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Retailers' Christmas Survey 2016

Stocking up for Christmas

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Introduction



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Introduction

Executive summary

Welcome to the Deloitte Retailers' Christmas Survey 2016. In the lead up to Christmas we surveyed a cross-section of executives and senior management from Australian retailers about their expectations for the 2016 Christmas period and beyond. This is the fifth year we have conducted the survey and this report analyses retailers' sentiment for the Christmas period, key trends and their expectations and priorities for 2017.



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Introduction

Executive summary

Onwards and upwards

The retail market has generally performed well over the course of 2016 and retailers remain confident this will continue into the Christmas trading period. Over two-thirds of respondents expect to increase their sales this Christmas compared to last year – a clear signal that there is a bit of a swagger amongst many Australian retailers at the moment.

When it comes to profitability, retailers are expecting the status quo to prevail, with 4 out of 10 survey respondents anticipating no change to their margins this Christmas compared to 2015. This reflects the ever increasing competitive retail landscape, with little scope to eke out margin increases for fear of losing market share.

And these competitive pressures mean we can expect the fight for consumers' wallets to be even more ferocious this Christmas.

Pricing is never more critical than at this time of year, and with a record 33% of respondents telling us they expect to start discounting in early December (27% in 2015), we can expect some early opportunities for consumers as retailers look to avoid being left nervously biting their nails on Christmas Eve.

Christmas strategies

With relentless competition in the Australian retail market, we asked retailers what was their most important focus area to increase sales this Christmas. There were two clear stand-outs: new products (34%) and customer service (27%). The fundamentals of retail have never changed – stock products your customer wants and give them a shopping experience that makes them feel great. Key to all of this is understanding your customer, with digital playing an increasingly important role. Some 84% of our survey respondents consider getting their digital strategy right very important/critical to their business. Understanding the customer continues to be key.

It's also pleasing to see that retailers are increasingly re-investing in customer service and recognising its importance to the consumer. One of the emerging challenges is enabling the salesforce with the right skills and access to information to make them relevant to today's shopper. In an age where consumers now invariably know more about a product than the people trying to sell it, the role of the sales assistant is evolving rapidly.

The most successful retailers will be those who understand their customers' needs and have a business model that allows them to respond and change quickly to customer demands.



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Bricks-and-mortar versus online

Online sales at Christmas are expected to continue to increase, with a third of respondents predicting online Christmas sales to make up 5% or more of their channel mix. With the continued growth in online sales, you may expect retailers to be reducing the levels of investment in physical stores. Our survey shows that this couldn't be further from the truth.

71% expect to increase their store footprint in FY17 – the highest we've seen in five years. Likewise 42% of respondents cited new stores as the most significant driver of sales growth in the next 12 months – again, a record high for this survey.

So what is this telling us? As companies refine their omnichannel strategy what is becoming clearer is the critical role of the store. With many pure play online retailers also now seeking a physical retail presence, the reality is that making money through online sales alone can be incredibly tough.

But underlying this, significant change is taking place in terms of what these new bricks-and-mortar stores look like and the role they perform. Just as consumers shop based on brand and product, not channel, so new stores are becoming intertwined with their online offering. Store layouts are changing, interactive technologies are being introduced, and the customer experience of a visit to these new stores is being transformed. The role of stores is expanding to include being distribution networks, marketing and brand builders, customer service centres, and a place where the experience for the consumer is second to none. We partly have the influx of international competitors to thank for helping drive this change, but there are also some great examples of Australian retailers driving innovation in this space such as the increasing use of flagship stores designed to primarily build brand not sales or the use of endless aisles to allow smaller store formats whilst still meeting the needs of the customer.

The new norm

A key trend from previous surveys has been the threat felt by Australian retailers to the influx of international retailers. This year's survey shows no change, with the same percentage as last year (41%) citing foreign-owned bricks-and-mortar stores as their greatest competition. What is noticeable is that foreign-owned online competition is now seen as the least threatening competitor. This both reflects the weakening of the Australian dollar, making overseas websites more expensive, but also the rise in the number and quality of online offerings being offered by domestic based retailers.

With continued strong economic conditions in Australia relative to other countries, we look set for more new international entrants in 2017. However, these new entrants should expect to find local retailers better prepared and skilled to take on this new challenge compared to five years ago.



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Outlook

Retailers are well-known for their glass half-full outlook, and this year is no exception. But with 64% of respondents expecting their earnings to increase by 5% or more in 2017, the levels of optimism are at their highest since we started this survey five years ago.

The feel-good factor from the continued growth in house prices in New South Wales and Victoria has undoubtedly helped discretionary spending over the past 12 months, as has low levels of interest rates and unemployment. The key source of this expected growth is from new stores and products, with not one of our respondents expecting price increases to be the key driver of earnings in FY17.

Whilst it is great to see such optimism amongst the retail community, there are a number of risks to consider. Failure to invest appropriately in both new stores and the right products is a real risk and typically the key driver of winners and losers. The importance of understanding the customer is key here to making the right decisions. Likewise consumer confidence is fundamental, with 91% of respondents expecting it to either increase or remain the same in 2017. Therefore any dents to confidence in the coming year through instability or uncertainties could be a major stumbling block to achieving earnings growth.

So as we head into the new year, prospects for Christmas and beyond appear to be very positive. Competition is fiercer than ever, but Australian retailers seem more confident in their ability to rise to the challenge. As the Australian retail industry continues to evolve and change, both retailers and consumers look set for another 12 months of opportunities and challenges – hold onto your hats!



David White

National Leader
Retail, Wholesale & Distribution Group





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Christmas expectations

Celebrating the sales season

There is a distinct air of confidence amongst retailers as we approach the peak sales season. Some 76% of respondents are expecting higher sales, with nearly a third anticipating sales growth in excess of 5%, compared to Christmas 2015.

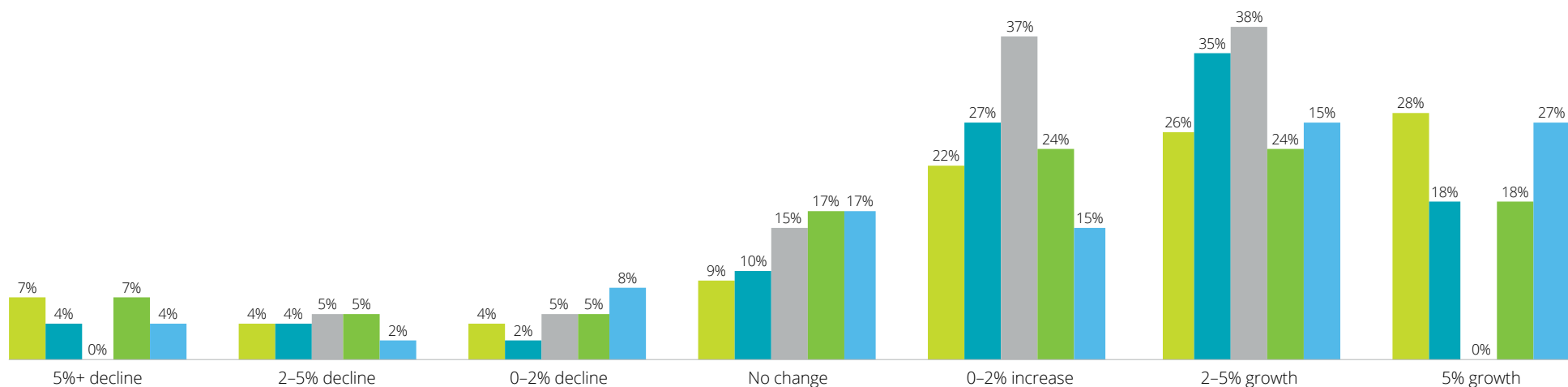
This confidence stems from a combination of a relatively good financial year for many retailers, together with low interest rates and unemployment and a strong performance in the key markets of New South Wales and Victoria where the housing market continues to strengthen. Certain retail sectors have faced more challenging environments, such as groceries where there has been strong price deflation. Nevertheless, overall it's been a pretty good year for many.

In last year's survey we saw that nearly two-thirds of respondents expected to pass on price rises at Christmas due to a weaker Australian dollar.

In 2016 the Australian dollar has remained more stable, and the survey this Christmas reflects this stability with only 30% of respondents expect to pass on higher costs arising from the Australian dollar devaluation.

Do you expect Christmas sales to exceed the previous Christmas trading period?

● 2016 ● 2015 ● 2014 ● 2013 ● 2012



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Christmas expectations

Celebrating the sales season

Achieving sales growth is all well and good, but the results need to hit the bottom line. In previous years, we've seen many retailers achieve sales growth, but at the expense of margin. This doesn't seem to be the case in 2016, with the majority of retailers expecting at a minimum to maintain their margins over Christmas. Only 13% of respondents are expecting margins to decrease this Christmas compared to 26% in 2015. Indeed, nearly half of all respondents expect to see an increase, albeit modest, in their margins.

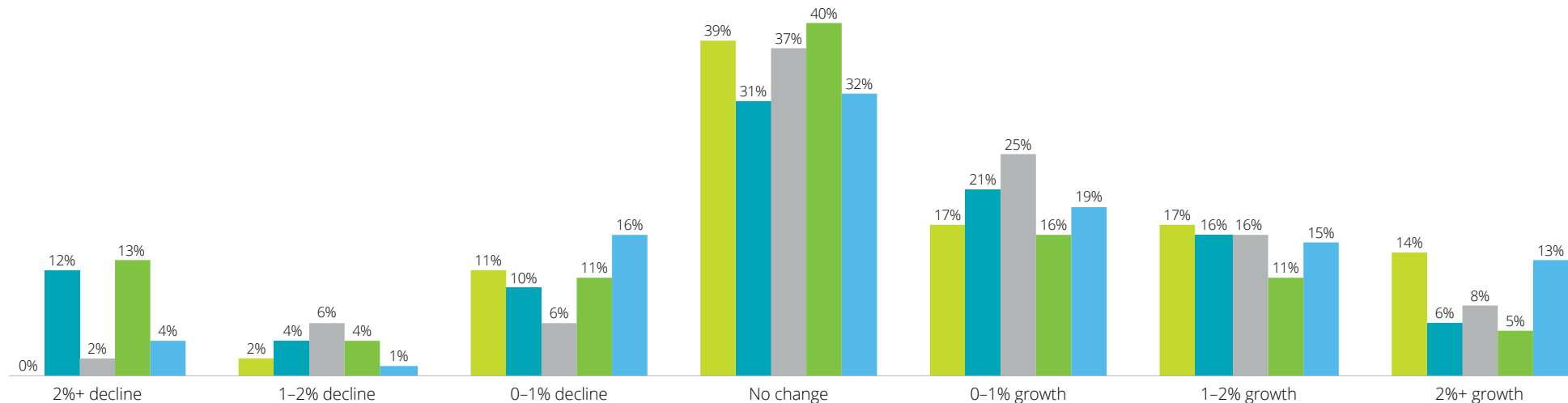
With two-thirds of respondents stating that higher costs from the weakening Australian dollar can't be passed on to consumers, retailers will continue to have to find efficiencies elsewhere in their business to maintain their margins.

"It continues to be a tough battle to maintain full margin selling in a competitive and static market."

- Survey respondent

Do you expect Christmas margins to exceed the previous Christmas trading period?

● 2016 ● 2015 ● 2014 ● 2013 ● 2012



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Christmas expectations

Celebrating the sales season

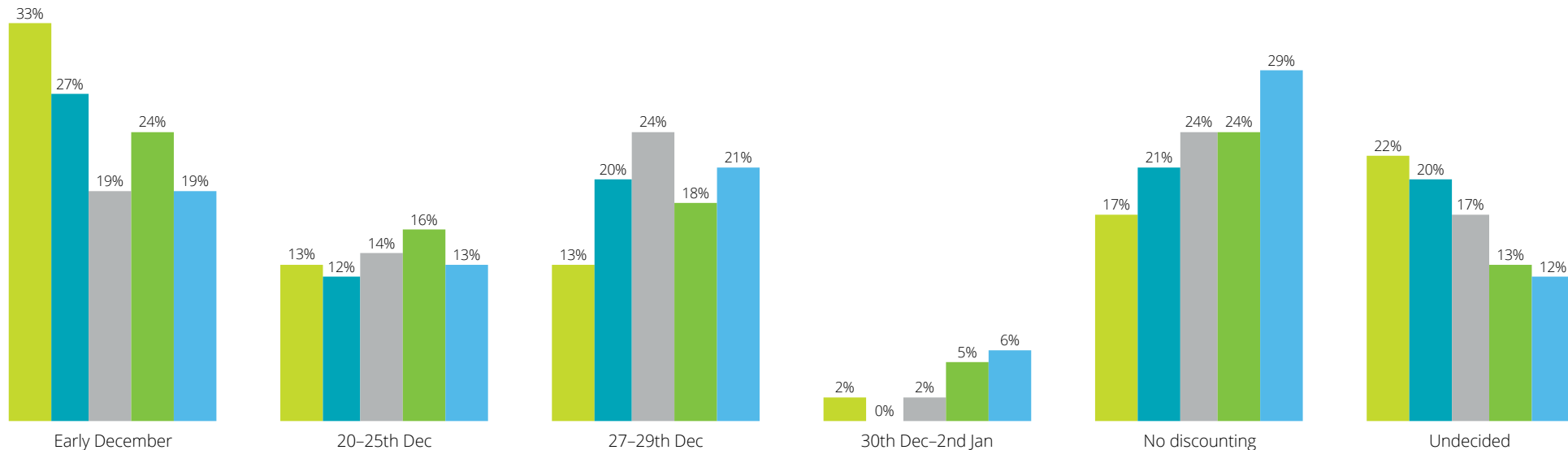
One of the critical decisions facing retailers this Christmas is when to discount and by how much. Retailers may have the best laid plans, but when the season starts slowly there is always a huge temptation to react quickly around price. This has been exacerbated over recent years, with consumers leaving their Christmas shopping later and later.

The war for the wallet looks set to continue, with discounting due to start earlier than ever. A third of respondents plan to start discounting in early December – the highest figures we've seen over the past five years of the survey. It appears many retailers are prepared to sacrifice margin early on to ensure they aren't forced to heavily discount later in the period.

The percentage of respondents yet to decide on their discounting strategy is, however, also higher than we've ever seen before. Some 20% of respondents have yet to make a call on when, if at all, they will lower their prices to generate higher volumes. Those retailers competing only on price and failing to differentiate stand to lose out most.

At what point do you expect to begin discounting around Christmas?

● 2016 ● 2015 ● 2014 ● 2013 ● 2012



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“I worry about the sustainability of our national discounting fervour. It’s becoming almost impossible to sell anything at full price.”

– Survey respondent

Christmas expectations

Celebrating the sales season

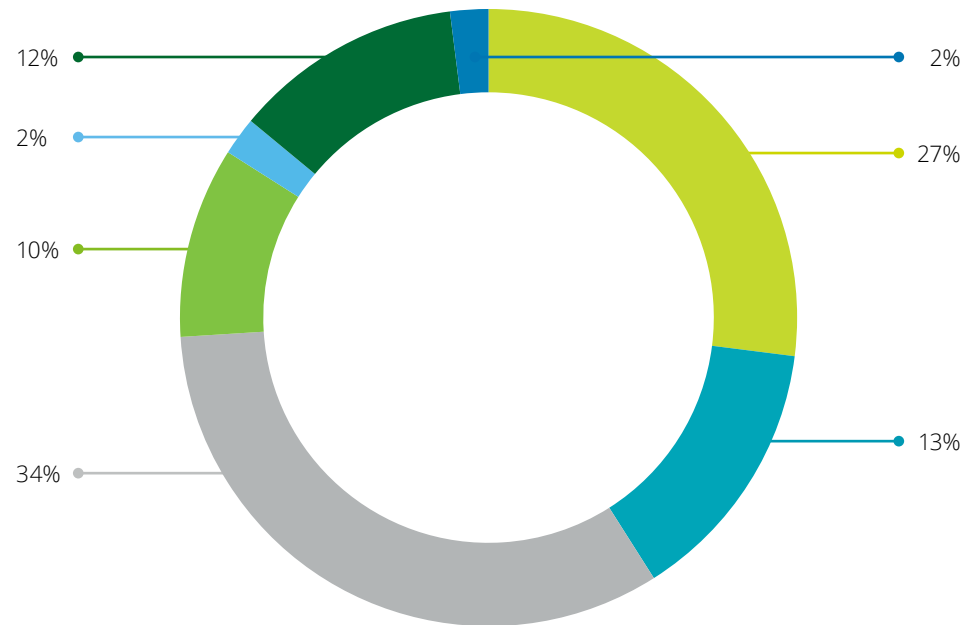
So what does a winning strategy look like this Christmas? We asked retailers what was their main focus area to increase Christmas sales and their response was loud and clear: *new products and customer service.*

These two elements are fundamental to any successful retailer, but over the past few years many seem to have lost their way. Therefore it's pleasing to see retailers refocus on the basics. We are seeing retailers not only re-invest more in staffing numbers, but some of the best retailers are re-designing the way in which training content is developed and delivered to their sales staff. When customers have more and instantly available information to hand on products than the sales assistant, retailers need to really think about how they add value to the consumer. And training staff appropriately is key.

It's also noteworthy that pricing as a key focus area has crept up from 2% in 2015 to 12% in 2016. We are increasingly seeing retailers deploy sophisticated pricing models using advanced algorithms to determine pricing strategies. As the traditional "gut-feel" approach to pricing is being usurped, in many cases retailers are reaping the benefits through reducing unnecessary lost margin.

What is the single most important focus area of your business to increase sales this Christmas?

- Customer service
- Marketing
- New product range
- Omnichannel investment
- Other
- Pricing
- Store format



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“As the market becomes over shopped the only success stories will be those who can differentiate with product or service.”

– Survey respondent



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Australian retail macroeconomic outlook



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The retail environment remains intensely competitive this year, as weak wage growth across the economy has taken its effect on sales (especially for food). In saying that, the Christmas trading period is expected to be decent, as non-food turnover receives a boost from rising asset prices.

Australia's economic growth is going relatively well, particularly once you take into account we are on the flipside of a once in a generation mining investment boom. Low interest rates have kept retail growth healthy and continued high levels of activity in the housing sector, while the weaker Australian dollar has fired up tourism and somewhat protected mining, farming and manufacturing employment. That combination has seen unemployment edge down recently, but jobs growth is easing and growth in hours worked across the economy has been weak.

Consumer confidence has improved since this time last year, partly due to reductions in interest rates by the RBA. The rate cut in May 2016 created a significant boost in consumer confidence, while the second cut in August had a smaller positive effect. The low interest rates have also pushed up asset prices, making Australians feel wealthier and thus more likely to cash in some of those gains. House prices in Melbourne and Sydney continue to grow strongly, while Perth and Darwin have fallen way behind. And after a brief scare to financial markets due to Brexit, share markets have recorded impressive growth in recent months.

Overall, real (inflation-adjusted) retail sales growth was 2.5% over 2015-16, a modest step down from the previous year. As the housing cycle cools, growth in retail turnover and overall consumer spending are likely to ease back further towards the weaker rate of underlying income growth.

Non-food turnover growth continues to outpace food, as low interest rates enable consumers to continue spending on discretionary goods despite weak income growth. That trend may continue going into Christmas, but will likely moderate next year, as the effects of weak wage growth and cooling of the housing cycle take effect. Within non-food spending, Australia's consumers have shifted their focus. Last year, the strong growth in housing activity spurred household goods turnover, while this year has been characterised by growth in apparel and department stores. This stronger performance has in part been driven by transformation strategies from major department stores, as well as the hype surrounding international fashion entrants to the Australian market.

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Australian retail macroeconomic outlook



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Retailers in the south-eastern states saw the strongest sales outcomes over the past year. Low interest rates, rising population growth and housing construction boosted New South Wales and Victorian retail turnover, and NSW has also benefited from a large infrastructure program. The low \$A has assisted South Australia and Tasmania by rejuvenating parts of manufacturing, and supporting international student numbers and tourism.



David Rumbens

Partner
Deloitte Access Economics

The resource rich states (Queensland, Northern Territory and Western Australia) were not so lucky. Real retail turnover has fallen in each of these states, due to the downturn in mining investment as the industry transitions from construction to production, and these trends are likely to continue into 2017.

Overall, Christmas trading in 2016 is expected to show a little lower growth than last year, as low interest rates lose their effect and the housing cycle starts to cool. In saying that, spending is likely to stay strong for non-food retail, with the risk of a more significant downturn in growth coming into play during 2017.



Online Friends



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Online trends

Dreaming of a digital Christmas

The onward march towards a greater online share of the sales mix continues. This year we have seen retailers temper their expectations about the online share of sales as digital strategies mature.

The number of retailers expecting online sales above 6% has decreased from 47% to 36%, with the majority of those respondents now expecting online sales to make up 3–5% of total sales at Christmas.

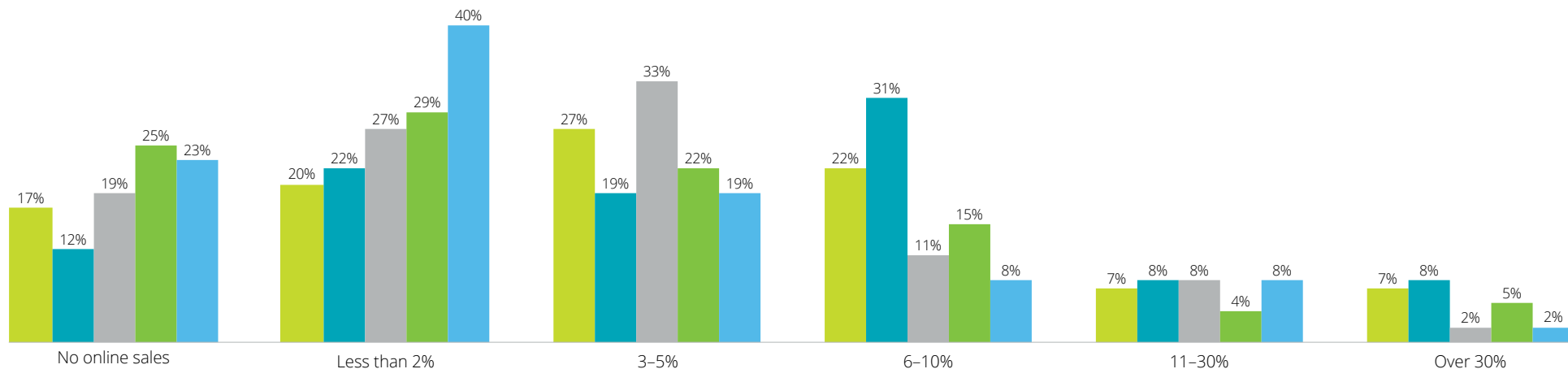
However, over 80% of respondents still consider an effective digital strategy to be critical or very important to their businesses.

Rather, what we continue to see is a convergence between bricks-and-mortar operators and online. Instead of a head-to-head fight with digital channels seeking to replace physical stores, the channels are working together to provide the customer with an integrated offering.

Digital isn't just a sales channel, it's also a way of empowering and connecting with the consumer, and more and more is effectively being used to increase foot traffic to bricks-and-mortar stores and increase basket size.

What % do you expect your online sales to be over the Christmas period?

● 2016 ● 2015 ● 2014 ● 2013 ● 2012



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Online trends

Dreaming of a digital Christmas

Whilst online sales remains a relatively small share of the channel mix, growth in online sales is expected to continue unabated. Over 60% of respondents expect their online sales to grow more than 10% this Christmas, albeit off a small base.

We can expect to see similar double-digit growth in online sales for the foreseeable future, but don't expect traditional retailers to be usurped by pure

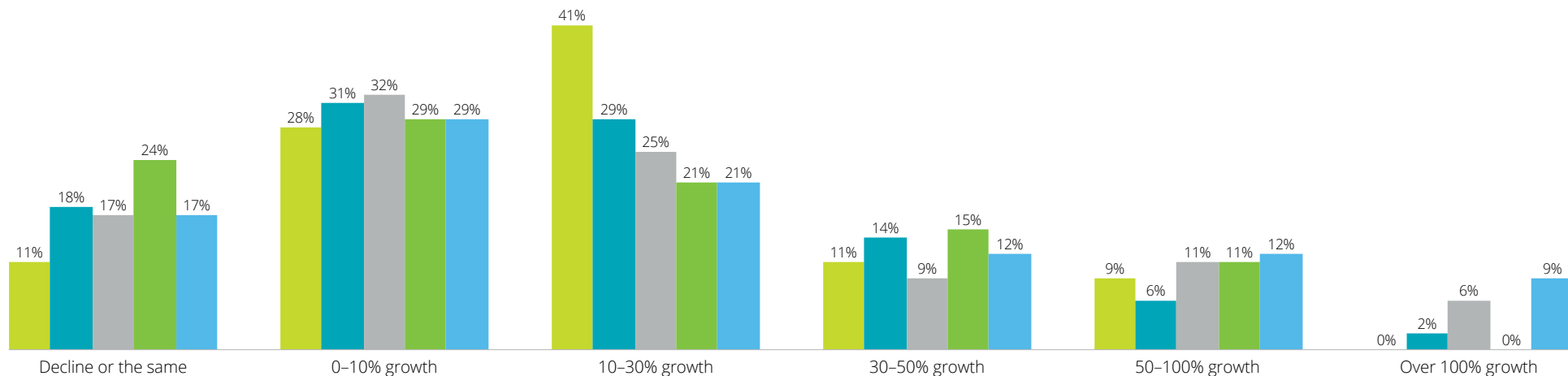
play online operations. Consumers want the ability to shop at their own convenience – and this is still very much in physical stores. At least, that is, in Australia.

Customers will respond to retailers' digital strategy only if it meets their needs – does it allow a customer to save time, weigh up the options and find what they are looking for at a touch of a button? To do this effectively,

digital strategies must be designed in tandem with the physical store and the supply chain, to offer a seamless experience for customers.

By what % do you expect online sales for the Christmas period to exceed last Christmas?

● 2016 ● 2015 ● 2014 ● 2013 ● 2012



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The experience of retail

There is no doubt retail is in an era of transformation. Driven by the acceleration and adoption of technology and the changing behaviours of shoppers, retail must adapt to thrive in the future.

Today's connected customer has greater expectations than ever before. With information at their fingertips, they are knowledgeable, in control and can choose to purchase anywhere at any time. Faced with a proliferation of options coupled with the ubiquitous use of mobile, we are seeing a trend towards more frequent, yet shorter interactions. This limited attention has set a challenge for retailers in evolving the way they think about engaging customers and driving loyalty to their brand.

It was only relatively recently that doubts were raised around the future of bricks-and-mortar retail. Emerging ecommerce players became more of an active threat and many have questioned if that would spell the end for the physical store. Fast forward however and quite the opposite is true. The store is far from dead and is now seen to be a key battleground for engaging with today's connected customer.

Despite the proliferation of devices and the growth of the digitally native millennial generation, the vast majority of purchases do and are predicted to continue to occur in bricks-and-mortar retail. This is not to say ecommerce and digital aren't important, quite the contrary. In fact critical to today's customer journey and in addition to showing strong growth as a sales channel, digital influences over 40% of all instore visits. For inspiration, personalisation, research, price comparisons and more, digital is invaluable. However when we examine the entire customer experience, so too is the store.

We know Australian consumers have one of the highest appetites for digital engagement in new stores and this is a primary focus for growth with two-thirds of retailers expected to expand their store network in the coming year.

What we are seeing is a recognition that whilst a key enabler, technology doesn't replace the emotional connection and engagement we are able to deliver from a physical, human interaction.



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The experience of retail

Leading retailers acknowledge customers now demand shopping experiences that are exciting, memorable, meaningful, educational and entertaining and the physical store provides an opportunity to deliver against this need. But in order to fully realise this potential, the role of the store must change.

Bricks-and-mortar retail holds great opportunity. Physical environments allow us to tell stories, to create multi-sensorial and interactive experiences and foster a sense of community both in and around the store. The service experience and how staff engage with customers is becoming increasingly important as is the opportunity to 'come out from behind the counter' and offer customers the knowledge, expert advice or personal connection they cannot get online.

Gone are the days of the store being somewhere simply to purchase.

The store of the future, and today, must be centred on experience. Shopping centres and flagship stores are becoming entertainment destinations that enable total immersion into the brand.

However not all stores need to be created equally. Smart retailers are taking their customer experience strategy one step further to develop a highly effective network that delivers for both the customer and the bottom line. By creating the right experience in the right store format and ensuring the role of mobile and ecommerce are included in this, retailers can deliver both a valid customer experience and operational efficiency.

Retailers, such as Country Road and Lululemon, are examples of those which understand their value proposition and how to deliver this to customers by strategically designing each format in their store network with an experience focus.

By combining ecommerce and social engagement with this store offer, they are able to better manage costs whilst giving their customers what they need.

To succeed retailers must start to see themselves the way their customers do. There is no longer any online and offline – it's all just retail and it's driven by experience. Those retailers that fundamentally rethink their experience and how to deliver it by becoming customer-centric across physical, digital, brand and service will be those that thrive in the future.



Karen Spear
Director
Brand & Spatial



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Competitive
Landscape



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Competitive landscape

Managing the risks

One of the key risks to Australian retailers continues to be macro economic factors. Given how important consumer confidence and the overall health of the economy is to a retailer's performance, this has always featured in the top three risks in our survey.

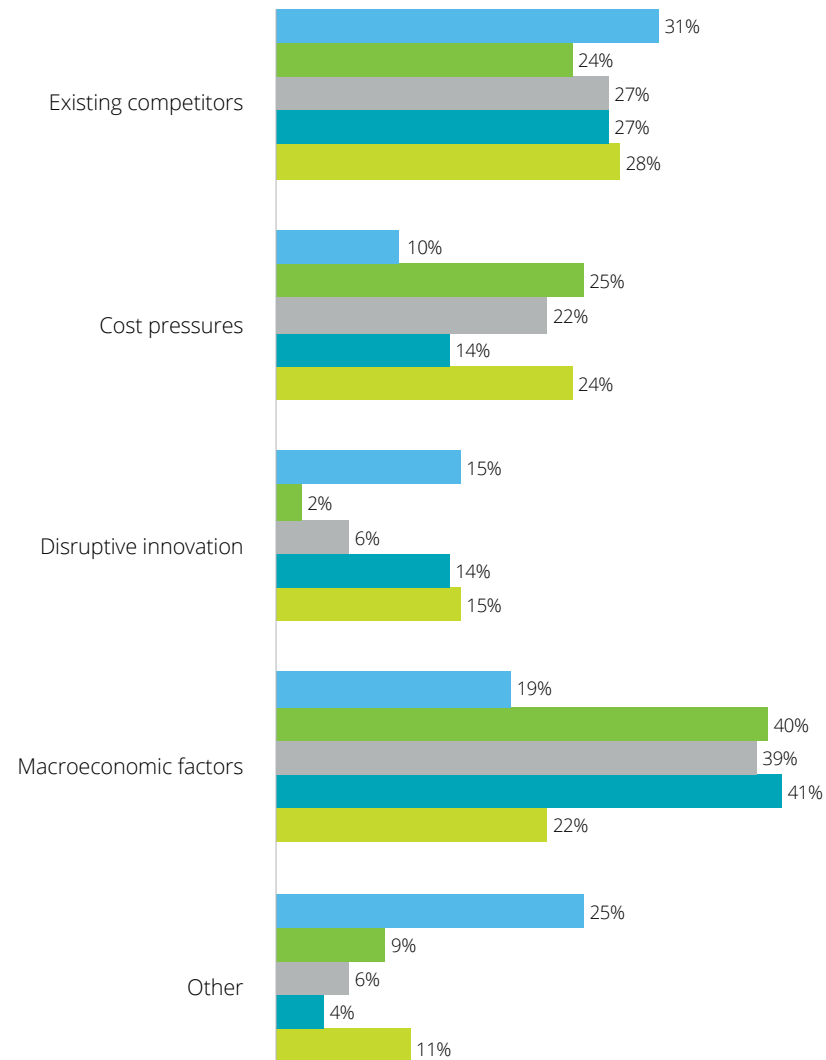
However, this year's survey has seen a fall from 41% to 22%, a sign that retailers are perhaps more confident with the overall state of the Australian economy.

In contrast, the perceived risk from cost pressures has increased from 14% in 2015 to 24% in 2016. With rising rents, salary costs, and cost of goods purchased from overseas with the weaker Australian dollar, it's not surprising that cost pressures are preying more on the minds of retailers. Yet only 7% of respondents cite efficiency and cost control as their highest strategic priority. This may imply retailers feel somewhat helpless to the constant pressures around rising costs.

This sentiment certainly isn't shared by all. We continue to see retailers and wholesalers driving cost efficiencies through greater integration with their logistics suppliers, providing an end-to-end integrated approach. This also allows the tracking of SKUs throughout the supply chain from the manufacturer to the warehouse and the store.

What do you consider to be the greatest risk in your business?

● 2016 ● 2015 ● 2014 ● 2013 ● 2012



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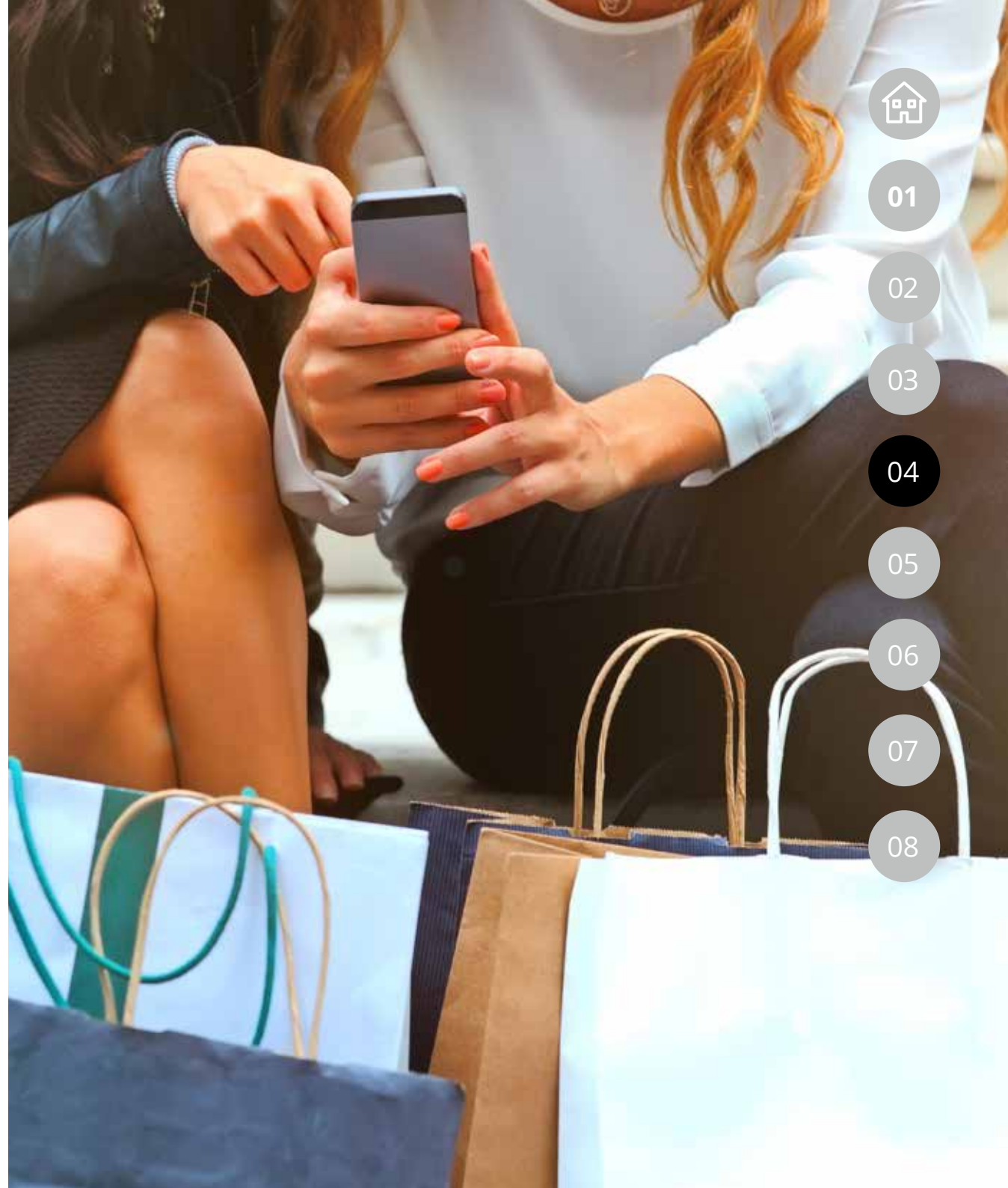
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“We need strong government to make and act on debt reduction initiatives to build confidence with Australian consumers.”

– Survey respondent



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Competitive landscape

Protecting the crown jewels

In the ever increasing need to better understand customers, retailers are collating and storing more and more of their customers' personal details.

But how secure is this data and do retailers care whether customers know how their data is being used? Our survey shows nearly a quarter of all respondents have little or no interest. Given the increasing importance of conduct for all forms of businesses, retailers run the risk of not only falling foul of the increasing number of regulations, but also of losing the trust of the customer if this area of their business is overlooked.

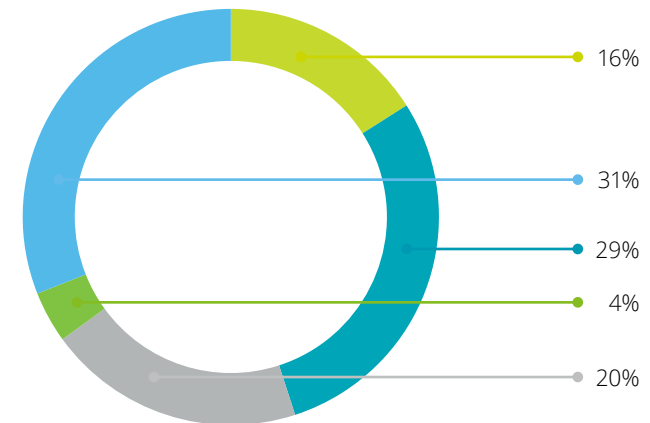
This sentiment is also repeated when it comes to cyber risk. For many organisations this is a key priority for the board when considering material risks to the business. However, our survey shows that there are still a large number of businesses which haven't yet come to the realisation of just how important it is to ensure their organisation is protected from the risk of a cyber attack.

Business risks are changing rapidly with technology and the ever increasing use of data to drive decisions. It's all very well having in-store security cameras and reconciliations over cash, but if your systems and data aren't protected then you run the risk of being pick-pocketed and not even knowing about it – until it's too late.

But cyber security isn't just about mitigating risks – it's also about creating opportunities. For example, developing mobile applications which allow one-click to make payment can give a competitive advantage and increase online shopping completion rates, but they have to be underpinned by systems and processes that protect against the risk of cyber attack.

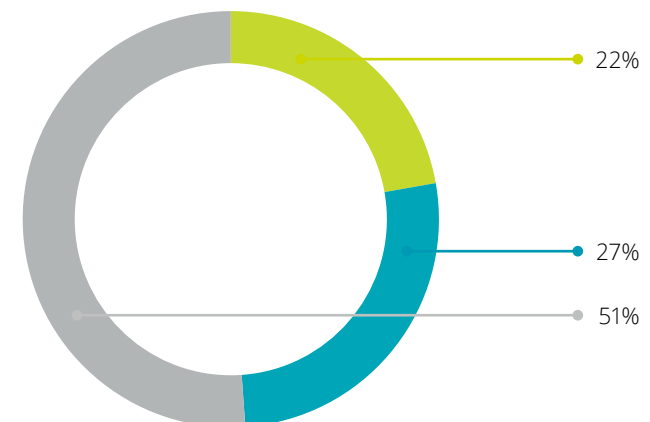
How important is it to you that your customers understand how their information is used?

● Critical ● Important ● Neutral
● Not important ● Very important



How significant a risk is Cyber Security to your business?

● High risk ● Medium risk ● Low risk



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Building trust with customers

2016 was the year that saw the Office of the Australian Information Commissioner start exercising powers particularly within the retail industry in assessing how data from loyalty programs was treated, specifically, that consumers were notified adequately as to the collection and use of their personal information.

It is no wonder then that almost 75% of retailers have indicated informing consumers of treatment of data is important to them. We see most retailers conducting an enterprise wide privacy assessment to ensure that areas for improvement are understood. The loyalty programs of both of the major grocery retailers were assessed during this year and we expect that these investigations will continue to assess major players in the industry.

As we approach Christmas, a savvier consumer who is being educated through media headlines of risks associated with handing over personal information is emerging. Being attune with consumer expectations has never been more important.

As retailers become more global or acquire new business, the ability to share data across organisational and jurisdictional borders is causing retailers to become more aware of the influence of global regulatory change. Further, the ability to share insights and data in a safe and secure way is the emerging challenge.

Alongside this we see both mandatory data breach notifications back on the table in the Spring sessions of Parliament – an introduction of this will force organisations to move away from blissful ignorance to confidently dealing with data incidents as they occur.

How will you approach building trust with your customers? With a breach in security or a consumer backlash to data practices an organisation can rapidly lose the trust of their customers, causing enormous harm to the brand reputation.



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Building trust with customers

In light of these emerging challenges, many organisations are conducting enterprise wide privacy assessments which assess information collected from customers, how this is used and protected plus the ability of customers to opt-in or opt-out of data collection.

Strategies can then be put in place to protect this information, provide adequate communication to customers on how the information is used, and set the standards by which all in the organisation should abide.



Cara Hartnett

Partner
Risk Advisory

By being responsible, transparent custodians of information organisations can earn the right to then use the information to provide tailored and personal insights to their customers.



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Competitive landscape

Foreign foes

Respondents continue to see international retailers as their key source of competition, particularly in respect of bricks-and-mortar stores.

International retailers are flocking to Australian shores both through their own brand offerings, or by snapping up local Australian retailers. And this is set to carry on.

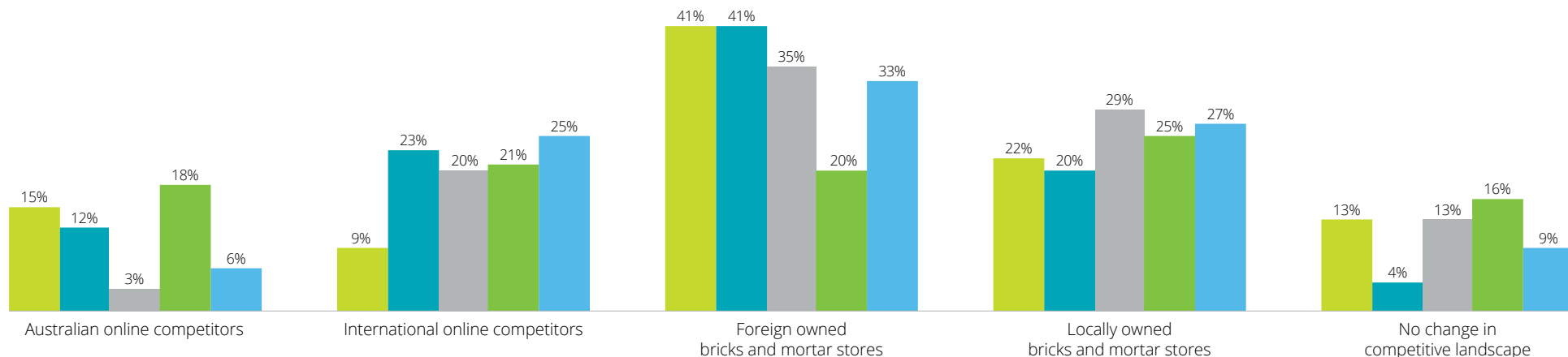
One of the key differentiators international retailers have brought to Australia is in their store design and customer experience model.

In an era where customers' expectations of an in-store experience are higher than ever, many international retailers have had an edge, leveraging their experience from larger markets. However, we are seeing local retailers slowly starting to fight back, with investments in store design, concept and flagship stores on the rise.

In contrast, the threat from international online competitors has seen a decrease year-on-year, reflecting both the less favourable exchange rates as well as the increased quality of offerings from Australian-based online retailers.

From which source do you expect to see the most increased competition?

● 2016 ● 2015 ● 2014 ● 2013 ● 2012



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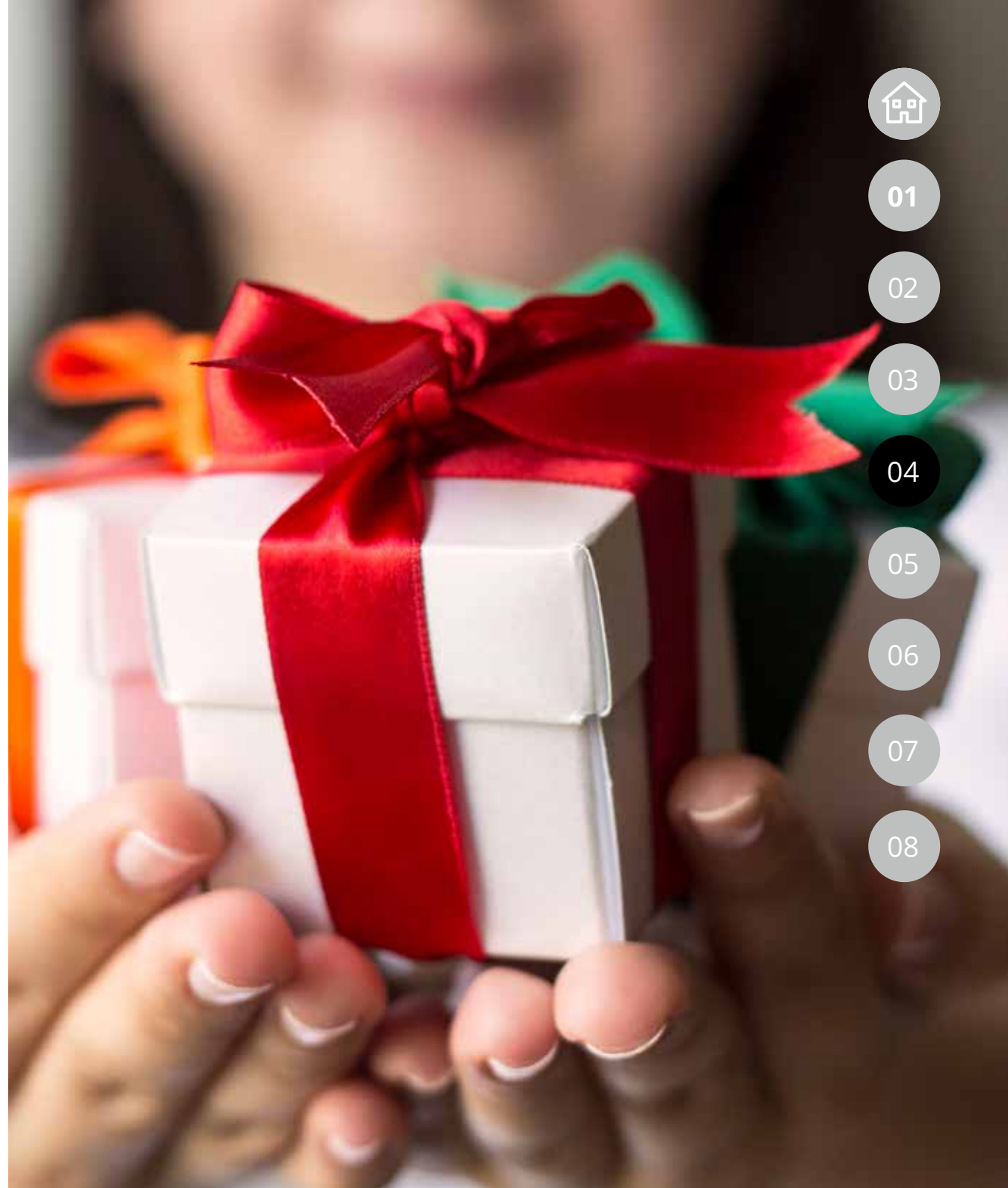
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“Competition will continue to increase as more international businesses start to trade in our market and you must develop closer relationships with your customers and build strong brands.”

– *Survey respondent*



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Competitive landscape

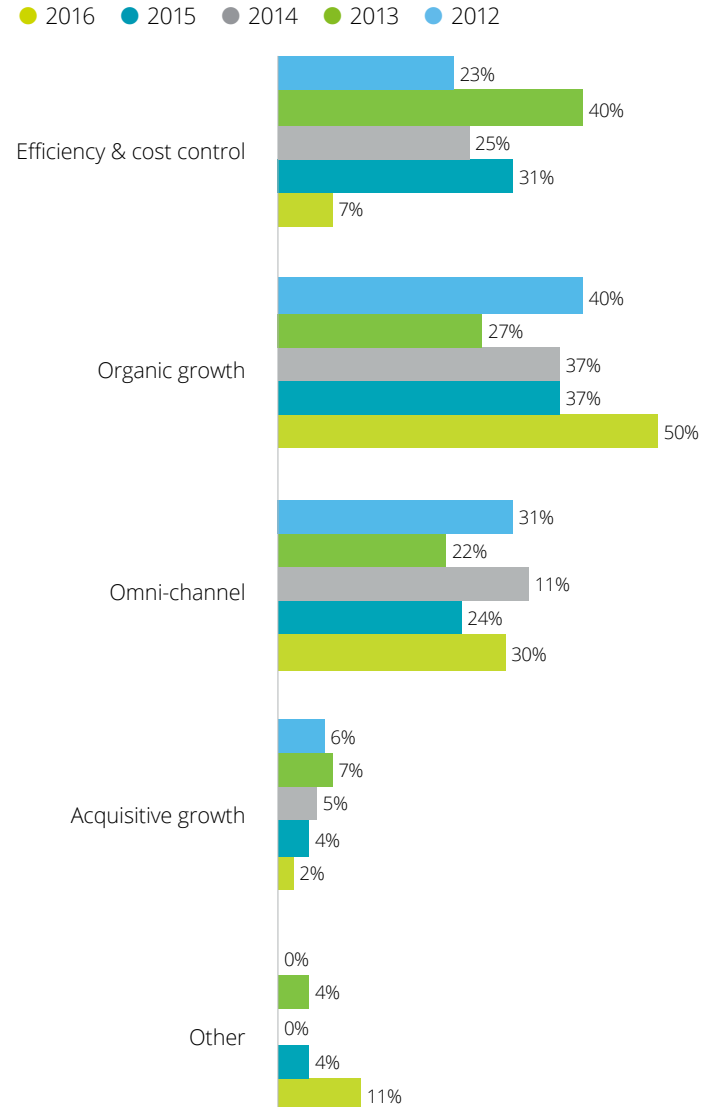
Focusing on the top line

Despite 24% of respondents identifying cost pressures as the greatest risk to their business, only 7% cite efficiency and cost control as their key strategic priority.

Instead, retailers are setting their sights firmly on generating top line growth, with 50% of all respondents calling out organic growth as their key priority in FY17. This is the highest we've seen organic growth feature as a strategic priority for retailers over the past five years, and reflects an encouraging level of confidence as we approach the new year.

But this doesn't tell the whole story. Omnichannel is the number one strategic focus for FY17 for nearly a third of respondents. Whilst many Australian retailers have been slow off the mark, this has allowed them to learn from mistakes made by other international retailers. Home delivery remains very expensive and logistically challenging, whereas click and collect leverages existing store networks, i.e. sunk costs and offers the opportunity for retailers to upsell.

What is the number one strategic focus of your business?



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“There will be continued buoyancy in specific sectors and brands provided there are no macroeconomic issues affecting consumer confidence.”

– Survey respondent

Competitive landscape

Hostages to consumer sentiment

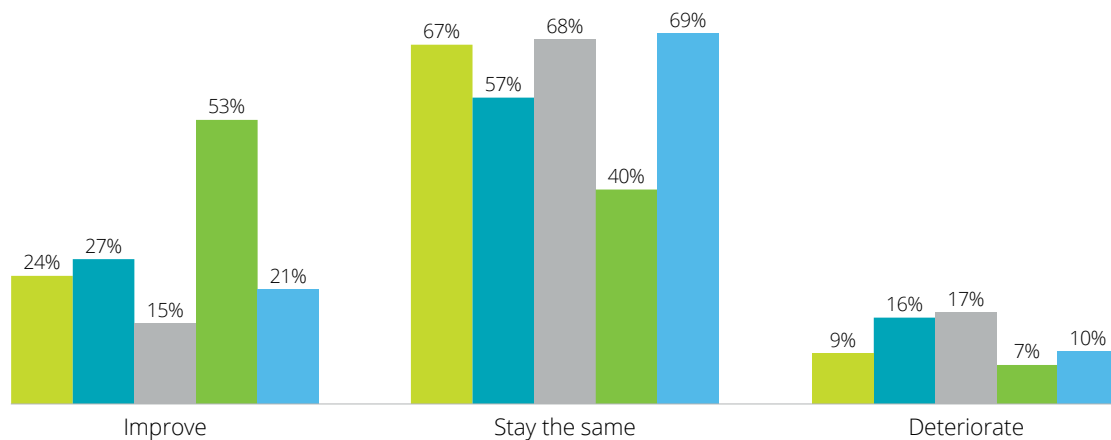
We have seen many retailers are anticipating a positive 2017, but what could threaten this?

In last year's survey we saw a spike around concerns over the relative weakness of the Australian dollar. In 2016, this risk doesn't even feature.

Instead, nearly half of all respondents are most concerned about whether consumer demand will hold up in 2017. Retailers could have the best strategy, but if consumer confidence falls away they are, in many respects, helpless to respond. Expectations amongst retailers are that consumer confidence will be relatively stable, but this doesn't stop them being nervous about the consequences of a deterioration.

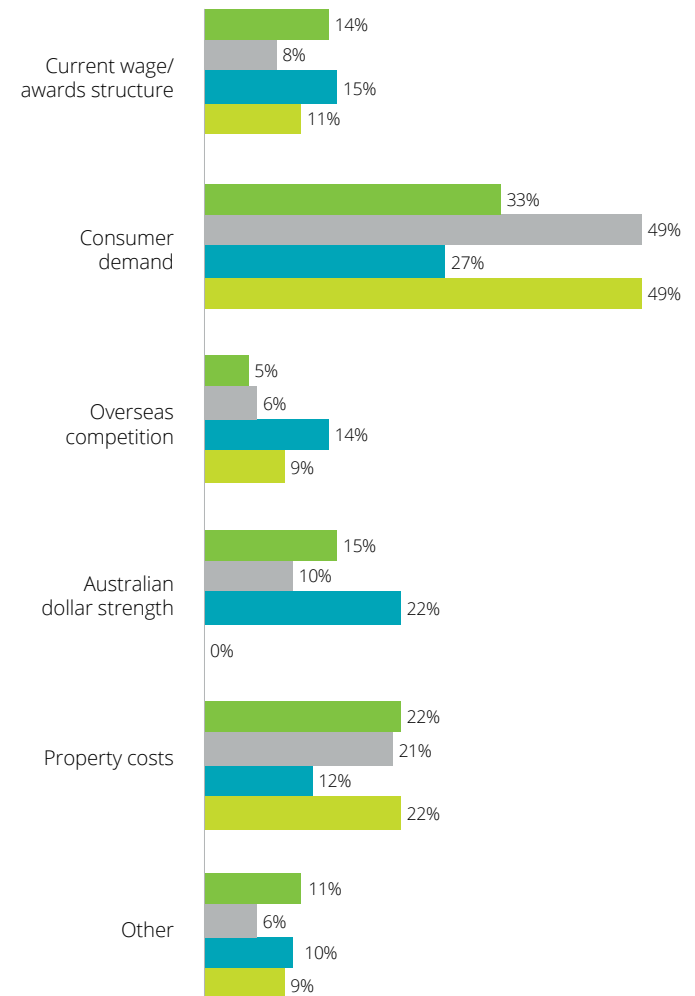
What is your expectation of consumer confidence in the next 12 months?

● 2016 ● 2015 ● 2014 ● 2013 ● 2012



What is the biggest impediment to you achieving sustainable growth?

● 2016 ● 2015 ● 2014 ● 2013



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A changing tax landscape



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Growth in a complex world

Global expansion continues to be a key focus for our survey respondents, whether it be foreign retailers establishing operations in Australia or the offshore expansion of domestic businesses. Interestingly, respondents identified traditional bricks-and-mortar stores (and not online retail) as where the growth potential was strongest or where most foreign and domestic competition would likely come from.

Access to new and larger markets and the ever increasing focus on globalisation has provided retailers with access to higher growth rates. Without an adequately holistic approach, including an appropriate focus on taxation, these activities may fall short of their potential to achieve the desired growth levels and ultimately increased shareholder value.

Entering New Markets

Method of market entry is a fundamental question retailers need to consider when contemplating foreign expansion. There are various options open to retailers to enter foreign markets including wholesale distribution, licensing, franchising, joint venture and owned expansion.

The ultimate decision as to the most appropriate way for entering a foreign market will be driven by commercial, operational and legal factors requiring a detailed assessment of the operational, organisational, and financial impacts of each method. The required level of investment and time to payback, the level of internal capabilities and knowledge of the new market, ensuring brand integrity and human resources requirements are some of the considerations that will drive the choice.

Whilst traditional bricks-and-mortar retailing has been identified as the strongest growth area and source of competition, in this day and age internet retailing should not be dismissed. Representing the fastest growing retail channel globally it is seen by some retailers as the best way to connect with international customers for the first time and also may allow for efficient management of value chain activities limiting investment, brand and operational risk.

Any assessment of the operational impact of expansion activities is not complete without a consideration of the associated tax implications. The home country and proposed new country tax treatment of those operations must also be considered to avoid inefficiencies and additional charges or leakages.

Retailers must consider the direct and indirect tax impacts on all aspects of the operating model – procurement, manufacturing, IP development and sales channels. Where the global expansion involves mergers and acquisitions, partnerships or joint ventures with other companies, additional complexities will need to be considered and managed.

A tax aligned value chain is easier said than done. It requires buy in from numerous parts of the business and challenges include negotiating compromises around varying business objectives and competing priorities. However it has the potential to deliver significant benefits over and above supply chain planning without tax.

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A changing tax landscape

Expansion in a changing tax landscape

Adding to these challenges and complexities is the fast-changing global tax landscape driven by the OECD Base Erosion and Profit Shifting (BEPS) project which is aimed at addressing the perceived tax avoidance of multinationals through the use of arbitrage between the tax laws of many countries. As a result of the BEPS project we are expecting widespread treaty and regulatory changes across many jurisdictions.

Australia continues to be at the forefront in implementing and enforcing these rules. Australia has already changed the transfer pricing rules in 2014, has introduced the new multinational anti-avoidance laws (MAAL) with effect from 1 January 2016 and is proposing to implement a UK style diverted profits tax (DPT) in 2017. These rules are designed to counter the erosion of the Australian tax base by entities using artificial or contrived arrangements to avoid the attribution of business profits to Australia through a taxable presence in Australia.

From 1 January 2017, overseas businesses will also be required to apply Australian Goods and Services Tax (GST) on intangible supplies (for example movies, games and electronic devices and digital services) made to Australian “private consumers” (i.e. in B2C models).

These new tax rules represent a significant change in position and may have broad ranging impacts on how businesses have set up their operations both in Australia and globally. Multinational companies that previously would not have had a taxable presence in Australia or in another foreign jurisdiction may now need to reconsider how their businesses are conducted and whether their activities may inadvertently give rise to a tax presence (permanent establishment) in the relevant country.

Furthermore, the varying rates of global implementation complicate an organisation's ability to manage its tax position and value chain globally meaning that businesses will need to undertake regular and ongoing reviews and potentially restructure their business model, legal entity structure and supply chain, in light of all these changes to ensure they do not have find themselves with unexpected exposures to additional tax.



Kamlee Coorey
Partner
Corporate Tax



Tina Zgela
Director
Corporate Tax



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Next 12 months

Banking on consumer confidence

Similar to consumer confidence, our survey shows retailers are largely expecting consistent economic conditions compared to the year just gone.

Two-thirds expect the economy to remain steady, with confidence in the economy driven by low interest rates and a strong property market.

This growth has been driven primarily out of New South Wales and Victoria, whilst next year we should see Queensland and Western Australia starting to recover as their economies continue the transition away from being overly reliant on the mining sector.

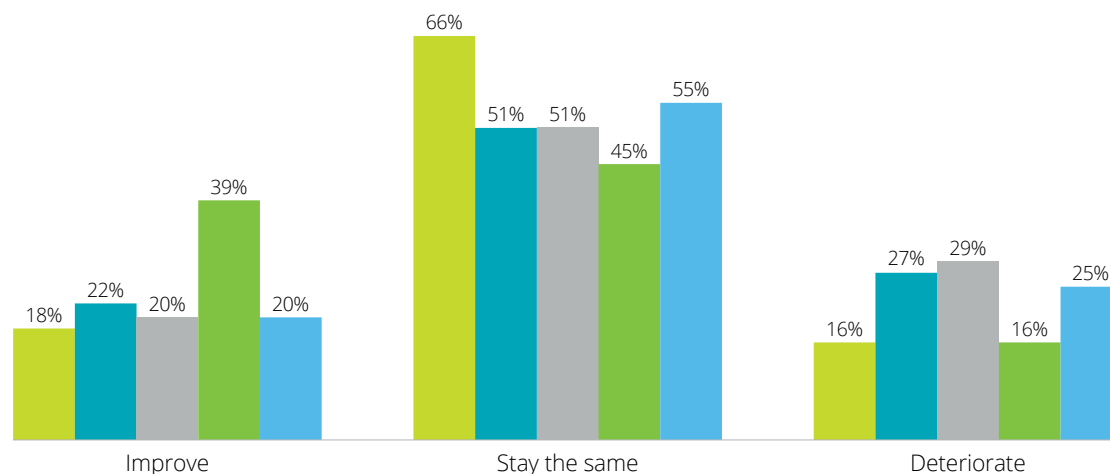
Notwithstanding the status quo in expected consumer confidence, retailers remain highly optimistic about their own growth prospects for 2017.

Some 93% are expecting an increase in earnings over the next 12 months – 11% up on last year.

More surprisingly, a third of respondents are expecting earnings growth in excess of 10%. With many retailers planning to grow organically through new stores, there will inevitably be some disappointed retailers come the end of 2017.

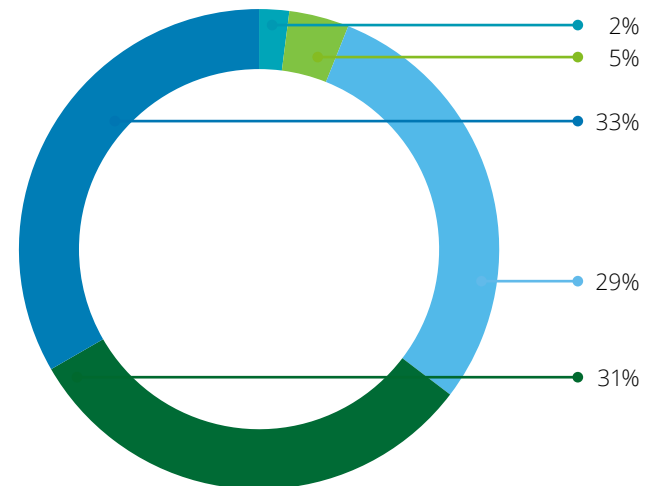
How will the broader economy perform in the next 12 months?

● 2016 ● 2015 ● 2014 ● 2013 ● 2012



What do you expect to be the overall earnings growth in your business in the next 12 months?

● 10%+ decline ● 5-10% decline ● 0-5% decline
 ● No change ● 0-5% growth ● 5-10% growth
 ● 10%+ growth



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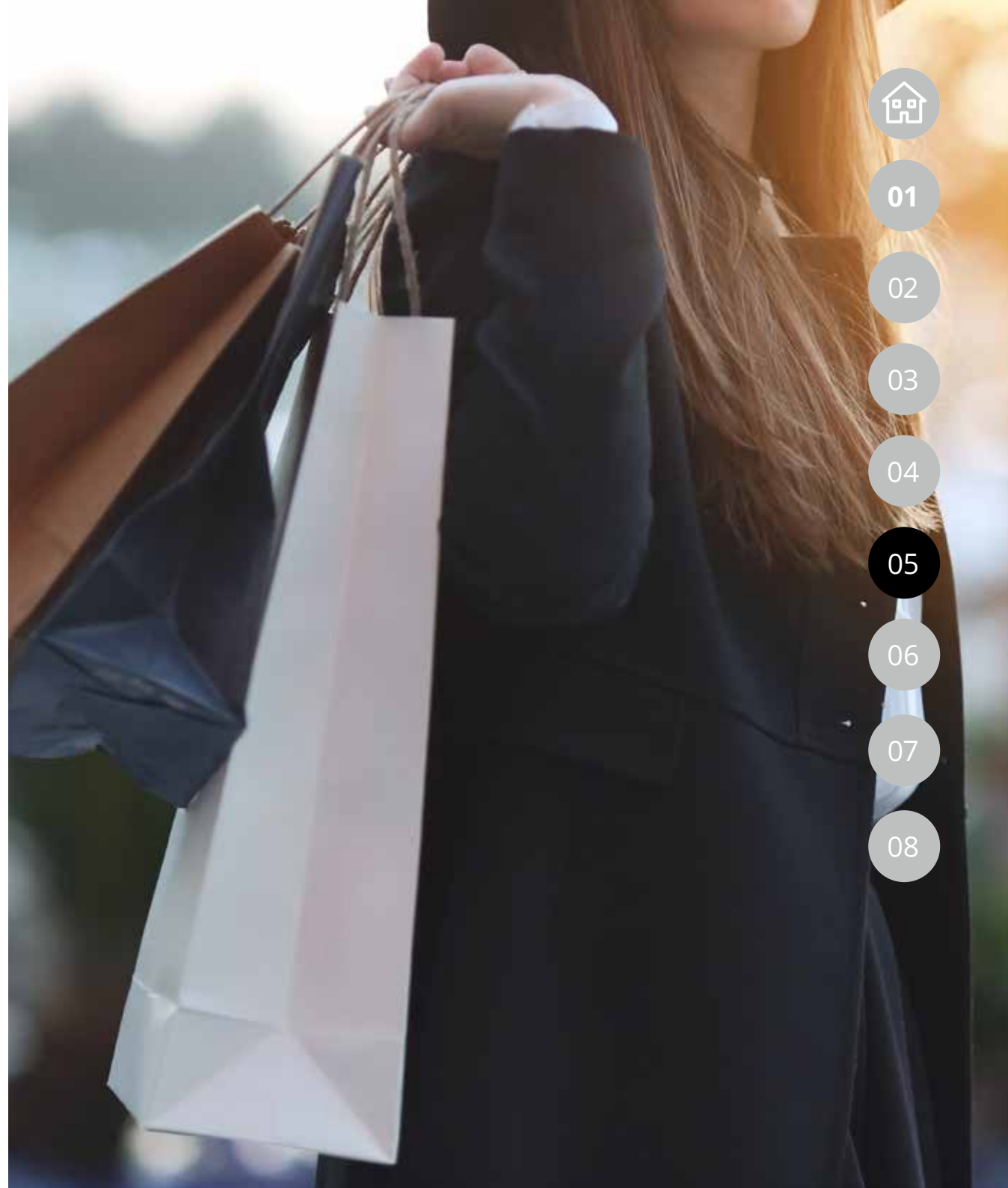
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“Provided inbound Asian tourist numbers are maintained or grow our retail sector should continue to grow.”

– Survey respondent



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Next 12 months

What's in store?

Retailers are looking forwards to 2017 with a sense of optimism, with new stores, new products and online offerings top of mind to drive sales growth.

Some 71% of respondents intend to increase the number of stores in the next 12 months, with 42% expecting new stores to be the most significant driver of growth in 2017.

So as consumers demand more convenient shopping, why do retailers continue to focus on opening more bricks-and-mortar stores?

Have retailers lost the plot? The answer lies in the changing role of the store itself. Consumers don't think channel, they think brand, product, quality and convenience, and so new stores are becoming intertwined with their online offering.

We are seeing retailers experimenting with new store layouts and footprints, the introduction of new technologies in-store which provide an

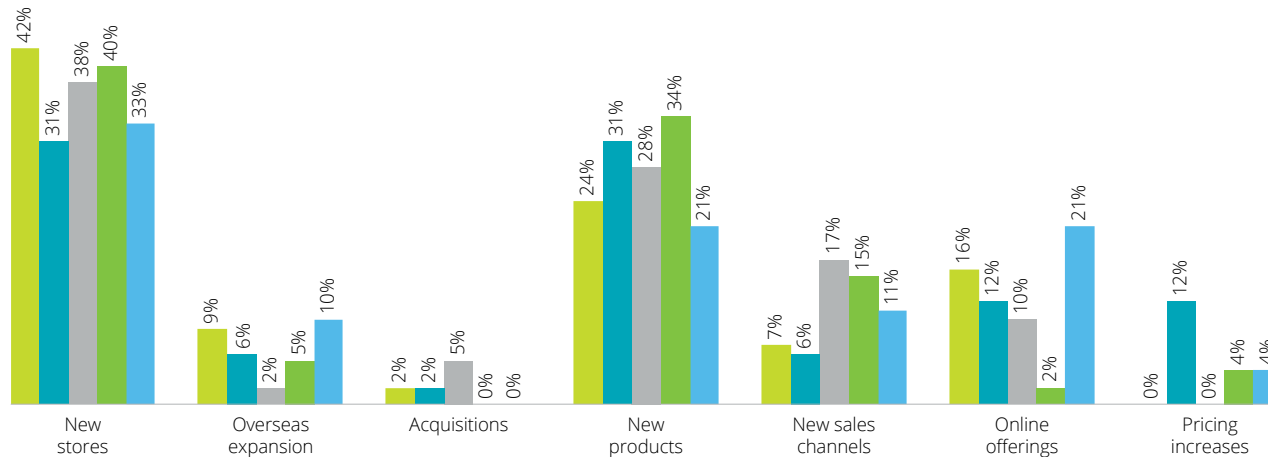
interactive experience for the customer, and product ranges which complement not compete with their online offerings.

The traditional role of the store is changing. Stores are now performing multiple functions: from distribution centres for click and collect purchases to marketing focal points designed primarily to build brand awareness.

Therefore store performance can no longer be measured solely based on in-store sales – their broader role and value to a company's business model is becoming so much more.

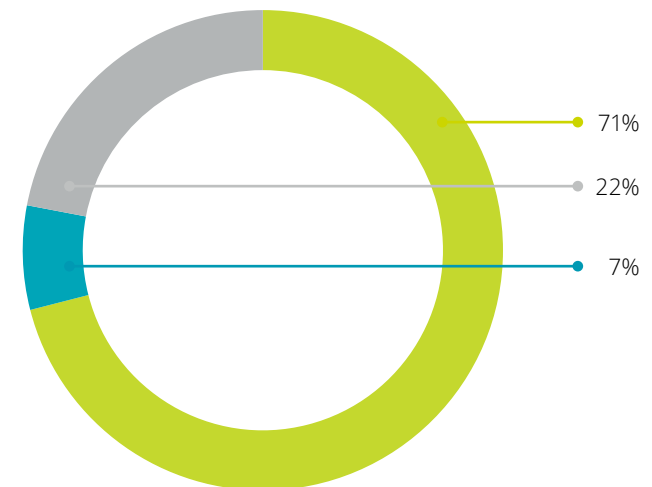
What do you expect will be the most significant driver of sales growth in your business in the next 12 months?

● 2016 ● 2015 ● 2014 ● 2013 ● 2012



Do you expect to increase net stores/outlets in the next 12 months?

● Increase ● Decrease ● No change/NA



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Next 12 months

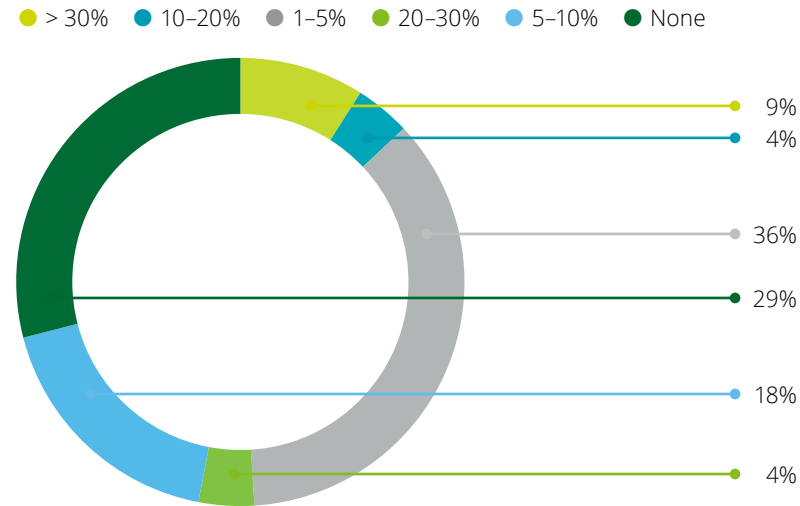
A leap of faith?

With the Australian market highly competitive and store networks becoming relatively saturated, retailers are increasingly looking overseas to provide new markets in which to operate.

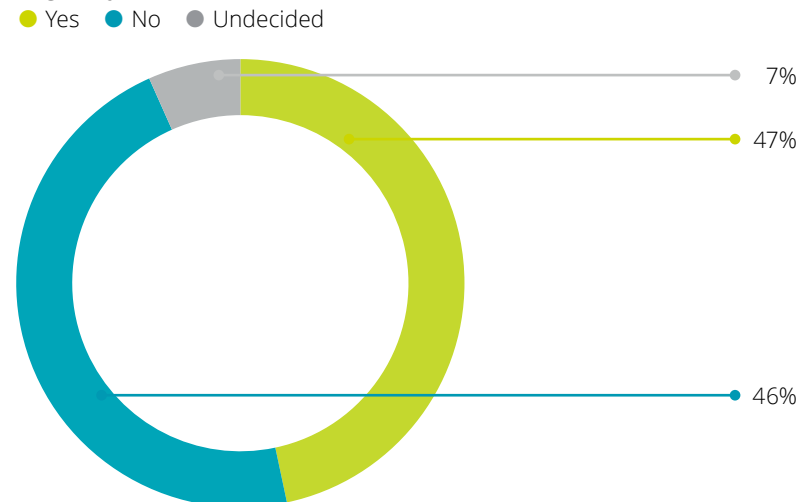
With almost two-thirds of respondents currently generating just 5% or less from overseas sales, there remains huge potential should retailers be brave and take their business model outside the relatively small market of Australia.

Certainly, overseas expansion continues to be on the radar of many Australian retailers, with nearly half of all respondents considering expanding overseas in the next 12 months. Over the course of 2016 we've started to see more Australian retailers expand their operations into the US, Europe and Asia Pacific, but the numbers are still relatively small. With competition in the domestic market threatening saturation in certain categories, we can expect to see more Australian retailers take a leap of faith into overseas markets in 2017.

What % of your sales are generated from operations overseas?



Do you see expanding your operations overseas as an opportunity to grow your business in the next 12 months?



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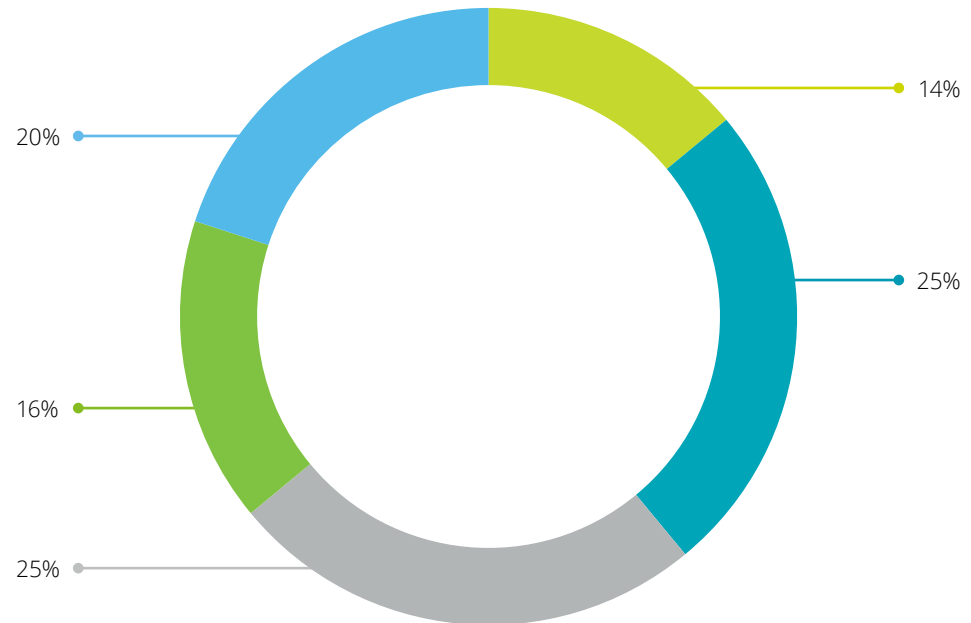
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About the survey

The Deloitte Retailers' Christmas Survey is based on a survey of 52 senior executives of leading retailers in the Australian market. The respondents are executive and senior management from a cross section of retailers inclusive of listed, private and foreign-owned businesses.

Ownership structure of respondents

- Australian owner-managed
- Australian private/other
- Australian listed
- Foreign private
- Foreign listed



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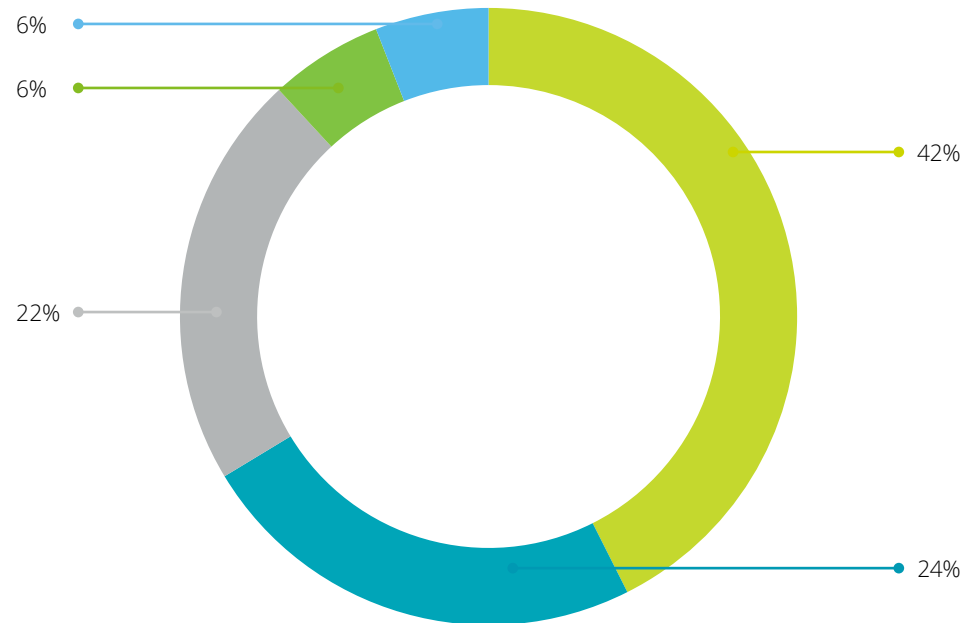
About the survey

The selection of participants is intended to provide a representative sample of large and small businesses, with most participants made up of the sub-1,000 employee segment.

The geographic reach of participants is evenly distributed between Australia, New Zealand and global retailers.

Number of employees

- 1-500
- 501-1000
- 1001-5000
- 5001-10000
- 10000+



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- Trade promotion management and control
- Customer relationship management
- Supply chain planning and optimisation
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- Logistics and warehousing management
- Store redesign and strategy
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Deloitte specialists in the retail sector

If you would like further information about any of the topics in this report, or our advisory capability to the retail industry, please contact us.



David White
National Leader
Retail, Wholesome and Distribution
Tel: +61 2 9322 5228
Email: davidwhite@deloitte.com.au



Kamlee Coorey
Partner
Corporate Tax
Tel: +61 2 9840 7030
Email: kcoorey@deloitte.com.au



Cara Hartnett
Partner
Risk Advisory
Tel: +61 3 9671 6608
Email: chartnett@deloitte.com.au



David Rumbens
Partner
Deloitte Access Economics
Tel: +61 2 6175 2000
Email: drumbens@deloitte.com.au



Damien Cork
Director
Assurance & Advisory
Tel: +61 2 9322 7123
Email: dcork@deloitte.com.au



Karen Spear
Director
Consulting
Tel: +61 2 9322 3427
Email: kspear@deloitte.com.au



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