Media Release

For Release: 12 December 2013

Australian retail sector rises to challenge by transforming business models

- Direct-source retailing creates greater exposure to fluctuations in the AUD, increasing the need for offsetting strategic initiatives -

ANZ today released industry research that found Australian retailers have responded to challenging headwinds by directly sourcing goods from overseas, resulting in price deflation across the sector, while margins have improved for best practise retailers.

"The migration to direct source retailing: Opportunities from a lower exchange rate", found that although this transition to direct-sourcing is putting some retailers in a strong cost leadership position, it creates a new set of challenges should the Australian dollar depreciate below USD0.90c.

Key Findings:

- The Australian retail sector is going through unprecedented change, challenged by cautious consumer behaviour, increased household savings, the rise of online shopping, and increased penetration of global chains in the domestic market.
- In response, around 60% of domestic retail businesses with annual revenue of more than $10 million have migrated to direct-sourcing retailing models
- The move to direct sourcing by retailers, not lower import costs from a higher AUD, is driving gross margin expansion and price deflation across the sector.
- Whilst driving significant efficiencies, the move to direct sourcing has also increased the import-intensity of the sector. Australian retailers have never been more potentially exposed to fluctuations in the AUD.
- Should the AUD/USD depreciate to 0.85c, 60% of Australia's direct-sourcing retailers would need to have employed offsetting strategic initiatives to avoid a substantial hit to profitability or pass through a sharp increase in retail prices
- Recommended strategic responses in a lower AUD environment include further increases in financial supply chain efficiency and a more active approach to FX risk management within the direct-sourcing model.

ANZ's Head of Consumer Sectors Australia, Andrew Hector said: "We've completed an in-depth analysis of the Australian retail sector and found that around 60 per cent of retail businesses, with annual revenue of more than $10 million, are now direct-sourcing the majority of their goods sold from overseas. This leaves less than half of Australian retailers now locally sourcing or through intermediaries.

"Interestingly, we're seeing that this practise is not just occurring at the 'big end of town', with SMEs also rapidly adapting their supply chain management and adopting the direct sourcing business model and importing directly.

"This change is driving significant business efficiencies for retailers. Indeed, one of our key findings is that gross profit margins for retailers have improved by 6 percentage points in the last six years, and that this improvement has been driven by the adoption of the direct source model. The assumption that retailers have primarily used a higher Australian dollar to drive recent margin improvement is an over-simplification and a common misconception about the sector.

“However the gap between best practise retailers and the rest of the pack has widened, with the former achieving 20 per cent higher gross product margins,” Mr Hector said.

The research paper also found that the consequence of this migration to direct-sourcing is increasing import intensity of the retail sector.

“The move to direct-sourcing has now left retailers and wholesalers more exposed to fluctuations in the Australian dollar as their import intensity has increased. This raises a new set of risk management considerations for the sector.

The report conducted a stress test of the profitability and cost impacts to retail and wholesalers at a range of average exchange rates over the next two years to understand the challenges a lower AUD will bring.

“Our analysis found that around 60 per cent of Australia’s direct-sourcing retailers would need to have employed offsetting strategic initiatives to avoid either a significant hit to profitability or sharply push up retail prices if the Australian dollar was to sustain a fall to USD0.85c.

“However, this is the worst case scenario and in reality we are seeing best practise retailers proactively managing these risks,” Mr Hector said.

The report finds that a more active approach to FX risk management within the direct sourcing model, as well as driving further increases in financial supply chain efficiency are amongst the strategic responses best practice retailers are now adopting.

For media enquiries contact:

Emily Kinnear
Media Relations Manager
Tel: 03 8654 3450
Mobile: 0478 401 280
Email: Emily.Kinnear@anz.com

For research enquiries contact:

Katie Dean
Head of Industry Analysis
Tel: 03 8655 9079
Mobile: 0435 961 255
Email: Katie.Dean@anz.com