal with the tectonic forces generated by Australia's two grocery retailing giants.

As always, change is inevitable. Some transformation programs have slowed; others have accelerated. How retailers, suppliers and service providers respond to the industry challenges created by the changes will determine their success.

Take action

- Independent retailers offer a higher-margin, high-growth channel so consumer and packaged goods companies should seek to develop and exploit this route to market.
- Third-party logistics providers should recognise the margin potential for high-service, multi-drop distribution contracts.
- Prepare for regional supply hubs to become standard practice in the Australian retail grocery supply chain over the next five years.
- Suppliers should be proactive and put pressure on retailers to find workable collaborative trading partnerships post the demise of CPFR.
- Recognise that automated forecasting and replenishment systems are no substitute for well-run collaborative forecasting. Integrate the two and customise tactical collaborative trading partnerships.
- Suppliers should prepare for the gradual increase in inventory pushed upstream by the major retailers.
- Third-party logistics providers should watch carefully the outcomes of de-merger activity, particularly if this involves de-merger of supply chain operations.
- Retailers should re-think their deployment of SRP to quantify its benefits and share them with suppliers to drive adoption.
- Prepare for RFID to become an important technology in the grocery retail supply chain – in the long term.
- Suppliers and third party logistic companies should develop a carbon strategy by first understanding and valuing their own carbon footprint before developing a means of reducing emissions.

The insight in this chapter has been provided by Oliver Sargent, Director, Performance Improvement.

Oliver Sargent is PwC's Supply Chain capability leader in Australia. He consults to a range of consumer packaged goods companies, retailers and wholesalers. In a rapidly changing grocery sector, Oliver advises clients on issues from strategy through to design and supply chain improvement.

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04

Passion driving technology fashion

It's on again! Internet technology is transforming at a rate not seen since the dot-com boom. *Time* magazine declares its Person of the Year for 2006 is "You" because of the explosive growth and influence of user-generated content such as blogs. Analysts, the media and even former celebrated sceptics such as Rupert Murdoch are claiming that this time, with greater availability of broadband, the web *will* change the way we do business.

Yet in Australia, few retailers appear ready to take advantage of the trends. Late last year *The Australian Financial Review* said it all when it reported: "You won't find any Christmas cheer from the major retailers online, and their respective bosses Bill Wavish, Mark McInnes and Gerry Harvey aren't losing any sleep over it."[1]

Our global insights have shown major retailers in the UK and US are investing heavily in the internet as part of their multi-channel strategies. They are building the required infrastructure in stores and at head office to ensure customer service is seamless and enhances brand values.

This is no passing trend and the time is right for Australian retailers to reconsider using internet technology to drive new growth opportunities with e-business and multi-channel retailing. Our own research into 27 local fashion retailers shows there is still a long way to go. Retailers need to understand the channels their own websites are serving and to effectively harness the passion of the new 'digital natives' to generate a commercial advantage.

[1] *The Australian Financial Review,* 12 December 2006.

The outlook

- Digital enablement of consumers will continue to accelerate and capturing the fastest growing segment of the internet will mean approaching web sites in new ways.
- While bricks and mortar stores are here to stay, retailers will have to leverage existing investments in their supply channel and analytics to deliver multi-channel offerings that regard the internet as part of the overall service promise to customers.
- As Australian broadband and wireless services continue to improve, smart retailers will look to the UK and US for successful business models.
- Without a compelling business plan that includes an integrated, multi-channel technology strategy supporting your brand, time-poor, internet-savvy consumers will switch to retailers that can offer them what they need, when they need it.

The complete version of this chapter covers:

- The time is now
- Defining, hunting, capturing and keeping the digital native
- Rules for the hunt
- What about the future and where to today?

The way I see it – Neil Ridgway, Marketing Director, Rip Curl International.

Conclusion

Internet technology is now enabling a fundamental transformation, where the consumer is driving content and product creation in ways not seen or imagined previously. It is the new way, but where it takes us is still being revealed.

One thing is clear: now is the time to act. Technology strategy can no longer stand on its own. Hindsight would say that it never could.

For the consumer it might be all about "you", as *Time* says. But for retailers, delivering on the expectations of the new consumer and capturing and retaining their business will require stronger integration of corporate, marketing and IT strategies than ever before.

Take action

- Review your technology strategy in conjunction with your business and marketing strategy. Do they align? Does IT know where the business is going and does marketing appreciate how technology can enable the market?
- Examine how you can leverage the new consumer to provide them deep information and interactivity, while gaining insights into trends that you can use in your business. Plan to integrate web sites into your analytics and data warehouses.
- Play to your strengths by understanding the advantages inherent in your existing channels to market and knowing how the internet complements them. It's not all about e-commerce.
- Look at your business model and analyse the impact of potential e-commerce and multi-channel activities. E-commerce and multi-channel could be part of your future retail growth strategy.
- Analyse the opportunities: understand what the technologies offer and stay abreast of the trends.
- Look to emerging models overseas and examine how they relate to your consumer base, your demographics and your customer behaviours. What is working that might apply to your business model?

The insight in this chapter has been provided by Tim Bull, Director, Business Solutions Technology.

Tim specialises in information technology (IT) architecture and emerging technologies. In an ever-changing technology landscape, Tim is passionate about helping companies plan practical roadmaps for the future using IT as an enabler to deliver real value.

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Acknowledgements

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