

Troubled times for retail?

The Australian economy has experienced an unprecedented boom in certain sectors. The impact this time has had a broad affect on businesses and more importantly individuals who have invested heavily in the stock market and have vast sums of money invested mostly mortgaged against the family home or from DIY superannuation funds.

With the recent uplift in the official interest rates by the Reserve Bank and the pro longed spike in petrol prices, consumers are finding less discretionary income to spend.

Those States like Western Australia, Tasmania and Queensland are performing significantly better than the other States, and the retail industry is hurting in the non-resource rich states with consumer spending significantly down and are only propped up by continuous sales with paper thin margins undermining and diminishing profits.

There are now more articles, in the media like the recent SMH article titled 'Market solid despite retail downturn' warning of the slow down in consumer spending which will contract further when this boom ends. We can only look back at the significant market corrections like the crash in 1987 or the dot.com crash in 1999. However this time the investment spread is across the whole spectrum of the stock market.

The retail sector will not be spared the fallout from this market correction. Consumers are driven by emotion. According to the Financial Review Weekend Edition, the Russell chart of the cycle in market emotions indicates that things build up from optimism to excitement then to thrill and euphoria. At this point consumers feel wealthier and spending is at its peak.

After that, things spiral downwards through anxiety, denial, fear, desperation, panic, capitulation and despondency. Consumers feel less wealthy and there is a contraction in spending.

High petrol prices and debt levels mean Australian consumers are becoming increasingly price sensitive, while the balance owing on credit cards has increased by 15% each year from 2000 to 2005. The first areas to be hit will be discretionary spending on clothing, department store purchases and restaurants.

Small companies will be hardest hit by the increase in petrol prices as they may not be able to absorb these costs. In recent weeks, airlines, industrial companies, retailers and even miners have warned of negative consequences from the sustained increase in oil prices.

Auto parts maker and retailer, Repco has already forecasted a weaker consumer environment that could begin to squeeze the bottom line of other companies. 'Petrol price rises are clearly affecting consumer discretionary spending, which remains subdued and patchy in the automotive sector' the company said.

Woolworths has also recently suggested that they were preparing for a consumer spending slowdown if petrol prices rise higher.

Qantas airlines has moved to pass on the higher petrol prices to consumers through a hike in the fuel surcharge on every domestic and international flight.

When examining a troubled retailer's sales and marketing function we expect to find all or some of the following:

- Focus is on volume rather than profits;
- Control of cash flow is poor;
- Poor information systems;
- Inconsistent pricing;

- Poor human resources functions with poorly defined incentives;
- Over optimistic targets;
- Non existent sales targeting;
- Poor customer service culture

From our discussions with retailers, it would appear that their greatest concerns are that landlords will maximise their rent reviews, utility costs are increasing and there is a continuing push for wage increases.

It is not too late for your clients to undertake significant and structural change to insulate their business from what we think will be the inevitable contraction in consumer spending. Such as:

- Examine closely the provisions in leases before signing up;
- Ensure conservative preparation of cash-flows;
- Undertake an exhaustive due diligence on customer bases (will your client be relying on passing foot traffic or are you situated in a centre or mall);
- Understanding obligations when leasing equipment;
- Understanding the implications attached to extended trading hours such as penalty wage rates for employees and public holiday allowances etc;
- Ensure your clients adopt a proper accounting system and pay themselves a wage instead of taking money out of the cash register for everyday living expenses;
- Encourage your client to become proactive rather than reactive and talk to you when they are encountering cash-flow problems;

If your client is finding it difficult to make payments in the normal trading terms of their business and/or industry and payables have extended beyond 90 to 120 days then you may have to advise them to take remedial action immediately. Doing nothing and waiting for consumer spending to resurge may be wishful thinking.

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